

Corporate M&A

Crowd Funding – The Fresh New Face of Equity Funding

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In a climate where access to credit lines is becoming more and more restricted, crowd-funding has emerged as the “new kid on the block” when it comes to raising finance. The concept of crowd-funding describes the collective effort of individuals who network and pool their resources, usually via the internet, to support projects and businesses initiated by other people or organisations.

Another form of crowd funding known as ‘equity crowd-funding’ offering an equity ownership stake of securities through the medium of an online platform has become popular in the US and is already gaining ground in Ireland also. The success stories should not be without a cautionary note as an offering of securities in return for cash investment raises a number of legal and regulatory issues which deserve consideration.

Private companies – Offers to the public

The majority of start-up companies are private companies and the applicable provisions of the Companies Act in Ireland prohibit a private company limited by shares from offering any of its securities to the public; there are limited exceptions to this, which include permitting a private company to make an offer of shares to 99 or fewer persons or to qualified investors.

When a company pitches to investors on a crowd-funding platform, such pitch is typically considered an “offer to the public”.

Prospectus law requirements

Crowd-funding offerings of securities must also be mindful of the requirements contained in the Prospectus Directive 2003/71/EC (as amended) as implemented in Ireland.

A prospectus must be published when either an offer of securities is made to the public within the EU or securities are admitted to trading on an EU regulated market. A prospectus is a disclosure document, containing key financial and non-financial information, that a company makes available to potential investors when it is issuing securities to raise capital.

The definition of an “offer of securities” refers to a communication in any form or by any means presenting sufficient information on the terms of the offer and the securities to be offered so as to enable an investor to decide to purchase or subscribe for securities. Offers made to the public at large via an online crowd-funding platform would typically fall under this definition. However, if it is established that there is an offer to the public, a number of exemptions from the requirement to produce a prospectus (if the securities are not admitted to trading on a regulated market) are contained in the Prospectus Directive.

Therefore it is important to structure an offer of securities so as to fall within one of the exemptions from the requirement to produce a prospectus as set out in the Prospectus Directive. From a crowd-funding perspective, companies should bear the following exemptions in mind:-

- Offers to fewer than 150 non-qualified investors per member state are considered to be exempt.
- Alternatively issuers of securities with minimum denominations of €100,000 (or equivalent in other currency) can offer these securities to the public without publishing a prospectus.
- Offers for securities below a certain size are also outside of the scope of the Prospectus Directive. In this regard, offers with a total consideration of less than €5 million will be exempt (formerly €2.5 million).

Regulated activities

Businesses which engage in regulated activities must comply with a host of authorisations and regulatory and reporting requirements prescribed by national and European legislation. For example, the Central Bank of Ireland is responsible for the regulation and supervision of Markets in Financial Instruments Directive 2004/39/EC (“MiFID”) investment firms authorised in Ireland. As it stands, a specific crowd-funding platform setup could potentially fall within the scope of such activities that are mentioned in the annex of the MiFID directive and become subject to regulatory requirements. In this context, legal certainty regarding the interpretation of crowd-funding platforms is not currently available.

The lack of specific legislation regulating the operation of crowd-funding in Ireland and the rest of the EU has raised suggestions that the regulatory framework needs to be redesigned in order to accommodate crowd-funding and similar innovations. Recent legislative changes in the US in the form of the Jumpstart Our Business Act (the “JOBS Act”) created a new legal framework for private share offerings. While crowd-funding initiatives depend on the collective passion of the crowd to launch a project, the lines have not yet been clearly drawn in this jurisdiction. Any offer for securities in a new business should be contemplated with the Prospectus Directive, the Companies Act and Central Bank of Ireland authorisations in mind.

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