A fund-raising mechanism made available to equity-minded investors in May of 2016 has seen the addition of several amendments which are now making their way to the U.S. Senate.

According to Forbes,¹ The Fix Crowdfunding Act was passed by the House of Representatives by a 394-4 vote in July.

The new bill is intended to fine-tune the legislation by:

• Increasing the annual fundraising limit from $1 million to $5 million
• Enabling Special Purpose Vehicles (SPVs) to group individual investors into one legal entity
• Exempting crowdfunded startups from some of the conventional registration requirements of publicly traded companies after they reach 500 investors
• Including a “Test The Waters” provision to allow companies to gauge investor interest online before officially launching the offering

The goal of this Investor’s Guide to Equity Crowdfunding is to answer some of the most common questions about this emerging investment trend to help investors determine if crowdfunding is right for them.

**FIRST, WHAT IS “CROWDFUNDING”??**

Crowdfunding is the practice of employing proprietary platforms through online portals to allow entrepreneurs to appeal directly to the general public for venture capital funding without using brokers or other regulated financial intermediaries.

For example, entrepreneurs can fund projects from independent films and music albums to innovative products, or even modeling careers. In exchange for their investment, investors may receive rewards or prizes that include film credits, early access to products, or other benefits.

**WHAT IS “EQUITY” CROWDFUNDING?**

With Equity crowdfunding investors are offered a share of the financial returns or profits from investment projects, instead of receiving prizes or other benefits.

**WHY IS THERE SUCH AN INTEREST IN EQUITY CROWDFUNDING NOW?**

For the first time, investors may be able to use crowdfunding portals to invest capital in an equity idea to receive a potential rate of return.

For many supporters of this idea equity crowdfunding is a game changer. It will allow smaller investors to make limited investments in ventures previously limited to only accredited investors. The theory is, by freeing up this new potential source of capital American businesses are more likely to grow, expand and hire more workers.
For many supporters, investment crowdfunding is presented as a positive game changer. For some consumer advocates, on the other hand, relaxing accreditation standards for investors may lead to record numbers of broken nest eggs for the unwary.

**POTENTIAL PROS**

- Frees up capital for investment purposes through crowdfunding, which may allow many more small businesses to be launched.

- Crowdfunding can act as a building block for lead generation strategies through “the crowd,” an entrepreneur may attain scale, validate the business model and open the door to much bigger private placement or hedge fund sponsors. Crowdfunding the be a first step toward larger asset commitments, too, from major institutions.

- Building a network of investors who may be open to other ideas from an entrepreneur or investment sponsor, may become a group of people dedicated to making your venture successful.

- Simple and direct crowdfunding may be more rapid to implement than more traditional forms of capital investing.

**POTENTIAL CONS**

- Crowdfunding can feel like gambling and some consumer advocates aren’t on board with investment crowdfunding’s prospective benefits. Barbara Roper, a director at the Consumer Federation, has said: “No one has to commit fraud, no one has to do anything wrong for this to be one stage removed from gambling. So now we’re going to connect unsophisticated investors with unsophisticated issuers to harness the power of the internet to buy these stocks? What can possibly go wrong?”2

- Many start-up firms who rely on crowdfunding will likely be in the early building stage, which can be riskier than later stage start-ups which may have already proven their ability to attract capital, according to a study by Shikhar Ghosh of Harvard Business School.3

- Finding the balance between over- and under-regulation, stock prices of larger companies are more or less established by market demand and fundamental performance. A private company’s stock, in contrast, may be difficult to value.

**HOW DO I KNOW IF I’M RIGHT FOR CROWDFUNDING?**

Here are some factors to consider before committing to one platform or another:

- **Your personal interests** Does the crowdfunding platform reflect the kind of investments or sectors you follow?

- **Minimum amounts** Make sure your financial resources match up with the funding requirements of the platform.

- **Platform team** How seasoned are the investment professionals behind the platform? Check their biographies and background before committing your dollars.

- **Understanding the fee structure** Fees vary from platform to platform. Makes sure you know what you are paying before you invest.
ARE THERE ANY “RED FLAGS?”
Common sense will aid you here. If something sounds too good to be true, it probably is. Just like any other investment product, take the time to review any and all online documents available. Don’t hesitate to consult with an investment advisor or other trusted financial professional to gain an additional perspective.

Consider avoiding investments that:
- Promise excessive rates of returns
- Use phrases like “safe and secure”
- Tell you to “act fast”
- Don’t provide adequate documentation
- Have unsavory hard-sell aspects
- Insufficient professional background details

HOW DO INVESTORS GET THEIR MONEY – AND ANY PROFIT – OUT OF AN EQUITY CROWDFUND?
The impact of crowdfunding on business creation, job growth, and the financial markets will not be known for a while, nor will all the potential risks.

Investors can profit if the start-up is acquired, but the business needs to have a healthy track record to attract buyers. Even if investors are able to sell their securities, they might have trouble figuring out whether the offer is fair or not. Recognizing these challenges, the SEC warned in its proposed rules that “uncertainty surrounding the exit strategies for investors in crowdfunding offerings also might limit the benefits.” Still, if and when equity crowdfunding gains traction, a secondary market may develop because investors will want to cash out.

CAN I PURSUE A TAX-ADVANTAGED STRATEGY WITH EQUITY CROWDFUNDING?
Those who invest in an equity crowdfund through self-directed IRAs, whether a traditional approach or a Roth, also gain a tax advantage.

CAN MY PROFESSIONAL EXPERIENCE PLAY A ROLE IN CHOOSING THE RIGHT CROWDFUNDING OPPORTUNITY?
Possibly. Retirees and pre-retirees who have spent a significant amount of time in major U.S. industries may have real-world experience with the product trends and economic influences in those businesses that could contribute to targeted growth opportunities in private equity funding situations. Capital for private equity can be used to fund new technologies, expand working capital within an existing company, make acquisitions, or simply shore up a thin balance sheet for the possible betterment of publicly traded shares.
While the value of private equity opportunities changes by sector year-to-year, employees or former employees of companies in technology, consumer goods, financials, materials and other sectors, can apply their own industry insights to examining and vetting private equity ideas with their financial advisor to determine if these investments are right for them.

WHAT ELSE SHOULD I KNOW ABOUT SELF-DIRECTED IRAS?

Historically, private equity participation was generally a taxable strategy for accredited investors. Private equity opportunities, though, may also fit in tax-advantaged, self-directed IRA programs.

It is strongly recommended, of course, that financial advisors and their IRA-minded clients undertake a prudent and rigorous review of each situation before investing. Independent custodians that can hold such investments in IRAs – like Equity Trust – do not perform due diligence reviews or make any determination as to the prudence or viability of any investment. A self-directed IRA with Equity Trust gives investors the flexibility they need to direct their assets to vehicles outside of the traditional market.

EQUITY INSTITUTIONAL: THE RESOURCES YOU NEED FOR THE RELATIONSHIPS YOU WANT

Equity Institutional (through Equity Trust Company) offers IRAs, qualified retirement plans and non-qualified custodial accounts for alternative and traditional assets. We service RIAs, registered reps, broker-dealers, investment sponsors, precious metals dealers and other financial professionals. Equity Trust Company is one of the largest custodians of alternative assets with the goal to make alternative investing easy so that your clients can achieve the diversification they are seeking. Perhaps the best reason to choose Equity Institutional is that we handle administrative details so that your focus can remain where it should be — on your clients.

EXPERIENCE EQUITY INSTITUTIONAL


3 The Wall Street Journal http://www.wsj.com/articles/SB10000872396390443720204578004980476429190