

## 5.1.2 Start-up Crowdfunding Guide for Funding Portals

### Start-up Crowdfunding Guide for Funding Portals

Crowdfunding is a process through which an individual or a business can raise small amounts of money from a large number of people, typically through the Internet. The objective is to raise sufficient funds in order to carry out a specific project. There are different types of crowdfunding, such as by donation, or pre-selling of products, and securities crowdfunding. This guide discusses securities crowdfunding.

#### Securities crowdfunding

In Canada, all trading of securities is subject to legal obligations. For example, a person cannot be in the business of trading securities unless the person is registered in the province or territory where it is carrying on this business or has an exemption from the registration requirement under securities laws. Similarly, a business 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 requirements under securities laws.

These obligations, however, can be costly for start-ups and early stage issuers. The securities regulators in British Columbia, Alberta, Saskatchewan, Manitoba, Ontario, Québec, New Brunswick and Nova Scotia (the **participating jurisdictions**) have made available exemptions to facilitate securities crowdfunding (the start-up crowdfunding exemptions) to help make it easier for start-ups and early-stage businesses to raise money by issuing securities.

The start-up crowdfunding exemptions allow:

- a start-up or early stage issuer to raise relatively small amounts of capital by distributing securities to investors without filing a prospectus (the start-up prospectus exemption); and
- a funding portal to facilitate trades of those securities without having to register as a dealer (the **start-up registration exemption**), although a funding portal can be operated by a registered dealer.

Start-ups and early stage issuers intending to conduct a start-up crowdfunding offering must use a funding portal. A funding portal posts information about investment opportunities and facilitates the payment of the purchase price from the investor to the issuer.

The purpose of this guide is to assist funding portals. In this guide, “regulator” means the securities regulator or regulatory authority in a participating jurisdiction.

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

- funding portals operated by persons relying on the start-up registration exemption
- funding portals operated by registered investment dealers or exempt market dealers

#### Funding portals operating under the start-up registration exemption

A person operating a funding portal does not have to register as a dealer if they meet all conditions of the start-up registration exemption. These conditions include, among other things, that the funding portal must:

- have its head office in Canada
- have a majority of its directors be Canadian residents
- not be registered under Canadian securities legislation
- not tell investors an investment is suitable for them or otherwise discuss the merits of an investment
  - This means the funding portal cannot tell an investor that the securities offered are a good investment or that the investor should make an investment for whatever reason. The funding portal must refrain from saying or doing anything that might lead an investor to think that they should buy the securities because the securities somehow meet their investment needs or objectives.
  - However, the funding portal can give factual information about the securities. For example, it may tell investors about the features of the securities, the risks of the investment, how start-up crowdfunding works, and other items of a general, factual nature.
- must make available the issuers' offering documents and risk warnings on its website

- A funding portal can carry out reviews of issuers before making their offering documents available on its website to protect the funding portal's own interests or reputation.
- Funding portals may want to be mindful that their website could be used in ways not intended by the funding portal. For example, peer-to-peer messaging systems on a funding portal's website might be used by the funding portal's visitors to solicit the purchase and sale of other securities without the portal's knowledge. This may result in the funding portal indirectly facilitating illegal securities distributions.
- ensure that investors confirm online, by ticking a box, that they have read and understood the offering document and risk warning available on the funding portal
- take reasonable measures to ensure that the head office of each issuer using the funding portal is in a participating jurisdiction and that each investor is a resident of a participating jurisdiction
- not allow entry to its website by any person until that person acknowledges that they are entering a website of a funding portal:
  - that is not operated by a registered dealer under Canadian securities legislation, and
  - that will not provide advice about the suitability or the merits of any investment

the regulators call this the "**pop-up acknowledgement**". For further information on the mechanics of the pop-up acknowledgement, please see the section in this guide entitled *Pop-up Acknowledgement*

- not receive a commission or fee from an investor
- discloses on its website:
  - the full legal name, municipality and jurisdiction of residence, business mailing and e-mail address, and business telephone number of each promoter,<sup>1</sup> director, officer and control person<sup>2</sup> (**principals**) of the funding portal, and
  - the names of the participating jurisdictions where the funding portal is operating and relying on the start-up registration exemption
    - Each of the participating jurisdictions has their own Start-up Crowdfunding Exemptions order (**blanket order**). With some exceptions, each blanket order is substantially harmonized with the other participating jurisdictions. However, the funding portal must ensure that they are in compliance with the blanket order in each participating jurisdiction where they are operating. Please check the applicable blanket orders which can be found on the regulators' website.

The regulators expect that these disclosures will be prominently displayed on the funding portal's website

- hold investors' assets separate from the funding portal's property, in trust for the investor and, in the case of cash, at a Canadian financial institution
  - This requirement is a fundamental obligation of the start-up registration exemption. Funding portals should expect that regulators will assess how the funding portal is handling client assets at both the initial stage and during future compliance reviews. The regulators intend to ensure that these conditions are followed closely.
- keep its books and records, including its compliance procedures, at its head office for eight years from the date a record is created
- not facilitate the distribution of securities to purchasers under prospectus exemptions other than the start-up prospectus exemption.

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<sup>1</sup> A person who founded, organized or significantly reorganized the funding portal is generally considered to be a promoter.

<sup>2</sup> A person who holds a sufficient number of voting rights to control the funding portal or who holds 20% or more of the voting rights of the funding portal is generally considered a control person of the funding portal.

**In Ontario, an unregistered funding portal must also disclose on its website the process the funding portal will use to notify purchasers if it becomes insolvent or discontinues operations, and how the funding portal will return the purchasers' assets it is holding to those purchasers.**

### **Before starting operations**

#### *Step one*

A funding portal intending to rely on the start-up registration exemption must deliver the following forms to regulators:

- a completed Form 3 – *Start-up Crowdfunding - Funding Portal Information Form* (Form 3)
- a completed Form 4 – *Start-up Crowdfunding - Funding Portal - Individual Information Form* (Form 4) for each principal of the funding portal
- any other completed documents and any additional information that may be requested by the regulators

Submitting the following documents to the regulators with the Form 3 may help expedite the process:

- business plans and financial statements, if the funding portal intends to facilitate start-up crowdfunding distributions in Québec
- organizing documents such as articles and certificate of incorporation or partnership agreement if the funding portal intends to facilitate start-up crowdfunding distributions in Saskatchewan, Manitoba, Ontario, Québec, or Nova Scotia
- business registration numbers and proof of extra-provincial registration if the funding portal intends to facilitate start-up crowdfunding distributions in Saskatchewan, Manitoba, Ontario, Québec, or Nova Scotia
- documents describing the funding portal's process and procedure for handling investors' funds, including the following details:
  - the name of the Canadian financial institution where the trust account for investors' cash is located
  - the name of the signatories on that trust account and their role with the funding portal
  - how the investors' assets will be kept separate and apart from the funding portal's assets
  - how the cash will flow from: (i) the investors to the funding portal's trust account; (ii) from the funding portal's trust account back to the investors' bank accounts in the event that the offering does not close; and (iii) from the funding portal's trust account to the issuer in the event that the offering does close
- a copy of the trust agreement for the funding portal's trust account with a Canadian financial institution or details surrounding the establishment of this account

The regulators may also request access to the funding portal's website in a test environment when the website is complete and ready for viewing.

The funding portal must deliver the forms and documents by e-mail to the regulator in each participating jurisdiction where the funding portal intends to facilitate start-up crowdfunding distributions. For example, a funding portal with a head office in Saskatchewan that intends to seek funds from investors in all participating jurisdictions must deliver the forms and documents described in this guide to the Financial and Consumer Affairs Authority of Saskatchewan and the regulators in each of the other participating jurisdictions.

Delivery of the forms, and documents by the funding portal is only the first step and does not mean that the funding portal can start operations. The regulators may have questions for the funding portal regarding these forms and documents.

#### *Step two*

**Before starting operations, the funding portal must receive written confirmation from the regulator that the forms and documents delivered to the regulator in step one are complete.**

Please note that the regulator may notify the funding portal that it cannot use the start-up registration exemption because its principals, or their past conduct, demonstrate a lack of integrity, financial responsibility or relevant knowledge or expertise. (In

Ontario, the regulator will make this assessment based on the criteria set out in the registration exemption in the Ontario Blanket Order, Ontario Instrument 45-506 *Start-Up Crowdfunding Registration and Prospectus Exemptions (Interim Class Order)*.

If a change occurs and the information in the forms and documents delivered to a regulator are no longer up-to-date, the funding portal must update the information by delivering a new form or document setting out the change. For example, if management at a funding portal changes, an updated funding portal information form as well as a funding portal individual information form for each new officer must be delivered to the regulators.

**In Ontario, an unregistered funding portal must file the Form 3, Forms 4 and supporting documents and then wait 30 days before soliciting investors. During the 30-day waiting period the regulator may notify the funding portal that it has not satisfied the start-up registration exemption and cannot operate as an exempt funding portal until such time as the funding portal is able to demonstrate it meets the conditions of the start-up registration exemption.**

**Some of the reasons this notification may be given include:**

- the documents the funding portal delivered are incomplete,
- the funding portal or any of its principals, or any entity it or its principals has been the principal of has had a judgment, sanction or similar order imposed against it based on fraud, theft, breach of trust, insider trading, or allegations of similar conduct, or
- the policies and procedures for handling funds in relation to a start-up crowdfunding distribution described in the funding portal information form and supporting documents does not satisfy the conditions of the start-up registration exemption.

### **Compliance with laws and regulations**

The funding portal's activities are subject to the securities laws of the jurisdictions where its head office or other places of business are located, as well as the jurisdictions where the issuers and purchasers are resident.

If a funding portal intending to rely on the start-up registration exemption has its head office located in a jurisdiction where that exemption is not available then the funding portal may be required to be registered as a dealer. Once registered as a dealer in any jurisdiction then the start-up registration exemption is no longer available (see later section on *Funding portals operated by registered dealers*).

Failing to comply with local securities laws is a serious offence that could prevent the funding portal from being able to rely on the start-up registration exemption. The funding portal must also ensure that it complies with all other applicable laws and regulations of a participating jurisdiction. We encourage funding portals to consult a lawyer for advice.

Regulators in the participating jurisdictions plan to conduct compliance reviews of funding portals relying on the start-up registration exemption soon after the commencement of operations. If a funding portal does not meet the conditions of the start-up registration exemption, then it cannot rely on that registration exemption.

**In Ontario, an unregistered funding portal must certify, within ten days of a calendar year-end, that it has sufficient working capital to continue its operations for at least the next 12 months. This is done by filing the necessary Form 5 with the Ontario Securities Commission.**

**A funding portal's working capital is calculated based on current assets less current liabilities. The terms "current assets" and "current liabilities" are defined under Canadian GAAP. Current assets generally include assets such as cash, accounts receivable, inventory and other assets that can be realised, sold or consumed within a year. Current liabilities generally include accounts payable, wages, taxes, and the portion of debt to come due within a year.**

**Good practices for compliance with this condition include:**

- Keeping documentation that is regularly maintained to ensure effective monitoring; and
- Establishing, maintaining and applying a system of controls and supervision sufficient to ensure the accuracy of the documents, including financial statements, used to support the funding portal's assessment of working capital.

### “Pop-up” Acknowledgement

The start-up crowdfunding exemptions require investors to acknowledge certain information before entering the platform of a funding portal, which may be the funding portal's website or app. This requirement does not distinguish between where or how the investor enters the funding portal's platform. As a result, funding portals must design their platform so that investors acknowledge the required information regardless of whether those investors enter the platform through the funding portal's home page or through another page on the funding portal's website.

The funding portal should also manage the risk that potential investors are visiting the funding portal's platform using a shared computer, tablet, or other mobile device. In other words, multiple people in a household may be entering the funding portal's platform at different times using the same device. As a result, in order to comply with the pop-up acknowledgment requirements, the funding portal should consider designing their website so that the required pop-up acknowledgements reappear each time the investor's internet browser is closed and re-opened.

We expect the pop-up acknowledgement to appear in the following circumstances:

<p>The pop-up acknowledgement should appear upon the first and every subsequent time a person enters a funding portal's website. This means that after opening their internet browser:</p> <ul style="list-style-type: none"><li>(a) If a person lands on any page of a funding portal's platform (home page or other page) the pop-up acknowledgment should appear.</li><li>(b) If the person clicks "I acknowledge" and then immediately closes out of their browser, when the person goes back to any page on a funding portal's platform, the pop-up acknowledgment should appear. The result is that the same person will have to click on "I acknowledge" to go back into the funding portal's platform regardless of the fact that they had just been to that platform.</li></ul>
<p>The pop-up acknowledgement should appear regardless of a person's entry point to the platform (home page or other page). For example:</p> <ul style="list-style-type: none"><li>(c) If a person were to search the name of the funding portal and finds a link to the funding portal's platform, the link would take the person to the funding portal's home page and a pop-up acknowledgement would appear.</li><li>(d) If a person were to search the name of the funding portal and finds a link to the funding portal's issuer-offering page, the link would take the person to that page of the funding portal's platform and a pop-up acknowledgement would appear.</li></ul>
<p>Once a person clicks "I acknowledge" and enters the funding portal's platform, they can navigate from page to page within the platform without the re-appearance of the pop-up acknowledgement.</p>

### Funding portals operated by registered dealers

Registered exempt market dealers and investment dealers are allowed to operate start-up funding portals. Exempt market dealers and investment dealers that operate funding portals must:

- meet their existing registration obligations under securities legislation (including the know-your-client, know-your-product and suitability obligations owed to investors)
- confirm to issuers that the funding portal meets certain of the conditions in the start-up prospectus exemption, such as making an offering document and risk warning available to investors on the funding portal's website
- prompt any person entering the funding portal's website to acknowledge that the funding portal is operated by a registered dealer that will provide suitability advice
- file a Form 33-109F5 *Change of Registration Information* that describes the change in its business to include operating a funding portal
- must disclose all fees charged to investors in accordance with relationship disclosure requirements under National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations*

A funding portal operated by a registered dealer is permitted to facilitate a larger investment. Typically, an investor may invest up to \$1,500 under the start-up prospectus exemption. However, in British Columbia, Alberta, Saskatchewan and Ontario, investors can purchase up to \$5,000 if the registered dealer has determined that the investment is suitable for the investor.

### How does start-up crowdfunding work?

Issuers are responsible for preparing an offering document that complies with the prescribed form in the province they are based, and the province the investor resides in. In particular, issuers must indicate the minimum amount necessary to close a start-up crowdfunding distribution. Issuers will provide the offering document to the funding portal to post online. The funding portal must take reasonable measures to ensure that the issuer is a resident of a participating jurisdiction where the offering document is made available. Investors will read the offering document and decide whether or not to invest.

Before accepting an investment, a funding portal must obtain confirmation from the investor that he or she has read and understood the offering document and the risks described in the risk acknowledgement form. A funding portal must obtain the investor's personal information and take reasonable measures to ensure the investor resides in a participating jurisdiction.

An issuer cannot close a distribution if it has not raised the minimum amount set out in its offering document and before each purchaser's right to withdraw has expired. At the closing:

- the issuer distributes shares or other eligible securities to investors
- the funding portal releases funds to the issuer

No later than 15 days following the closing of the distribution, the funding portal must notify investors that the funds have been released to the issuer, and it must provide the issuer with the following information on each investor:

- Full name
- Address
- Telephone number
- E-mail address
- Number of securities purchased
- Total purchase price

The issuer requires this investor information in order to complete a report of exempt distribution. When providing investor information to the issuer, we encourage the funding portal to use the same spreadsheet that the issuer is required to use for filing. Please refer to the *Start-up Crowdfunding Guide for Businesses* for more information on the issuer's filing requirements.

If the issuer withdraws its start-up crowdfunding offering or does not raise the minimum amount within 90 days after the funding portal posts the offering document online, all the funds must be returned in full to investors within five business days. No deductions are permitted. The funding portal must also send a notice to the issuer and each investor confirming that the funds have been returned to investors.

The funding portal may send notices to investors and issuers by e-mail.

### Related-party restriction

A funding portal cannot act in a start-up crowdfunding distribution if one of its principals is also a principal of the issuer group. The issuer group means the issuer, an affiliate of the issuer, and any other issuer that is engaged in a common enterprise with the issuer or an affiliate, or whose business is founded or organized by the same person or company who founded or organized the issuer.

### Investor's right to withdraw

Investors have the right to withdraw their investment within 48 hours following the investor's subscription. Investors also have the right to withdraw their investment within 48 hours of the funding portal notifying the investor of an amendment to the offering document.

To exercise this right of withdrawal, an investor must notify the funding portal. The funding portal must give investors the opportunity to exercise this right. The funding portal must return the funds to an investor who exercises this right, without any deduction, within five business days after the notice.

### Amendments to the offering document

An issuer must amend its offering document after it has been posted online if the information it contains is no longer true. This could be the case if, for example, an issuer wants to change the price of the securities or the minimum or maximum offering amount. The issuer must send the amended version to the funding portal for posting on the funding portal's website. The funding portal must notify investors about the amendment.

### Issuer's financial statements

Under the start-up prospectus exemption, issuers are not required to provide financial statements to investors with the offering document.

If an issuer wants to make its financial statements available to investors, it can place a hyperlink on the funding portal leading to the financial statements. However, the hyperlink must not appear in the offering document because the financial statements do not form part of it.

### Where can I get further information?

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

British Columbia	British Columbia Securities Commission Telephone: 604-899-6854 or 1-800-373-6393 E-mail: <a href="mailto:inquiries@bcsc.bc.ca">inquiries@bcsc.bc.ca</a> <a href="http://www.bcsc.bc.ca">www.bcsc.bc.ca</a>
Alberta	Alberta Securities Commission Telephone: 403-355-4151 E-mail: <a href="mailto:inquiries@asc.ca">inquiries@asc.ca</a> Website: <a href="http://www.albertasecurities.com">www.albertasecurities.com</a>
Saskatchewan	Financial and Consumer Affairs Authority of Saskatchewan Securities Division Telephone: 306-787-5645 E-mail: <a href="mailto:exemptions@gov.sk.ca">exemptions@gov.sk.ca</a> Website: <a href="http://www.fcaa.gov.sk.ca">www.fcaa.gov.sk.ca</a>
Manitoba	The Manitoba Securities Commission Toll free in Manitoba: 1-800-655-2548 E-mail: <a href="mailto:exemptions.msc@gov.mb.ca">exemptions.msc@gov.mb.ca</a> Website: <a href="http://www.mbsecurities.ca/">http://www.mbsecurities.ca/</a>
Ontario	Ontario Securities Commission Toll free: 1-877-785-1555 E-mail: <a href="mailto:inquiries@osc.gov.on.ca">inquiries@osc.gov.on.ca</a> Website: <a href="http://www.osc.ca">www.osc.ca</a>
Québec	Autorité des marchés financiers Direction du financement des sociétés Toll free in Québec: 1-877-525-0337 E-mail: <a href="mailto:financement-participatif@lautorite.qc.ca">financement-participatif@lautorite.qc.ca</a> Website: <a href="http://www.lautorite.qc.ca">www.lautorite.qc.ca</a>
New Brunswick	Financial and Consumer Services Commission Toll free: 1-866-933-2222 E-mail: <a href="mailto:emf-md@fcnb.ca">emf-md@fcnb.ca</a> Website: <a href="http://www.fcnb.ca">www.fcnb.ca</a>
Nova Scotia	Nova Scotia Securities Commission Toll free in Nova Scotia: 1-855-424-2499 E-mail: <a href="mailto:nssc.crowdfunding@novascotia.ca">nssc.crowdfunding@novascotia.ca</a> Website: <a href="http://nssc.novascotia.ca">nssc.novascotia.ca</a>

*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 Ontario Instrument 45-506 Start-Up Crowdfunding Registration and Prospectus Exemptions (Interim Class Order), please follow the instrument and the related forms.*

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