Citizen Investors—A 90 Day State-of-the Union On Crowdfunding, Reg A+

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On May 16, 2016 the flood gates opened. That is when all American citizens were allowed a direct pathway to seed stage investing through a new type of security, technically called "Regulation Crowdfunding."

We're now 90-days in. Are startups reeling in newfound cash from mom, pop and every Tom, Dick and Sally on Main Street? Not yet.. In the first few months of this new market, just over $6 million has been raised and 70-something businesses are seeking a total of about $60 million according to the new CCA Regulation Crowdfunding Indices. (If you're interested in this funding space, definitely bookmark this site.)

I'm learning a lot by studying these indices, and I get even more insights by meeting with industry experts. Call me a policy wonk if you must, but one perk of my role as Executive Director of the Angel Capital Association is to attend DC insider meetings where the latest investing issues are discussed and debated. Recently, I attended the NASAA Capital Formation Roundtable, a meeting where state securities regulators talk with leaders from various securities markets across the US and Canada. A key topic was comparing notes about equity crowdfunding.

Since everyone seems to have an opinion on these topics, sometimes making it difficult to distinguish fact from fiction, I found it refreshing and insightful to get a dose of reality in this state of the union-like review of the market. Here are my general takeaways. I hope you find them as eye opening as I did:

Equity Crowdfunding: My 90-Day State-of-the-Union

- Who can invest? Anyone
- What types of crowdfunding are there? Equity crowdfunding offerings are available via two mechanisms: 1) at the federal level "Regulation Crowdfunding" lays out the rules for entrepreneurs and investors and 2) "intrastate crowdfunding," which allows for state residents

to invest in businesses in that state. Currently 34 states have approved intrastate crowdfunding and 29 are currently online.

- Where can you invest? All federal deals must be done via broker-dealers or investing platforms approved by the SEC. The last I saw 14 platforms are approved by the SEC to offer equity crowdfunding offerings. A few of the approved platforms are also ACA members that also separately have platforms for accredited investors only. Most of the intrastate markets also work via special platforms as well.
- What is the investment activity? So far, activity in these two types of crowdfunding has been minimal. In the first 90 days of crowdfunding at the national level, 70-plus offerings were filed. At the intrastate level, there have been 177 filings since 2011 in the first state with crowdfunding rules. And what state would you think that would be? Kansas.
- What are the growth projections? The state-type crowdfunding appears to be on a growth path, with many states just getting started. At the federal level, entrepreneurs and investors seem to be holding back due to confusion about how much information issuers can provide about their offerings. SEC rules allow for limited advertising of offerings outside of the crowdfunding platforms, but issuers can provide some basic information. Read "Crowd" doesn't mean fully public for details. Congress is working on some "fixes" to crowdfunding, although the fixes do not include this issue.
- What kinds of companies are raising money? The indices for Regulation Crowdfunding show the most action with wine and spirits, technology/hardware, entertainment, food and beverage, and real estate. The majority of companies using state platforms are consumer and retail oriented - pubs, restaurants, hair salon, dog groomer, etc.
- Is there a typical deal structure emerging? State regulators have noticed that many of the intrastate crowdfunding deals are structured not as equity, but as debt, membership units, or profit or revenue sharing. Regulators noted that many of these deals are "homegrown, local, community-based models" and that the issuers are not candidates for the type of exits expected in other types of equity investing. It makes sense to me then that many of these offerings need alternative deal structures.

Separately, the JOBS Act also allowed for new Regulation A+, which allows anyone to invest in offerings of up to $50 million with some different specific rules. Here are a few updates from the meeting on that market, which got started in 2015:

- What are the two "tiers" of Reg A+? Tier 1 offerings include deals up to $20 million and require approval by each state in which the offering is sold. Tier 2 offerings are for deals up to $50 million and are approved by the SEC.
- What is the approval process? Tier 1 deals have a more complicated approval process, since multiple state regulators are involved. NASAA has created a coordinated review process to remove some of the red tape.
- What is the activity level? Tier 1 of Reg A+ hasn't been a popular route: 11 deals have filed since 2014. Five of those were approved, two are pending, and four were withdrawn. One of the withdrawn offerings went to the tier 2 space, which has considerably more activity. More than 100 offerings have been filed for tier 2, seeking more than $2 billion.

Look to this column for future updates on these relatively new types of funding markets. It will be interesting to see how they progress as they mature and evolve. If you're interested learning more, ACA has invited two industry experts, Jackson Mueller, of the Center for Financial Markets at the Milken Institute and Dr. Richard Swart, Chief Strategy Officer at NextGeneration Crowdfunding, to answer questions and demystify crowdfunding for everyone at this August 31 webinar, which will also be available for later viewing in the ACA webinar archive