

## Start-up Crowdfunding Guide for Funding Portals

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, or pre-selling of products, and securities crowdfunding. This guide discusses securities crowdfunding.

### *Securities crowdfunding – legal obligations*

In Canada, all trading of securities is subject to legal obligations. For example, a person cannot be in the business of trading securities unless the person is registered in the province or territory where it is carrying on this business or has an exemption from the registration requirement under securities laws. Similarly, 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 requirements under securities laws.

These obligations, however, can be costly for start-ups and early stage issuers. The securities regulators in British Columbia, Saskatchewan, Manitoba, Québec, New Brunswick and Nova Scotia (the **participating jurisdictions**) have made available registration and prospectus exemptions to facilitate securities crowdfunding to help make it easier for start-ups and early-stage businesses to raise money by issuing securities. 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 (the **start-up registration exemption**), although a funding portal can be operated by a registered dealer

Start-ups and early stage issuers intending to conduct a start-up crowdfunding offering must use a funding portal. A funding portal lists investment opportunities and facilitates the payment of the purchase price from the investor to the issuer.

The purpose of this guide is to assist funding portals. In this guide, “regulator” means the securities regulator or regulatory authority in a participating jurisdiction.

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 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.

### **Funding portals operating under the start-up registration exemption**

A person operating a funding portal does not have to register as a dealer if they meet all conditions of the start-up registration exemption. These conditions include, among other things, that the funding portal must:

- have its head office in Canada
- have a majority of its directors be Canadian residents
- not be registered under Canadian securities legislation
- not tell investors an investment is suitable for them or otherwise discuss the merits of an investment
- ensure that investors confirm online, by ticking a box, that they have read and understood the offering document and risk warning available on the funding portal
- take reasonable measures to ensure that the head office of each issuer using the funding portal is in a participating jurisdiction and that each investor is a resident of a participating jurisdiction
- not allow access to its website to any person until that person acknowledges it is accessing the website of a funding portal that is not registered under Canadian securities legislation and provides no advice about the suitability or the merits of an investment
- not receive a commission or fee from an investor

- discloses on its website the full legal name, municipality and jurisdiction of residence, business mailing and e-mail address, and business telephone number of each promoter,<sup>1</sup> director, officer and control person<sup>2</sup> (**principal**) of the funding portal
- hold investors' assets separate from the funding portal's property, in trust for the investor and, in the case of cash, at a Canadian financial institution
- keep its books and records, including its compliance procedures, at its head office for eight years from the date a record is created
- not facilitate the distribution of securities to purchasers under prospectus exemptions other than the start-up prospectus exemption

### *Before starting operations*

A funding portal intending to rely on the start-up registration exemption must deliver the following forms to regulators at least 30 days before starting operations:

- a completed Form 3 – *Start-up Crowdfunding - Funding Portal Information Form*
- a completed Form 4 – *Start-up Crowdfunding - Funding Portal - Individual Information Form* for each principal of the funding portal
- any other documents that may be requested by the regulators

Submitting the following documents to the regulators with Form 3 will help expedite the regulators' review:

- business plans and financial statements, if the funding portal intends to facilitate start-up crowdfunding distributions in Québec
- organizing documents such as articles and certificate of incorporation or partnership agreement if the funding portal intends to facilitate start-up crowdfunding distributions in Saskatchewan, Manitoba, Québec, or Nova Scotia
- business registration numbers and proof of extra-provincial registration if the funding portal intends to facilitate start-up crowdfunding distributions in Saskatchewan, Manitoba, Québec, or Nova Scotia.

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<sup>1</sup> A person who founded, organized or significantly reorganized the funding portal is generally considered to be a promoter.

<sup>2</sup> A person who holds a sufficient number of voting rights to control the funding portal or who holds 20% or more of the voting rights of the funding portal is generally considered a control person of the funding portal.

- documents describing the funding portal's process and procedure for handling investors' funds, including the following details:
  - the name of the Canadian financial institution where the trust account for investors' cash is located
  - the name of the signatories on that trust account and their role with the funding portal
  - how the investors' assets will be kept separate and apart from the funding portal's assets
  - how the cash will flow from: (i) the investors to the funding portal's trust account; (ii) from the funding portal's trust account back to the investors' bank accounts in the event that the offering does not close; and (iii) from the funding portal's trust account to the issuer in the event that the offering does close
- a copy of the trust agreement for the funding portal's trust account with a Canadian financial institution or details surrounding the establishment of this account

As part of the regulator's review, the funding portal will also be requested to provide access to its website in a test environment.

The funding portal must deliver the forms by e-mail to regulators in each participating jurisdiction where the funding portal intends to facilitate start-up crowdfunding distributions. For example, a funding portal with a head office in Saskatchewan that intends to seek funds from investors in all participating jurisdictions must deliver the forms and documents described in this guide to the Financial and Consumer Affairs Authority of Saskatchewan and the regulators in each of the other participating jurisdictions. In such a case, it is suggested the funding portal e-mail each regulator involved at the same time.

If the forms are complete, the funding portal can start operations 30 days after it delivers the forms. However, if a regulator notifies the funding portal that it needs more time to review the documents, the funding portal must wait until the regulator confirms it has completed its review.

A regulator can notify the funding portal that it cannot use the start-up registration exemption because its principals, or their past conduct, demonstrate a lack of integrity, financial responsibility or relevant knowledge or expertise.

If a change occurs and the information in the forms and documents delivered to a regulator are no longer up-to-date, the funding portal must update the information by delivering a new form or document setting out the change. For example, if management at a funding portal changes, an updated funding portal information form as well as a

funding portal individual information form for each new principal must be delivered to the regulators.

### *Compliance with laws and regulations*

The funding portal's activities are subject to the securities laws of the jurisdictions where its head office or other places of business are located, as well as the jurisdictions where the issuers and purchasers are resident.

If a funding portal intending to rely on the start-up registration exemption has its head office located in a jurisdiction where that exemption is not available then the funding portal may be required to be registered as a dealer. For example, an Ontario resident intending to operate a funding portal may have to register as a dealer with the Ontario Securities Commission even though the funding portal is not soliciting issuers or investors from that province. Once registered as a dealer in any jurisdiction then the start-up registration exemption is no longer available (see later section on *Funding portals operated by registered dealers*).

Failing to comply with local securities laws is a serious offence that could prevent the funding portal from being able to rely on the start-up registration exemption. The funding portal must also ensure that it complies with all other applicable laws and regulations of a participating jurisdiction. We encourage funding portals to consult a lawyer for advice.

Regulators in the participating jurisdictions plan to conduct compliance reviews of funding portals relying on the start-up registration exemption soon after the commencement of operations. If a funding portal does not meet the conditions of the start-up registration exemption, then it can no longer rely on that registration exemption and may be required to become a registered dealer.

### *No suitability advice*

A funding portal relying on the start-up registration exemption must not give advice to investors. This means the funding portal cannot tell an investor that the securities offered are a good investment or that the investor should make an investment for whatever reason. The funding portal must refrain from saying or doing anything that might lead an investor to think that they should buy the securities because the securities somehow meet their investment needs or objectives.

However, the funding portal can give factual information about the securities. For example, it may tell investors about the features of the securities, the risks of the

investment, how start-up crowdfunding works, and other items of a general, factual nature.

A funding portal can carry out reviews of issuers before making their offering documents available on its website to protect the funding portal's own interests or reputation.

### *Holding client assets in trust*

Under the start-up registration exemption, a funding portal must segregate client assets and hold them in trust. Funding portals should expect that regulators will assess how the funding portal is handling client assets at both the initial stage, and during future compliance reviews.

This is a fundamental obligation on the funding portal reliant on the start-up registration exemption. A funding portal found to be non-compliant with this condition may no longer be able to rely on the start-up registration exemption and may be required to become a registered dealer.

### **Funding portals operated by registered dealers**

Registered exempt market dealers, investment dealers and restricted dealers are allowed to operate start-up funding portals. Registered dealers that operate funding portals must:

- meet their existing registration obligations under securities legislation (such as the know-your-client, know-your-product and suitability obligations owed to investors)
- confirm to issuers that the funding portal meets certain of the conditions in the start-up prospectus exemption, such as making an offering document and risk warning available to investors on the funding portal's website
- prompt any person entering the funding portal's website to acknowledge that they are entering a website of a funding portal:
  - that is operated by an investment dealer, exempt market dealer or restricted dealer as applicable, and
  - that will provide suitability advice if required to do so under securities legislation or
  - that will not provide suitability advice if not required to do so [for example as in the case of a restricted dealer operating under the terms and conditions under MI 45-108]

- file either a completed Form 33-109F5 *Change of Registration Information*, or Form 33-109F6 *Firm Registration* that describes its business as including operating a funding portal under the start-up crowdfunding exemptions. The funding portal must disclose all fees charged to investors in accordance with relationship disclosure requirements under National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations*.

## How does start-up crowdfunding work?

Issuers are responsible for preparing an offering document that complies with the prescribed form. In particular, issuers must indicate the minimum amount necessary to close a start-up crowdfunding distribution. Issuers will provide the offering document to the funding portal to post online. The funding portal must take reasonable measures to ensure that the issuer is a resident of a participating jurisdiction where the offering document is made available. Investors will read the offering document and decide whether or not to invest.

Before accepting an investment, a funding portal must obtain confirmation from the investor that he or she has read and understood the offering document and the risks described in the risk acknowledgement form. A funding portal must obtain the investor's personal information and take reasonable measures to ensure the investor resides in a participating jurisdiction.

An issuer cannot close a distribution if it has not raised the minimum amount set out in its offering document and before each purchaser's right to withdraw has expired. At the closing:

- the issuer issues shares or other eligible securities to investors
- the funding portal releases funds to the issuer

No later than 15 days following the closing of the distribution, the funding portal must notify investors that the funds have been released to the issuer, and it must provide the issuer with the following information on each investor:

- Full name
- Address
- Telephone number
- E-mail address
- Number of securities purchased
- Total purchase price

If the issuer withdraws its start-up crowdfunding offering or does not raise the minimum amount within 90 days after the funding portal posts the offering document online, all the funds must be returned in full to investors. No deductions are permitted. The funding portal must also send a notice to the issuer and each investor confirming that the funds have been returned to investors.

The funding portal may send notices to investors and issuers by e-mail.

### **Related-party restriction**

A funding portal cannot act in a start-up crowdfunding distribution if one of its principals is also a principal of the issuer group. The issuer group means the issuer, an affiliate 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.

### **Investor's right to withdraw**

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 the offering document.

To exercise this right of withdrawal, an investor 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.

### **Amendments to the offering document**

An issuer must amend its offering document after it has been posted online if the information it contains is no longer true. This could be the case if, for example, an issuer wants to change the price of the securities or the minimum or maximum offering amount.

### **Issuer's financial statements**

Under the start-up prospectus exemption, issuers are not required to provide financial statements to investors with the offering document.



If an issuer wants to make its financial statements available to investors, it can place a hyperlink on the funding portal leading to the financial statements. However, the hyperlink must not appear in the offering document. Financial statements do not form a part of the offering document.

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