

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 via the Internet. The objective is to raise sufficient funds in order to carry out a specific project. There are different types of crowdfunding:

Crowdfunding by way of donation or pre-sale

Internet funding portals connect individuals or businesses that have a project proposal with people interested in contributing financially.

Crowdfunding is often used to finance projects in various fields, such as arts, culture and philanthropy. For example, funds can be raised to hold a cultural event, produce a motion picture or music album, or support victims of a natural disaster.

Small businesses also use crowdfunding to finance their business activities, raising funds as donations or product pre-sales.

Joan operates a coffee shop. She needs to replace the shop's ice cream machine in time for the approaching summer. The cost of a new machine, with delivery and installation, is \$13,000. She solicits for funds on a funding portal. For \$100, donors will receive promotional articles and discount coupons and their name will be featured on a list of donors at the entrance to the coffee shop.

Securities crowdfunding

Securities crowdfunding is when a business raises funds in this manner by issuing debt securities (such as bonds) or securities giving the right to participate in future profits (such as shares) to a purchaser (an investor). This type of crowdfunding is overseen by the regulator of the province or territory where the business is 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 campaign.

The start-up prospectus exemption

In general, a business that issues securities (an issuer) to the public must satisfy certain legal requirements. For example, issuers that seek capital from the public through the issuance of securities must file a prospectus with the regulator of their province or territory.

In this guide, “regulator” means the securities regulator or regulatory authority in a participating jurisdiction.

These obligations, however, can be costly for start-ups and early stage issuers. An exemption from the prospectus requirement (the start-up prospectus exemption) is available in British Columbia, Saskatchewan, Manitoba, Québec, New Brunswick and Nova Scotia (the participating jurisdictions). **Under certain conditions, this exemption allows issuers to raise capital through the issuance of securities without filing a prospectus.** The regulators refer to this as start-up crowdfunding.

Is start-up crowdfunding available in my province or territory?

The start-up prospectus exemption is available if the issuer’s head office is located in British Columbia, Saskatchewan, Manitoba, Québec, New Brunswick or Nova Scotia.

Is it appropriate for my business?

Before launching a start-up crowdfunding campaign, 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 a start-up crowdfunding campaign.
- Determine the type of securities that will be sold.
- Determine the number of securities to be sold and at what price.
- Estimate if they have the capabilities to manage a great number of security holders.

If a start-up crowdfunding campaign is successful, the founders of the issuer may have to give up part of the ownership of the issuer to investors. The issuer will be accountable to investors. Investors will likely expect to be informed about successes and failures of the issuer’s business. The issuer may have to spend time and money to maintain contact with investors.

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).

What is the maximum amount that can be raised?

\$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 issue the securities, which is the closing of the offering.

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

What is the maximum number of distributions per calendar year?

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

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

What is the funding portal's role?

A funding portal lists start-up crowdfunding campaigns on its website and facilitates the payment of the purchase price from the investor to the issuer. Any start-up crowdfunding campaign is made through a funding portal that meets the required conditions.

There are two types of funding portals that may participate in start-up crowdfunding:

- funding portals that are relying on the start-up crowdfunding exemption, and
- funding portals that are operated by registered dealers.

The issuer has the option to choose either type of funding portal to use for its start-up crowdfunding campaign.

Preparing an offering document

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

The following will help issuers to complete certain of the items of the offering document and should be read together with Form 1.

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 A minimum amount to be raised must be set before a start-up crowdfunding distribution can close. 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 so an investor can 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 see the issuer's organizing documents. Making these documents available online may be convenient for them.
- 6.5 The issuer is not required to provide financial statements to investors in connection with a start-up crowdfunding distribution. However, investors may be more interested in a business that can show good accounting practices and that is prepared to share their financial condition. Investors may be reluctant to invest in a business that refuses to 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. Making financial statements available online on the issuer's website may be convenient for 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 certain accounting principles and to audit the financial statements using certain auditing standards.

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).

Fees payable to the funding portal should be mutually agreed with the issuer prior to posting the offering document.

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.

Posting the offering online on a funding portal

The funding portal makes the offering document available to investors through its website. Funding portals will generally charge issuers for posting a start-up crowdfunding campaign.

Investors will then be able to read about the offering and decide whether or not to invest. Before investing, investors will have to confirm that they have read the offering document and understood that the investment is very risky.

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.

Investors may withdraw their investment within 48 hours of subscription if the investor no longer wishes to invest. Investors who want to withdraw their investment during this time must notify the funding portal.

The funding portal will hold the funds raised in trust for the investors. If the issuer is unable to raise the minimum amount, the funds will be returned to investors.

Amendments to the offering document

The information contained in the offering document must be kept up to date throughout the duration of the start-up crowdfunding campaign.

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 inform investors about the amendment. Investors will then have 48 hours to withdraw their investment. Investors who want to withdraw their investment during this time must notify the funding portal.

The offering document does not require updates once the start-up crowdfunding campaign is over.

Closing of the distribution

If the minimum amount has been raised within the determined time period, the issuer can proceed to close the start-up crowdfunding campaign. The issuer will issue the securities and instruct the funding portal to release the funds. However, the issuer must wait until the expiry of the 48-hour withdrawal period for each investor.

If the offering document states that the issuer can raise more than the minimum amount (which cannot exceed \$250,000) and explains what it intends to do with the excess funds raised, the issuer can wait before closing the distribution and continue to raise funds until the end of the period determined by the issuer (that cannot exceed 90 days).

At the closing, the funding portal must release the funds raised to the issuer.

Concurrent distributions

Although there cannot be two start-up crowdfunding campaigns running at the same time, the issuer can raise money using other prospectus exemptions during a start-up crowdfunding campaign. Other prospectus exemptions are found in National Instrument 45-106 *Prospectus Exemptions*. The funds raised under other prospectus exemptions can serve 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 \$65,000 from several investors. At the same time, Paul, who is considered to be an "accredited" investor by reason of his income and assets, unconditionally undertakes to invest \$10,000 in Valérie's enterprise. Since this amount exceeds \$1,500, Paul's investment cannot be made through the funding portal. Nevertheless, the minimum amount has been reached and Valérie can ask the funding portal to release the \$65,000 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

No later than 30 days after the closing of the distribution, the offering document and a *Report of Exempt Distribution* must be filed with the regulator of each participating jurisdiction where the issuer has raised money. 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.

If not already filed, 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 money was raised in this jurisdiction.

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

In British Columbia, the report of distribution is in Form 45-106F6 – *British Columbia 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 other amount paid by the issuer to the funding portal in respect of the start-up crowdfunding distribution