

Start-up Crowdfunding Guide for Businesses

Crowdfunding is a process through which an individual or a business can raise small amounts of money from a large number of people, typically through the Internet. The objective is to raise sufficient funds in order to carry out a specific project. There are different types of crowdfunding, such as by donation, pre-selling of products or securities crowdfunding. This guide discusses securities crowdfunding.

Securities crowdfunding

With securities crowdfunding, a business raises funds through the Internet by issuing securities (such as bonds or shares) to many people. This type of crowdfunding is overseen by the regulator of the province or territory where the business and potential purchasers are located.

Valérie has a brilliant idea. She has developed a soft drink flavoured with maple syrup and other local products. She has prepared a detailed business plan and hopes to turn a profit from her business venture. She thinks there is a market for maple soft drinks in gourmet grocery stores, bars and restaurants. She wants to begin production. She needs \$75,000 in order to bottle and market her soft drinks. She applied to a financial institution for a loan, but was refused. She is thinking about raising the funds she needs by issuing shares through a securities crowdfunding distribution.

Legal Obligations

In Canada, all trading of securities is subject to legal obligations. For example, a business seeking to raise capital by issuing securities must file a prospectus with the securities regulator of their province or territory or have an exemption from the prospectus requirement under securities law.

These obligations, however, can be costly for start-ups and early stage businesses. The securities regulators in British Columbia, Saskatchewan, Manitoba, Québec, New Brunswick and Nova Scotia (**the participating jurisdictions**) allow start-ups and small businesses (issuers) to raise funds using securities crowdfunding without filing a prospectus or preparing financial statements. The securities regulators refer to this as the “start-up crowdfunding exemptions” or “start-up crowdfunding”.

The start-up crowdfunding exemptions allow:

- a start-up or early stage issuer to raise relatively small amounts of capital by distributing securities to investors without filing a prospectus (**start-up prospectus exemption**)
- a funding portal to facilitate trades of those securities without having to register as a dealer (**start-up registration exemption**), although a funding portal can be operated by a registered dealer

How Start-up Crowdfunding Works

In order to raise funds using the start-up prospectus exemption, issuers must prepare and post an offering document on a funding portal's crowdfunding website. Investors will then be able to read about the offering and decide whether to invest. Before investing, investors will have to confirm that they have read the offering document and understood that the investment is risky.

When should an issuer consider start-up crowdfunding?

Before launching a start-up crowdfunding distribution, the management of the issuer should:

- evaluate other sources of funding, such as a loan from a financial institution
- assess whether they are willing to invest the time and efforts needed to prepare and run a start-up crowdfunding distribution
- determine the type and characteristics of securities that will be sold
- determine the number of securities to be sold and at what price
- assess if they have the capabilities to manage a great number of security holders

If a start-up crowdfunding distribution is successful, the issuer may have to give up part of the ownership of the issuer to investors. The issuer will also need to be accountable to investors. Investors will expect to be informed about successes and failures of the issuer's business. Management of the issuer should assess whether they are willing to spend the time and effort to maintain contact with investors.

Where is start-up crowdfunding available?

The start-up crowdfunding exemption is available if both the investor and the issuer's head office are located in any one of the participating jurisdictions (British Columbia, Saskatchewan, Manitoba, Québec, New Brunswick or Nova Scotia).

What is the maximum amount that can be raised? Are there any time limitations for raising that amount?

\$250,000 per start-up crowdfunding distribution. The offering document must indicate a minimum amount that has to be raised before the offering can close. The issuer has a maximum of 90 days to raise the minimum amount, starting on the day the issuer's offering document is first made available to investors through a funding portal's website.

The money will be held in trust by the funding portal until the minimum amount of the offering is reached. The issuer may then complete the offering by issuing the securities.

If the minimum amount is not reached, or the start-up crowdfunding distribution is withdrawn, the funding portal must return the money to the investors.

How often can an issuer raise money using start-up crowdfunding?

An issuer group may complete a maximum of two start-up crowdfunding distributions per year. The issuer group cannot have more than one start-up crowdfunding distribution running at the same time or on different funding portals for the same purpose. The issuer group must wait until the first distribution has ended before launching a second one.

The issuer group means the issuer, any affiliates of the issuer and any other issuer that is engaged in a common enterprise with the issuer or an affiliate, or whose business is founded or organized by the same person or company who founded or organized the issuer.

What is the maximum amount an issuer can raise from each investor?

\$1,500 per start-up crowdfunding distribution. The issuer may require a minimum amount per investor (e.g. \$500).

Launching a Start-up Crowdfunding Distribution

Once an issuer has determined that it will launch a start-up crowdfunding distribution, it will need to prepare an offering document and choose a funding portal to post its offering document. Issuers are to prepare the offering document using Form 1 – *Start-up Crowdfunding – Offering Document*.

What is a funding portal?

A funding portal lists start-up crowdfunding distributions on its website and facilitates the payment of the purchase price from the investor to the issuer. Funding portals will generally charge issuers for hosting a start-up crowdfunding distribution.

The funding portal is responsible for

- providing a risk warning form to potential investors
- holding all investor funds in trust until the issuer raises the minimum funding target
- returning funds to investors, without deduction, if the issuer does not reach its minimum funding target or if the issuer withdraws its distribution

What types of funding portals are available?

There are different types of funding portals that may facilitate start-up crowdfunding:

- funding portals operated by persons or companies relying on the start-up registration exemption that are not registered under Canadian securities legislation and that cannot give advice about the suitability of any security or about the merits of any investment
- funding portals operated by a registered investment dealer, exempt market dealer or restricted dealer under Canadian securities legislation that are required to provide advice about the suitability of the security
- funding portals operated by a registered restricted dealer under Canadian securities legislation and subject to the terms and conditions of their registration that cannot give advice about the suitability of any investment. An example of this type of funding portal would be one operated by a restricted dealer subject to the terms and conditions of Multilateral Instrument 45-108 *Crowdfunding* (MI 45-108). Please note this MI 45-108 restricted dealer is not allowed to operate in BC.

The issuer has the choice of which type of funding portal to use for its start-up crowdfunding distribution.

A funding portal operated by a registered dealer must confirm in writing to the issuer that it can provide certain services necessary for start-up crowdfunding, including that it will make the offering document and risk warnings available to the purchaser through its website. The issuer may also call a regulator to determine whether the

funding portal is authorized to operate in jurisdictions that it proposes to conduct start-up crowdfunding.

What information needs to be in the offering document?

The offering document must include basic information about the business and the offering, how it will use the money and any risk to the project. The offering document must also include the minimum amount needed to be raised to accomplish the business' goals.

The information contained in the offering document must be kept up to date throughout the duration of the start-up crowdfunding distribution. If information contained in the offering document is no longer true, the issuer must amend the offering document as soon as practicable and send the new version to the funding portal. The funding portal will post the new version of the offering document on its website and will notify investors about the amendment.

The offering document does not need to be updated after the start-up crowdfunding distribution is over.

If the issuer raises funds in Québec, the offering document and the risk acknowledgement form must be made available to investors in Québec in French or in French and English.

For additional details on the offering document, including instructions on how to prepare this document, please see the section *"Preparing an offering document"* below.

What if an investor changes their mind?

Investors have the right to withdraw their investment within 48 hours following the investor's subscription. Investors also have the right to withdraw their investment within 48 hours of the funding portal notifying the investor of an amendment to an offering document.

To exercise this right of withdrawal, investors must notify the funding portal. The funding portal must give investors the opportunity to exercise this right. The funding portal must return the funds to an investor who exercises this right, without any deduction, within five business days after the notice.

Completing a Start-up Crowdfunding Distribution

Once the minimum amount has been raised, the issuer has the discretion to close the start-up crowdfunding distribution by issuing the securities to investors. However, the issuer must wait until each investor's 48-hour withdrawal period has expired.

If the issuer has disclosed in the offering document what it will do with any extra funds raised above the minimum amount, then the issuer can continue raising funds provided the issuer closes the distribution within the 90-day maximum offering period and up to the maximum amount indicated in the offering document. This maximum amount cannot be more than \$250,000.

At the closing of the distribution the funding portal releases the funds raised to the issuer.

Can an issuer use another prospectus exemption to meet the minimum amount?

Although an issuer cannot have two start-up crowdfunding distributions running at the same time or on more than one funding portal, the issuer can raise funds using other prospectus exemptions during a start-up crowdfunding distribution. For example, the issuer may issue securities to an accredited investor. Other prospectus exemptions, such as the accredited investor exemption, are found in the instruments and rules of the local securities regulator, including [National Instrument 45-106 Prospectus Exemptions](#). The funds raised under other prospectus exemptions can be used to reach the minimum amount stated in the offering document if they are unconditionally available to the issuer.

Valérie's objective is to raise a minimum of \$75,000. The funding portal raised \$45,000 from investors under the start-up crowdfunding exemption. At the same time, Paul, who is considered to be an "accredited investor" because of his income and assets, unconditionally undertakes to invest \$30,000 in Valérie's enterprise. The minimum amount has been reached and Valérie can ask the funding portal to release the \$45,000 raised as soon as the 48-hour withdrawal period has expired for all investors.

After the closing

Filing of the offering document and report of exempt distribution

The offering document and a report of exempt distribution must be filed with the regulator of each participating jurisdiction where investors are located no later than 30 days after the closing of the distribution. For example, if the issuer has raised money in

Québec and Nova Scotia, the offering document and report of exempt distribution must be filed with the Autorité des marchés financiers and the Nova Scotia Securities Commission.

In addition, the offering document and report of exempt distribution must be filed with the regulator of the participating jurisdiction where the issuer's head office is located, even if no investors were located in this jurisdiction.

When filing the offering document, the issuer must include all copies of the offering document including any amended versions.

In British Columbia, the report of distribution is Form 45-106F6 *British Columbia Report of Exempt Distribution*. Elsewhere it is Form 5 – *Start-up Crowdfunding – Report of Exempt Distribution*.

Confirmation notice to investors

Within 30 days after the closing of the distribution, the issuer must send a confirmation notice to each investor who purchases securities with the following information:

- the date of subscription and the closing date of the distribution
- the quantity and description of securities purchased
- the price paid per security
- the total commission, fee and any other amounts paid by the issuer to the funding portal in respect of the start-up crowdfunding distribution

Preparing an offering document

Issuers are responsible for preparing an offering document that investors will read to determine if they want to invest in that issuer. The offering document must be prepared using Form 1 *Start-up Crowdfunding – Offering Document*. The issuer must provide information for each of the items in the form.

The following will help issuers complete certain items of the offering document and should be read together with the form.

Item 2: The issuer

2.1 (a) The organizing documents are the issuer's articles of incorporation, limited partnership agreement or other similar documents.

(b) The head office is generally where the people managing the issuer, including the CEO, maintain their offices. This may be the same address, or different from the registered office address, depending on the legal structure of the corporation. The address of the head office should be a physical address and not be a P.O. Box.

Item 4: Management

4.1 The people named here are important for investors to assess if they want to invest in the issuer. These people should preferably have experience in managing a business, or in the same industry as the issuer.

Director: An individual occupying the position of director with the issuer. If the issuer is a limited partnership, information should also be provided for the directors of the general partner.

Officer: Includes the CEO, president, a vice-president, corporate secretary, general manager or any other individual who performs functions of officer for the issuer. If the issuer is a limited partnership, information should also be provided for the officers of the general partner.

Promoter: A person who takes the initiative in founding or organizing the issuer is generally considered a promoter of the issuer.

Control person: A person that holds more than 20% of the voting rights, alone or with other persons acting in concert, is generally considered a control person of the issuer.

- 4.2 If any of the persons listed in item 4.1 is or has been subject to any of the proceedings described in item 4.2, state this fact. Provide the name of the person involved and enough details on the time, nature and the outcome of the proceedings.

A quasi-criminal offence may include offences under the *Income Tax Act* (R.S.C. 1985, c. 1 (5th Suppl.)), the *Immigration and Refugee Protection Act* (R.S.C., 2001, c. 27) or the tax, immigration, drugs, firearms, money laundering or securities legislation of any province or territory of Canada or foreign jurisdiction.

Item 5: Start-up crowdfunding distribution

- 5.1 The issuer must provide the offering document to a funding portal. The funding portal must make the offering document available on its website before the issuer can begin to raise money. If the issuer is using a funding portal that is operated by a registered dealer, it must provide the name of the registered dealer in addition to the name of the funding portal. The offering document can only be posted on one funding portal.

- 5.3 (a) A start-up crowdfunding distribution is not allowed to close if the minimum offering amount has not been reached within 90 days. The offering document will be posted on the funding portal's website on the date agreed to by the issuer and the funding portal.

(b) During the offering period, the issuer must immediately amend the offering document if the information that it contains is no longer true. Provide the date the amended offering document is posted on the funding portal's website and a description of the information that was amended. If the offering document is amended, the issuer must not modify the date in (a). Investors will have the right to withdraw their subscription within 48 hours of the funding portal notifying the investor that the offering document has been amended.

If the offering document has not been amended, (b) is not applicable.

- 5.5 The issuer must tell investors what rights are attached to the securities described in item 5.4, if any. This information is usually found in the organizing documents referred to in item 6.3.
- 5.6 The restrictions and conditions to be described here are generally found in shareholder's agreements or limited partnership agreements.

A tag-along right is a contractual obligation used to protect minority shareholders. The right assures that if the majority shareholder sells his stake, minority shareholders have the right to join and sell their securities on the same terms and conditions as would apply to the majority shareholder.

A drag-along right is designed to protect a majority shareholder. A drag-along right enables a majority shareholder to force minority shareholders to join in the sale of a company, by giving the minority shareholders the same price, terms, and conditions as any other seller.

A pre-emptive right is the right of existing shareholders to acquire new shares issued by the issuer. It can allow existing shareholders to maintain their proportional ownership of the issuer, preventing stock dilution.

- 5.7 The issuer must set a minimum amount to be raised before it can close a start-up crowdfunding distribution. The maximum amount cannot exceed \$250,000.

The amount raised needs to be equal to the total number of securities the issuer wishes to issue multiplied by the price per security.

- 5.8 The issuer has the option to set a minimum investment amount per investor. This amount cannot be over \$1,500. If the issuer does not wish to set a minimum investment amount, item 5.8 should be left blank. The minimum investment amount per investor cannot be below the price per security.

Item 6: Issuer's business

- 6.1 The description of the issuer's business is a very important part of the offering document. Enough details should be provided for an investor to clearly understand what the issuer does, or intends to do. Consideration should be given to the following:

- What makes the issuer's business special and different from other competitors in the industry?
- What milestones has the issuer already reached?
- Where does the issuer see its business in three, five and ten years?
- What are the issuer's future plans and hopes for its business and how does it plan to get there?
- What is the issuer's management experience in running a business or in the same industry?

- 6.2 Indicate whether the issuer is a corporation, a limited partnership, a general partnership or other. Also, indicate the province, territory or state where the issuer is incorporated or organized.
- 6.3 Specify where investors can review the issuer's organizing documents. Online access to these documents is convenient for investors.
- 6.5 The issuer is not required to provide financial statements to investors in connection with a start-up crowdfunding distribution. However, many investors use financial statements to assess and compare investment opportunities and may be reluctant to invest in a business that does not provide this type of information.

The issuer can choose to make financial statements available to investors. If so, it must include the statement provided in item 6.5 in the offering document. The issuer may want to post the financial statements on the issuer's website for the convenience of its investors.

The issuer should not, however, include the financial statements with or provide a link to the financial statements in the offering document. If the issuer chooses to include the financial statements or a link in the offering document, there may be an obligation under securities laws to prepare the financial statements using Canadian GAAP for publicly accountable enterprises and to audit the financial statements using Canadian GAAS.

Item 7: Use of funds

- 7.1 If the issuer has previously raised funds, specify for which purpose they were used. Include enough details so an investor can clearly understand:
- How much money the issuer has already raised
 - How the issuer raised it
 - What prospectus exemption was used
 - How has that money been used

If the issuer has not previously raised funds, state this fact.

- 7.2 The issuer must tell investors what it will do with the money raised from this start-up crowdfunding distribution by providing enough details to allow investors to make a reasoned investment decision. Incomplete or unrealistic

information will not help the issuer raise more money. Therefore, the issuer should make sure its plans are realistic and achievable.

Item 8: Previous start-up crowdfunding distributions

- 8.1 Provide the information listed under item 8.1 if any of the persons listed in item 4.1 have been involved in a start-up crowdfunding distribution in any of the participating jurisdictions in the past five years, whether with the issuer, or with another issuer.

Item 9: Compensation paid to funding portal

- 9.1 Describe the fees (e.g., commission, arranging fee or other fee) that the funding portal is charging for its services. Describe each type of fee and the estimated amount to be paid for each type. If a commission is being paid, indicate the percentage that the commission will represent of the gross proceeds of the offering (assuming both the minimum and maximum offering).

Item 10: Risk factors

- 10.1 Explain the risks of investing in the issuer for the investor in a meaningful way, avoiding overly general or “boilerplate” disclosure. Disclose both the risk and the factual basis for it. Risks can relate to the issuer’s business, its industry, its clients, etc.

Issuers should be truthful, reasonable and clear. Investors deserve to be able to make a reasoned decision based on all the information, even the downside. Issuers may indicate how the business plans to mitigate these risks, but should not de-emphasize the risks by including excessive caveats or conditions.

Item 11: Reporting obligations

- 11.1 Tell investors how the issuer will keep them informed about the business and their investment.

The regulator does not require that the issuer report to investors, but investors will want to be kept informed. If the issuer fails to do this, it may create disgruntled investors that can make it difficult for the issuer to raise money in the future.

Setting out a reasonable reporting plan is important. Issuers should make sure the plan is realistic. Reporting doesn’t have to be complex or costly. Reporting can be through newsletters, social media sites, email, financial statements or

similar documents. Issuers should go over the milestones that have been met, confirm how investors' money was used, and discuss future plans.

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