

Note: [02 Oct 2019] – The following is Start-up Crowdfunding Guide for Investors as it was initially implemented. This version no longer current.

Start-up Crowdfunding Guide

For Investors



ASC
Alberta Securities Commission

This guide is published by staff of the Alberta Securities Commission, the regulatory agency responsible for administering Alberta's securities laws.

The information in this Guide is for educational purposes only and does not constitute legal advice.

If any information in this guide is inconsistent with Blanket Order 45-521 *Start-up Crowdfunding Registration and Prospectus Exemptions*, or the corresponding orders in other jurisdictions, please follow the applicable blanket orders and related forms.

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START-UP CROWDFUNDING GUIDE FOR INVESTORS

Crowdfunding is a process through which an individual or a business typically raises small amounts of money from a large number of people, usually through the Internet. The objective is generally 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 by selling shares, loans or other securities, i.e., securities crowdfunding. This guide discusses securities crowdfunding.

Securities crowdfunding

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

Legal obligations

In Canada, the sale of securities is subject to securities law obligations. For example, a person or company 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 can be costly for start-ups and early stage businesses. Most businesses therefore rely on prospectus exemptions to sell their securities. Most of these exemptions can be found in National Instrument 45-106 *Prospectus Exemptions*. (See also Multilateral Instrument 45-108 *Crowdfunding*.) In addition, the securities regulators in Alberta, British Columbia, Manitoba, New Brunswick, Nova Scotia, Québec and Saskatchewan (the **participating jurisdictions**) allow start-ups and small businesses to raise funds using securities crowdfunding by preparing a brief disclosure document that, significantly, does not require preparing financial statements. In this guide, we refer to this as the “**start-up crowdfunding exemptions**” or “**start-up crowdfunding**”.

The start-up crowdfunding exemption allows 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**).

Top 3 things to do before investing in a start-up crowdfunding project

#1 Know the process

#2 Do your homework

#3 Understand the risks

1 – KNOW THE PROCESS

Business (Issuer)



A small business or a start-up has an idea but needs to raise funds to make it happen. They create a pitch to investors that includes basic information about the business and the offering, how they will use the money, and the risks of the project. Then they set a minimum amount they need to raise to accomplish their goal. The pitch will be found on a crowdfunding website.

Investor



An investor spots an interesting business on a crowdfunding website. After reading all the business information (which they should make sure to understand) and researching the business and the people involved, the investor can invest up to \$1,500. In certain circumstances, investors resident in Alberta, British Columbia and Saskatchewan can invest up to \$5,000 if a registered dealer has determined that the investment is suitable for the investor. They must confirm they have read and understood the offering document and risk warnings presented.

Crowdfunding Website (Portal)



The crowdfunding website holds the money the business raises in trust for investors until the minimum amount is raised. If the business does not raise the money it needs, the portal must give each investor their money back.

Start-ups and small business (issuers)

The business has an idea but needs to raise funds to make it happen. It must prepare an offering document that includes basic information about the business and the offering, how it will use the money and the risks of investing in the business. The business must state the minimum amount it needs to raise to accomplish its goal. The business must use a crowdfunding website called a funding portal to raise funds this way.

Investor (you)

You, the investor, spot an interesting business on a funding portal website. After reading the business' offering document and doing your homework, you may decide to invest up to the amount described in the "How much can I invest?" section of this guide. Before you complete your investment, the funding portal will ask you to confirm that you understand the risks and have read and understood the business' offering document. You have 48 hours after your investment to change your mind and get your money back.

Crowdfunding website (funding portal)

The funding portal posts start-up crowdfunding projects on its website. The funding portal is responsible for:

- providing a risk warning form to potential investors;
- holding all investor funds in trust until the business raises the minimum funding target; and
- returning funds to investors, without deduction, if the business does not reach its minimum funding target or if the business withdraws the start-up crowdfunding campaign.

When you enter a funding portal website, you will see a pop-up notice telling you whether the funding portal is:

- operated by a registered dealer under Canadian securities legislation. (Note: before you invest, these registered portals must determine whether the investment is suitable for you); or
- not registered under Canadian securities legislation. (Note: these portals cannot give you advice. You must decide for yourself if the investment is right for you.)

You will be asked to acknowledge that you have read this pop-up notice before entering the funding portal website.

You can check to see whether the funding portal can do business in Alberta. You can check this link to see whether the funding portal is registered:

<https://www.securities-administrators.ca/investortools.aspx?id=1128>.

To see whether the funding portal has filed all documents required to operate an unregistered portal in Alberta you can check the ASC website on the webpage for start-up crowdfunding and/or contact ASC inquiries at 403-355-4151 or email at registration@asc.ca

2 – DO YOUR HOMEWORK

Before investing, you should:

- Read the start-up crowdfunding offering document posted on the funding portal website. It contains basic information about the business' activities, its management, its financial condition, the amount it wants to raise, how the money raised will be used and the risks. **The securities regulators have not reviewed or approved the offering document. It is your responsibility to understand the information in the offering document.**
- Search the Internet for information on the business, its industry and the people operating its business. Check their background to see whether they were ever disciplined for bad business practices. You can contact the business and the funding portal for further information.
- The business may also raise funds at the same time other than through start-up crowdfunding. Those investors may receive more or less information than what you are provided in the start-up crowdfunding offering document.

- You can ask the business and its principals about any previous successes or failures they may have had trying to raise funds in the past. The start-up offering document must disclose whether that business had any previous start-up crowdfunding distributions and whether they were successful or not. However, businesses are not required to report any failed or withdrawn offerings if they raised funds in another way.
- If the business gives you financial statements, **you should know that those financial statements have not been provided to, or reviewed by, securities regulators.** Confirm whether they are part of the offering document. You should ask the business whether the financial statements have been audited and which accounting standards were used to prepare the financial statements. Do the financial statements include a balance sheet, income statement, statement of changes in financial position and detailed supporting notes? If you are not comfortable or proficient with financial statements, seek advice from a qualified person and/or visit InvestRight.org to learn more on how to understand company material.
- Consider their business plan. How is the business going to grow? How will it make money and within what period? Watch for unsupportable claims about the business' future success.
- Consider how you will receive a return on your investment. What type of securities is the business going to give you in exchange for your investment? The securities must be described in the offering document. If the business is offering debt securities, consider when the business intends to pay you back. If the business is offering equity securities, such as common shares, read the rights attached to these securities described in the offering document. Consider how you will ever be able to sell those shares or make a return.
- Review all documents relating to your investment. There may be other rights and restrictions about the investment detailed in the business shareholder's agreement or other agreements.
- Investments in early stage and start-up businesses are very risky. It's hard to develop a successful profitable business. Even for those businesses that are successful, achieving that can take many years. Think carefully about your risk tolerance and what you can afford to lose if the investment doesn't turn out as hoped. Consider the cons as well as the pros.
- Ask the business any other questions you may have. The offering document will provide contact information for someone at the business who is able to answer your questions.

For more information on investing, we encourage you to refer to the ASC's Check First Site:
<http://www.checkfirst.ca/>

3 – UNDERSTAND THE RISKS

To make an informed decision, you must have a good understanding of the risks related to the start-up crowdfunding offering. These include:

- Securities of start-ups or small businesses are risky. Statistics show that a high percentage of start-ups and small businesses fail. You could lose the entire amount you paid for your investment.
- What is your risk tolerance? If your risk tolerance is low, an investment in a start-up or small business is probably not suitable for you.
- What do you know about the individuals operating the business? Do they have the knowledge and experience required to manage it? Businesses are sometimes managed by inexperienced individuals. Find out more about the individuals operating the business before investing.
- Do you have the resources to be patient? If you think you will have to resell your securities in the short term, this type of investment is probably not suitable for you. Securities purchased through start-up crowdfunding offerings are not publicly traded. You may have to wait indefinitely before reselling the securities or you may not be able to resell them at all.
- A great deal of information and analysis is available about public companies. This is not the case for start-ups and small businesses. Unlike reporting issuers (such as public companies listed on a stock exchange), start-ups and small businesses are not required under securities law to file audited financial statements or provide other periodic disclosure. You will likely receive much less information about a start-up or small business both at the time you invest and after you invest.
- Once you have made the investment, the start-up or small business will not generally have any obligation to provide you with updates (such as an annual report). You will have to track your investment on your own.
- If you are willing to take risks and invest in a start-up, you may want to consider investing in a business that operates in a sector you know well. You may be in a better position to assess its likelihood of success.

THE START-UP CROWDFUNDING PROCESS – AN EXAMPLE

Oliver has heard about start-up crowdfunding. He goes to ABC Funding Portal's website and sees a pop-up notice that says ABC Funding Portal is not registered but is operating under the start-up crowdfunding registration exemption. He checks the names of their management and does some research to see whether they have ever been disciplined for bad business practices.

After satisfying himself about ABC Funding Portal, Oliver browses through the start-up crowdfunding projects listed on its website. He comes across Valerie's Maple Cola Company. Valerie wants to raise \$75,000 by selling shares in her business, to market and bottle soft drinks flavoured with maple syrup and other local products. Oliver thinks the investment looks interesting.

Oliver reads Valerie's Maple Cola Company's start-up crowdfunding offering document carefully, particularly the section that warns of the risks of this investment. Oliver does some additional research on Valerie's Maple Cola Company, Valerie and her management team and the beverage manufacturing business.

Oliver decides he wants to invest \$750 in Valerie's Maple Cola Company. He reviews the risk warning on ABC Funding Portal website. He confirms, by ticking a box, that he has read the offering document and understands the risks he is taking. He pays for the investment.

ABC Funding Portal holds Oliver's money in trust until Valerie raises at least \$75,000. If Valerie doesn't raise her \$75,000 target within 90 days of posting the offering document on the funding portal website, ABC Funding Portal must return Oliver's money to him, without any deductions.

If Valerie successfully raises \$75,000, she can proceed to complete the start-up crowdfunding offering. Oliver is now a shareholder of Valerie's Maple Cola Company. Upon completion of the offering, Oliver receives a confirmation setting out the number of the common shares he purchased and how much he paid.

There is no guarantee as to the future value of Oliver's investment. Oliver will have to hold onto these securities for an indefinite period and may be unable to resell them at all.

THE START-UP CROWDFUNDING PROCESS – AN EXAMPLE

Where can I find start-up crowdfunding offerings?

You will find start-up crowdfunding offerings posted on the websites of funding portals. Before a funding portal can operate in any Canadian jurisdiction, it must either be registered as a dealer or comply with the terms of a registration exemption including delivering mandatory documents to the securities regulatory authority in that jurisdiction.

Should I get investment advice?

You should use a funding portal that is a registered dealer if you want or need investment advice because registered dealers must determine whether, having regard to the information you have provided about your financial circumstances and risk tolerance, an investment is suitable for you. When a registered dealer advises that a start-up crowdfunding investment is suitable for you, you can, in certain circumstances, invest more than you could if only an unregistered funding portal is involved, i.e., up to \$5,000. See "How much can I invest?"

If you are viewing offerings on an unregistered funding portal, you will not receive investment advice. They are prohibited from giving you investment advice as they are not qualified to tell you whether the investment is suitable for you. You must be prepared to make your own investment decision when investing through an unregistered funding portal. Unregistered portals are also prohibited from charging you a fee or commission for investing through their website.

When you enter a funding portal website, a pop-up notice will inform you whether or not the funding portal is operated by a registered dealer. To check whether the funding portal is operated by a registered dealer, go to www.aretheyregistered.ca.

To check whether an unregistered funding portal is permitted to operate in Alberta, check the ASC website page relating to start-up crowdfunding or call the phone number listed below under “*Where can I get further information?*”

How much can I invest?

Because businesses conducting start-up crowdfunding distributions provide investors with only a brief offering document and risk warning, there are limits on how much money they are permitted to accept from investors, individually and in aggregate. You can invest up to \$1,500 in a start-up crowdfunding offering. However, this amount can be increased to \$5,000 if all of the following apply:

- you live in Alberta, British Columbia or Saskatchewan;
- the business you are investing in has a head office in Alberta, British Columbia or Saskatchewan;
- a registered dealer has determined that the investment is suitable for you.

What will I get in return for investing in a start-up crowdfunding project?

With securities crowdfunding, investors receive securities in exchange for their investment. This is different than other types of crowdfunding, where you may get a product. Start-up crowdfunding is restricted to particular types of securities: debt securities, such as bonds; equity securities, such as common shares or preference shares; limited partnership units; and convertible securities, such as warrants, that are convertible into either common shares or preference shares.

The offering document must describe the type of security you will receive in exchange for your investment.

Investing in start-up and early stage businesses involves significant risk. You may not get any return on your investment. Even if the business is ultimately successful, it may take many years before that occurs.

What if I change my mind?

Once you have committed to purchasing securities:

- You may withdraw your investment within 48 hours of subscription if you no longer wish to invest; or
- If the business amends the offering document, you also have the right to withdraw your investment within 48 hours of the funding portal notifying you that the offering document has been amended.

In either case, you must notify the funding portal that you wish to withdraw before the end of this 48-hour period. After receiving your notification, the funding portal will return your funds to you within 5 business days.

WHERE CAN I GET MORE INFORMATION?

For more information about the start-up crowdfunding exemptions in the participating jurisdictions, please refer to the following contact information:

Alberta	<p>Alberta Securities Commission Telephone: 403-355-4151 Email: inquiries@asc.ca Website: https://www.albertasecurities.com/</p>
British Columbia	<p>British Columbia Securities Commission Telephone: 604-899-6854 E-mail: inquiries@bcsc.bc.ca Website: www.bcsc.bc.ca</p>
Saskatchewan	<p>Financial and Consumer Affairs Authority of Saskatchewan Securities Division Telephone: 306-787-5645 E-mail: exemptions@gov.sk.ca Website: www.fcaa.gov.sk.ca</p>
Manitoba	<p>The Manitoba Securities Commission Toll-free in Manitoba: 1-800-655-2548 E-mail: exemptions.msc@gov.mb.ca Website: www.mbsecurities.ca</p>
Québec	<p>Autorité des marchés financiers Direction du financement des sociétés Toll-free in Québec: 1-877-525-0337 E-mail: financement-participatif@lautorite.qc.ca Website: www.lautorite.qc.ca</p>
New Brunswick	<p>Financial and Consumer Services Commission Toll-free: 1-866-933-2222 E-mail: emf-md@fcnb.ca Website: www.fcnb.ca</p>
Nova Scotia	<p>Nova Scotia Securities Commission Toll-free in Nova Scotia: 1-855-424-2499 E-mail: nssc.crowdfunding@novascotia.ca Website: https://nssc.novascotia.ca/</p>