



CROWDFUNDING UPDATE

March 2013

This bulletin is being provided for investors, consumers, and interested parties as a brief update on the status of federal crowdfunding rulemaking and current California regulatory practices related to crowdfunding-type solicitations.

Background

Crowdfunding began as a way for the public to donate small amounts of money, often through social networking websites, to help musicians, filmmakers and other artists finance their projects. These types of crowdfunding are generally altruistic and contributors (who are not, strictly-speaking, investors) do not receive equity in the projects they are funding. The term “crowdfunding” was used in the 2012 Jumpstart Our Businesses Startups (JOBS) Act to describe a way for small businesses and start-ups to obtain investment capital to get their business ventures off the ground.

As a rule, the offer and sale of securities must be registered or exempted with a state regulatory agency or the Securities and Exchange Commission (SEC). Investments in these securities are offered by professionals, such as broker-dealer firms and investment advisers, who must recommend investments that are based on their clients’ investment objectives and levels of sophistication. Through JOBS Act Crowdfunding, individuals are able to invest in entrepreneurial start-ups through an intermediary, such as a broker-dealer or a “funding portal.” By law, these funding portals are not allowed to provide investment advice.

JOBS Act Crowdfunding: Currently Prohibited

Until the SEC adopts rules and regulations implementing the 2012 JOBS Act, JOBS Act Crowdfunding is not legal in California or anywhere else. It is anticipated that the SEC will adopt rules and regulations later this year.

When fully implemented, the 2012 JOBS Act will promote small business capital formation by enabling private companies to sell, through a portal registered with the SEC, up to \$1 million in securities over a 12-month period to an unlimited number of investors and exempting those offerings from registration with state or federal authorities. Disclosure of all material facts and risks will still be required under federal and state law.

Any investment opportunities which claim to be crowdfunding under the JOBS Act should be reported to the Department of Corporations (DOC) at (866)-ASK-CORP or email at AskCorp@corp.ca.gov.

What is not JOBS Act Crowdfunding

The Department has observed some confusion regarding the legal status of JOBS Act Crowdfunding and whether it is already occurring. The misunderstanding appears to be due in part to the use of the term “crowdfunding” to describe investment activities that may not be JOBS Act Crowdfunding.

In general, entities are not subject to Department securities regulation if they do not offer or deliver profits in return for a contribution. The Department is aware of organizations that have raised millions of dollars from consumers who received no profits or offer of profits in exchange for their contributions. Although the Department does not regulate these entities, they may still be subject to other rules or regulations.

Because of the popularity of the crowdfunding concept, the term has emerged as a marketing tool to attract attention to securities offerings that have been “qualified” by state or federal regulators for offer and sale to the public, but are not JOBS Act Crowdfunding or crowdfunding in the nonprofit sense. A security is qualified and approved for sale to the public after submitting an application to the appropriate regulatory agency, and undergoing review and comment. Consumers can find out if securities have been qualified for offer to the public through the DOC, the SEC, or other appropriate state regulators.

The term crowdfunding has also recently been used to market unregistered securities over the Internet that rely on the exemption from the registration requirements contained in Federal Rule 506 (Reg D). The Reg D exemption, while currently legal, means offers must meet a specific set of rules. Generally, Reg D offers can only be made to “accredited” investors that meet specific income or net worth requirements and it is not currently legal to make Reg D offers over the Internet to the general public.

The Department is monitoring the SEC deliberations on JOBS ACT Crowdfunding and investigating all credible leads on unauthorized JOBS Act Crowdfunding. We will update this information when the SEC rules are issued or other important developments occur.

WHAT SHOULD **INVESTORS** KNOW ABOUT JOBS ACT CROWDFUNDING?

- JOBS Act Crowdfunding investments cannot be offered legally until the SEC adopts rules to permit them. Avoid offerings that seek investments immediately and report them to the Department of Corporations.
- Once the SEC adopts regulations under the JOBS Act, state regulators will not be allowed to review and approve JOBS Act Crowdfunding issuers or their offerings, so less information may be available to investors.
- Crowdfunding investments are mostly illiquid and investors must be prepared to hold their investments indefinitely. It may also be difficult to resell securities due to the lack of a secondary market.

WHAT SHOULD **ENTREPRENEURS** KNOW ABOUT JOBS ACT CROWDFUNDING?

- JOBS Act Crowdfunding investments cannot be offered legally until the SEC adopts rules to permit them.
- The JOBS Act Crowdfunding exemption will only be an exemption from securities law registration requirements. It does not change the securities law disclosure requirements. Failure to comply with disclosure requirements may result in liability for securities fraud and other enforcement actions, as well as civil lawsuits.
- Funding portals must be registered with the SEC, belong to a self-regulating organization, and comply with other rules the SEC may issue.

For more information on investor protection, the offering of securities and raising capital, contact

**The California Department of Corporations at
(866)-ASK-CORP or online at www.corp.ca.gov.**