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New Opportunities for Crowdfunding in Manitoba

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Crowdfunding has become an increasingly popular method for start-ups and small and medium-sized enterprises to raise business capital.

The three common models of crowdfunding are the donation model, the reward model and equity/investment model. The donation model is commonly used for charitable causes, such as disaster relief or non-profit fundraising. Other enterprises use the reward-based model of crowdfunding. Under the rewards-based model, the business or entrepreneur offers rewards, such as early release music albums or t-shirts, in exchange for financial support.

In Canada, the reward model and the donation model can be used without requiring consideration of special legal issues. Under these models, businesses are not offering shares of their companies; therefore, securities law considerations are not triggered.

The equity/investment model, however, allows a business (called an “issuer”) to use the internet and online platforms to raise capital and to source investors for its projects. These online platforms, called “portals”, essentially create mini online stock exchanges, creating issues with securities law in Canada. Currently, Canadian issuers can only raise capital by issuing a prospectus, which is very costly to prepare, or by falling into the limited exceptions, such as the private issuer exception, which allows private companies to sell shares of their companies to up to fifty (50) people who fall into a defined category such as family, friends or colleagues.

Additionally, securities laws in Canada are provincially legislated, making it difficult for potential issuers to navigate and ensure compliance with every jurisdiction where investors may be located. Based on these restrictive and at times conflicting securities laws, equity/investment crowdfunding has not been an easy or viable method of raising business capital in Canada to date.

Nevertheless, the popularity of crowdfunding as a method of raising capital has been growing. Due to its increased popularity, in early 2012, the United States enacted legislation aimed at promoting equity-based crowdfunding, called the *Jumpstart Our Business Start-ups Act* (the “JOBS Act”).

Not wanting to miss out on the opportunities that crowdfunding was creating in the United States, in late 2012, the Ontario Securities Commission (the “OSC”) sought feedback on proposals to open up the limited exemptions as described above and to create a framework which would allow equity crowdfunding in Ontario. The OSC proposed possible restrictions on crowdfunding which could be implemented to protect the parties involved, similar to the JOBS Act, including limits on the amount of capital being sought, mandatory Canadian incorporation, limits on the types of shares issued and limits on the issuer’s advertising of the investment opportunity, as well as investor protection measures.

Following the lead of the OSC, on March 20, 2014, the Canadian Securities Administrators (the “CSA”) published a notice and released for comment two proposed equity crowdfunding prospectus exemptions. Manitoba, along with New Brunswick, Nova Scotia, Quebec and Saskatchewan (the “Participating Jurisdictions”) through The Manitoba Securities Commission (the “MSC”) has now published the Crowdfunding Prospectus Exemption and Crowdfunding Portal Requirements (the “Crowdfunding Exemption”) and the Start-Up Crowdfunding Prospectus and Registration Exemption (the “Start-Up Exemption”) for a 90 day comment period. These exemptions have been proposed as complementary exemptions, aimed at different stages of business development for potential issuers in Manitoba.

Below, we summarize the general terms of both the proposed Crowdfunding Exemption and the proposed Start-Up Exemption and how businesses and investors in Manitoba can take advantage of these exemptions.

Crowdfunding Exemption

The Crowdfunding Exemption is proposed to be available to both private and public issuers, provided that the following initial criteria is met:

- the issuer must be incorporated or organized in Canada, with a head office in Canada; and
- the majority of the directors must be residents of Canada.

The Crowdfunding Exemption has two major components: (1) a crowdfunding prospectus exemption; and (2) a set of proposed funding portal registration requirements. For the purposes of this article, we will only provide comment on the prospectus component.

Crowdfunding Prospectus Exemption

The prospectus is normally a document which the issuer must provide to potential investors which explains in reasonable detail the nature of the issuer’s business, the project for which the issuer is soliciting funds (the “offering”), and what the issuer hopes to achieve with the raised capital.

As part of the Crowdfunding Exemption, an issuer must prepare and provide what is a called a Disclosure Document which describes the offering, the issuer and the portal . This document must be provided to the relevant provincial regulator (in Manitoba, the MSC) at the time the offering is posted on the portal’s website. The Disclosure Document must include a significant amount of detail including, but not limited to, the following:

- the amount of the offering, how many securities will be offered and the rights attached to the securities purchased by investors;
- whether there is an ability for the investor to re-sell its shares;
- the rights of action (legal recourse) for an investor if there has been a misrepresentation in the Disclosure Document and how an investor can exercise its rights in this event, including who the investor needs to contact and how they can contact that person;
- the business plan and how the money raised through crowdfunding will help the issuer achieve its next milestone or further the activities set out in that plan;
- the risks facing the business of the issuer and the financial information of the issuer (the level of financial information required to be provided depends on whether the issuer is a private or public company and the issuer’s financial status)
- a description of how the investor will be able to obtain continuing disclosure and information about the issuer, particularly if the issuer is a private company (for public companies distributing securities under the Crowdfunding Exemption, all continuous disclosure obligations under securities laws will apply); and
- background information about the directors, officers or other key persons involved with the issuer, as well as the contact information for the issuer.

An offering cannot be open for more than ninety (90) days. Issuers cannot raise more than $1.5 million dollars in a year, and this limit extends to all affiliates and subsidiaries of the issuer.

Information for potential investors

For investors considering investing in an issuer under the Crowdfunding Exemption, the proposed limit per individual investment is $2,500.00 per single investment, and no more than $10,000.00 per person in a calendar year.

Investors must also sign a risk acknowledgement form confirming that they have not exceeded their investment limits and that they understand that they could lose their entire investment. Investors will have until 48 hours prior to the disclosed offering deadline to withdraw their investment.

The Disclosure Document and the restrictions on investors have been designed with the goal of protecting the investors who will be providing funds to the issuer, while still allowing issuers to raise a significant amount of capital.

Start-Up Exemption

The Start-Up Exemption is aimed at issuers who are in a very early stage of development and are seeking an infusion of capital into their business or venture, but not to the same level that may be required in connection with the Crowdfunding Exemption. Unlike the Crowdfunding Exemption, the Start-Up Exemption is only available to private (non-reporting) issuers, provided that the issuer is located in a Participating Jurisdiction, as defined above, and provided that the issuer has met the requirements outlined in the Start-Up Exemption.

While a formal Disclosure Document is not required, the issuer must provide an offering document to the MSC at least 10 business days prior to the offering, which then must be made available to investors through the portal, providing potential investors with the following information:

- a description of the business carried on by the issuer;
- how the issuer has previously raised funds and what those funds have been used for;
- the purpose of the offering and the minimum amount required for the offering, which must be equal to the amount needed to carry out the purpose described in the offering document;
- a description of what the issuer will do with excess funds if it raises more than the minimum amount;
- how many securities will be offered and the rights attached to the securities purchased by investors;
- a description of how the issuer will report to its investors; and
- any important risks an investor should be aware of before investing, be it regulatory risks, industry risks or even a statement that the nature of the business is seasonal and could be affected by elements outside the control of the issuer.

An offering cannot be open for more than ninety (90) days. Under the Start-Up Exemption, an issuer cannot raise more than $150,000.00 per offering, as compared to $1.5 million under the Crowdfunding Exemption, and this exemption cannot be used by an issuer more than twice in a calendar year.

Information for potential investors

For investors considering investing in an issuer under the Start-Up Exemption, the proposed limit per individual investment is $1,500.00 per single investment, with no yearly restriction.

Based on the lower offering limits, the Start-Up Exemption does not attract the same legal rights of recourse in the event of a misrepresentation in the offering document, nor does it offer investors the chance to revoke their investment up until 48 hours prior to the offering deadline.

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Summary

The Start-Up and Crowdfunding Exemptions are currently only in a proposed stage, and the MSC is seeking feedback on these proposals up until June 18, 2014. If accepted, these exemptions could have a large impact on entrepreneurship in Manitoba by providing businesses with a way to raise capital outside of the traditional methods. Not only that, it provides potential investors with the ability to participate in projects of interest which may not have otherwise been available to them. Nevertheless, there are important considerations to be made prior to deciding to invest in an issuer, or before deciding to solicit investments through an offering. Prospective issuers should be aware of all obligations imposed on them by legislation if they choose to raise capital through the crowdfunding exemptions.

If you are considering becoming a funding portal for equity crowdfunding, there are significant obligations which are imposed on portals under these exemptions, which should be carefully reviewed with a lawyer prior to the creation of a funding portal or website.

For more information on these exemptions and/or to provide feedback to the MSC about the exemptions, please contact:

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