

# *Virginia*

## *Regulatory Hot Tip 2014 – 6*

*Professional Insurance Agents Association of Virginia and DC, Inc.*

---

### WHAT IN THE WORLD IS CROWDFUNDING?

Recently I was invited to a seminar on how to capitalize a food cart business, but my interest in the presentation, since most of you know that I hardly ever cook, focused on the discussion of crowdfunding. I wanted to learn a little more about it because I had read some recent articles in the newspaper about Kickstarter and Kiva Zip, but I really didn't know much about these vehicles as sources of capital for start-up businesses. After this seminar, I began to dig a little deeper on the subject and thought that many of you might be interested in my findings. Importantly, the term "crowdfunding" is a new phrase and not even recognized by the spell check on my computer.

First off, crowdfunding is a vehicle under many different names that permits someone to fund a project, a business, or an idea in a non-traditional manner. You do not generally crowdfund by going to your local bank, completing paperwork and getting a loan. Crowdfunding also provides a vehicle for folks who want to contribute funds to someone's creative ideas and who seek a platform to collect such contributions. Surprisingly and certainly unlike banks, some crowdfunding vehicles that I researched

---

The author of this Regulatory Hot Tip endeavors to provide accurate and authoritative information about the subject matter covered as of the date of publication. However, the substantive information and any statutory authority contained in this Hot Tip should be verified as they are subject to change with the passage of time. The author provides this Hot Tip with the understanding that she is not rendering legal, accounting, or other professional advice or counsel. If legal advice or other expert assistance is required, the services of a competent professional should be sought. This publication is authored by JoAnne L. Nolte, JD, CIC, CPCU, FLMI, CLU, who practices at The Nolte Law Firm, P.C., 1427 W. Main Street, Richmond, VA 23220. NolteLaw offers [Solutions for Business—Large and Small](#); just call (804) 658-4518.

NolteLaw's practice focuses on general business matters (such as business formation, acquisitions, dissolutions and employment questions) and administrative law issues (such as rulemaking and compliance) affecting regulated entities. Our diverse client base includes restaurants, healthcare providers, contractors, fiber-optic and conduit installers, business entrepreneurs, telecommunications companies, insurance entities, financial institutions, mortgage loan originators, water & sewer providers, and insurance receiverships. Jo has served as attorney for the Virginia State Corporation Commission and as in-house counsel to a privately owned national corporation. She also owned and operated an insurance surplus lines brokerage agency and an insurance consulting business.

didn't even require payback of the invested funds, while others operated more like loans, some with interest and some without interest. However, crowdfunding is such a new mechanism for raising cash that the success/failure statistics are not compiled at this juncture. To be successful with your crowdfunding venture, you generally must rely upon the "last leg of funding," originating with your family and friends.<sup>1</sup>

You simply must know the rules of the crowdfunding vehicle that you choose to use. Don't be surprised by not asking enough questions of the crowdfunding source. With traditional banks pulling back on their lending, particularly lending to start up ventures, and the increased red tape in trying to find a loan, many people are looking for "investor angels" to fund their projects. Because I am often asked how to locate business funds when banks remain pretty conservative on lending, I have been looking into the various methods for business funding options, including crowdfunding. However, I caution you that you have to know the rules of each crowdfunding method, participate in keeping with the respective funding vehicle's rules and be aware that many times it may cost you something to participate. Sometimes merely applying for the funds can become quite time consuming and expensive. I have learned that there are consultants who specialize in helping individuals get through the crowdfunding process, though no one can guarantee the outcome of such a drive.

### *Popular Crowdfunding Sites.*

So you are interested in learning more about crowdfunding, the rules, etc. and don't know where to go. As said before, crowdfunding generally occurs on internet platforms. Forbes compiled a list of the ten top crowdfunding sites in an article published on May 8, 2013.<sup>2</sup> In 2013 the popular sites were:

1. Kickstarter (<http://kickstarter.com>),
2. Indiegogo (<http://indiegogo.com>),
3. Crowdfunder (<http://crowdfunder.com>),
4. RocketHub (<http://rockethub.com>),
5. Crowdrise (<http://crowdrise.com>),
6. SoMoLend (<http://somolend.com>),
7. appbackr (<http://appbackr.com>),
8. AngelList (<http://angellist.com>),
9. Invested.In (<http://invested.in>), and
10. Quirky (<http://quirky.com>).

---

<sup>1</sup> NASAA Daily News Highlights: May 30, 2014.

<sup>2</sup> <http://www.forbes.com/sites/chancebarnett/2013/05/08/top-10-crowdfunding-sites-for-fundraising/>.

Since 2013, you can bet others have entered the marketplace. For example, Kiva Zip ([www.KivaZip.org](http://www.KivaZip.org)) is another crowdfunding site, but Kiva Zip offers short term (24 months or less) interest free loans rather than simply giving money away. However, Kiva Zip generally limits its initial loans to an amount of \$2,500.00 or less, so it is basically for smaller initiatives.<sup>3</sup> Up to 22 sites were identified in a recent Inc. magazine article which included other familiar names such as: Bolstr, Fundable, etc.<sup>4</sup>

***Know the protocol before you get involved and what your supporters get in return.***

Do your homework before you mount a campaign through any of these crowdfunding mechanisms. I have to give thanks to Barb Upchurch, Blueberry Marketing, Richmond, VA, who introduced me to Kickstarter and Kiva Zip. Barb also gives seminars to assist folks in trying to obtain such funds, walking them through the stages of the process. She has convinced me that a successful campaign is not pie-in-the-sky, but neither is it cheap or easy to pull together.<sup>5</sup> To be successful in some of these crowdfunding endeavors, you must make a video complete with audio about who you are, what you plan to do with the funds, etc. The more polished the video, of course, the better chance of the recipient actually reaching their funding goal. There are other rules. Some of the crowdfunding sites encourage you to have a gift of some kind to offer your “financial supporters”.<sup>6</sup> Others, I am told, may even require that you give up some form of ownership in the entity attempting to raise the funds. Indeed, one article indicates that there are four different returns that supporters who participate in crowdfunding typically receive:

a. *donation*: Sometimes the return to the supporter is merely a warm and fuzzy feeling. They believe in the cause and want to support it. For example, supporters contribute to a youth sports team, assisting them to achieve a goal, attend a tournament;

b. *reward*: The return could be something tangible, such as being the recipient of the product or service that the business produces in exchange for monetary support;

c. *equity*: Supporters actually become owners of the business for which they are lending support; thus the supporters anticipate that they might share in any returns on the investment they make if the entity performs well, in the form of a distribution or

---

<sup>3</sup> See, [www.KivaZip.org](http://www.KivaZip.org).

<sup>4</sup> <http://www.inc.com/magazine/201306/eric-markowitz/how-to-choose>.

<sup>5</sup> “The Ten Commandments of Crowdfunding”, a seminar by Stephanie Ganz and Barb Upchurch, Blueberry Marketing, given at Ellwood Thompsons Community Room on February 20, 2014.

<sup>6</sup> Ibid.

dividend. Depending on how an equity offering is structured, it could be deemed to be a “security” under both State and Federal law.

d. *debt*: The entity involved in the crowdfunding campaign does not issue ownership interest in the entity, but rather borrows money from the supporters of the crowdfunding campaign. Indeed, the supporters receive a binding commitment from the entity to repay each loan using a payment plan. This may involve interest payments. SterlingFunder and Kiva Zip are examples of crowdfunding sites employing the debt vehicle for crowdfunding drives.<sup>7</sup> Be aware, however that, depending on how a debt offering is structured, it could be deemed to be a “security” under both State and Federal law. Again, caution is the word here.

But, be careful what you wish for. Some of you may have seen the article in the *Richmond Times Dispatch* focusing on the toy manufacturer that attempted to raise \$38,000.00 through crowdfunding, but instead found himself raising more than \$820,000.00 for a “Mini Museum” product concept. Such results sound like a hugely successful Kickstarter campaign, but now the manufacturer needs to fulfill thousands of orders for the product which he had previously been developing from his home. The recipient estimated that he had spent over \$300,000 over the years in development of his product. He also indicated that he had spent most of his life collecting items to be put into these mini-museums.<sup>8</sup> Be aware that under many crowdfunding platforms, if you do not achieve your entire financial goal, you may not receive any funding, hence the recommendation that you always be prepared to have the last leg covered by a committed family member or friend.

### *State and Federal crowdfunding laws, rules and regulations.*

Also realize that government regulation of some of these crowdfunding vehicles is under way. As we learned in law school, difficult facts make difficult law. With the advent of this form of raising funds for projects, business or personal, apparently comes abuses. Though many of the state regulators have been waiting for the federal government to lead the way on any regulation that will be imposed on crowdfunding and in spite of voluminous draft regulations being published, **there are no final federal rules and regulations in place yet.**

In spite of this, it may interest you to know that, purportedly, the JOBS Act which President Obama signed into law in April, 2012, was drafted in part because of

---

<sup>7</sup> <https://www.sterlingfunder.com/blog/what-is-crowdfunding-and-its-different-types/>.

<sup>8</sup> *Toy designer's 'Mini Museum' takes off*, *Richmond Times Dispatch*, Tuesday, March 4, 2014, at B7.

the momentum of the crowdfunding exemption movement. The JOBS Act establishes limitations as to the value of securities an issuer may offer and individuals can invest through crowdfunding platforms. Specifically, “[a] issuer may sell up to \$1,000,000 of its securities per 12 months, and, depending upon their net worth and income, investors will be limited to investing up to \$100,000 in crowdfunding issues per 12 months”.<sup>9</sup> Moreover, “[t]he JOBS Act enables equity based crowdfunding only when it is conducted by a licensed broker-dealer or via a Funding Portal registered with the SEC”.<sup>10</sup> Keep in mind that there are opportunities for insurance agents in crowdfunding, particularly as the SEC draft rules require portals to purchase a fidelity bond of at least \$100,000 to protect the investing public from specified losses because of bad conduct by the crowdfunder’s officers and employees.<sup>11</sup> Whether this bonding provision makes it out in the final version of the rules is still to be determined. I can also envision some creative surplus lines insurers developing special insurance, sort of like hole-in-one coverage for borrowers in the crowdfunding arena to perhaps cover the last leg of funding, for example.

There are over a dozen states that have some form of rule or regulation for crowdfunding.<sup>12</sup> The Governor of Washington State signed legislation in March, 2014 authorizing equity crowdfunding there.<sup>13</sup> The announcement of this event signaled that Washington-created businesses will have the opportunity to raise up to a million dollars in any twelve month period applying the vehicle of crowdfunding.<sup>14</sup> Keep in mind that a constant theme throughout all of these new pieces of legislation is that they **only apply to intrastate activities**. Not only does your business have to be created in the state with the authorizing legislation, but your crowdfunding attempts must be limited to residents of the same state.<sup>15</sup> Recall your advertisements, including your website, should clearly set forth the intrastate nature of any crowdfunding campaign and exactly what states the campaign is legally permitted to draw supporters from.

Virginia toyed with crowdfunding legislation to boost the amount of funds available to business during the 2014 General Assembly Session in the form of HB 880 (left in committee) and SB 351 (carried over until the next session). Both bills, similar to those in Washington state, regulate equity crowdfunding. Among other requirements, both bills limited the amount that a Virginia-created business could raise using this vehicle from residents of Virginia to a ceiling of \$1,000,000 during any twelve month

---

<sup>9</sup> [http://en.wikipedia.org/wiki/Crowd\\_funding](http://en.wikipedia.org/wiki/Crowd_funding).

<sup>10</sup> Ibid.

<sup>11</sup> Ibid.

<sup>12</sup> <http://www.forbes.com/sites/kauffman/2014/05/28/state-equity-crowdfunding-policies-hold-promise>.

<sup>13</sup> <http://www.crowdfundinsider.com/2014/04/35019-washington-state-legalized-equity-crowdfunding/>.

<sup>14</sup> Ibid.

<sup>15</sup> <http://www.forbes.com/sites/kauffman/2014/05/28/state-equity-crowdfunding-policies-hold-promise>.

period. Assuming that the federal government does not implement regulations permitting crowdfunding in the near future, these or similar bills may be back on the agenda for 2015.

Let's turn for a moment to the federal government's attempt to form a regulation for crowdfunding. Of course it has hundreds of pages in text, and comments were due in February 2014. If you believe you would like to plow through the document, the link follows: <https://www.sec.gov/rules/proposed/2013/33-9470.pdf>. Most commentators seem to believe that because of other issues currently pending before the Securities and Exchange Commission, the implementation of national crowdfunding rules is not likely to occur in the near future. Until the federal government tackles this project, the states are pretty much left to implement their own policies on a state-by-state basis.<sup>16</sup>

So as a Virginian, where does that leave us? Well Virginians, like residents of other states, are availing themselves of crowdfunding techniques to achieve project goals. Though the earlier Kickstarter successful crowdfunding campaign certainly isn't the norm, it causes pause that such internet platforms can be successful and are available to the entrepreneur to access money. I have also learned that a fair number of Virginians are going online and contributing funds to prospective businesses and projects with which they align themselves. So, Virginians are already participating both as investors and contributors. Everyone that I know that is involved in active crowdfunding cautions that oftentimes family and friends have to be on tap and available to contribute the last leg of funding to make the drive successful; without that prop, crowdfunding may become more of a pie-in-the-sky source of funds.

Be aware that the more the campaign looks like a security, be it debt or equity, the more likely that you may run afoul of Virginia's security laws because currently there are no Virginia exemptions similar to other states which permit true equity or debt based crowdfunding.

Crowdfunding is an evolving subject, but one that you should be aware of and perhaps consider using if you have the time, commitment and are willing to spend a little money to attempt to raise some funds for a goal.

---

<sup>16</sup> <http://www.firstventurelegal.com/state-equity-crowdfunding/>.