The CDFI Jobs Portal & Crowdfunding Regulations

Enhancing the job-creation impact of the Crowdfunding Act through CDFIs
The Crowdfunding Market

Growth in Worldwide Funding Volume for Equity- & Reward-based Crowdfunding (millions of dollars)

<table>
<thead>
<tr>
<th>Year</th>
<th>Growth</th>
<th>Volume (Millions of Dollars)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2009</td>
<td>61%</td>
<td>530</td>
</tr>
<tr>
<td>2010</td>
<td>72%</td>
<td>854</td>
</tr>
<tr>
<td>2011</td>
<td>91%</td>
<td>1,470</td>
</tr>
<tr>
<td>2012</td>
<td></td>
<td>2,806</td>
</tr>
</tbody>
</table>

Source: Crowdfunding Industry Report, Massolution (Crowdsourcing.org), Kiva.org/stats, and Kickstarter/org/data
Sources of Mission Funding

Charitable Giving Sources

- Individuals: 81%
- Foundations: 14%
- Corporations: 5%


CDFI Capital Sources

- Individuals: 19%
- Banks: 38%
- Other sources: 6%
- Internal Funds: 6%
- Philanthropic: 10%
- Gov’t: 10%
- Corporations: 10%

Types of Crowdfunding

1. DONATION
2. REWARD & PRE-PURCHASE
3. PEER-TO-PEER LENDING
4. EXEMPTED SECURITIES
Brewhaha: The Story of How A Case Became A Hearing

In an attempt to buy the Pabst Blue Ribbon brewery, marketing executives Michael Migliozzi II and Brian Flatow created a site, BuyaBeerCompany.com, to solicit pledges from the public.

They promised investors a stake in the company and beer valued at the amount equal to how much was invested.

Their goal was to get:

- $300 MILLION from public investors

How much was pledged after just 7 months?

By nearly 5 MILLION fans.

On June 2011, the Securities and Exchange Commission ordered Migliozzi II and Flatow to cease and desist for failing to register their offering.

Inspired by the case, Rep. Patrick McHenry introduced legislation to allow private companies to use crowdfunding.

Graphics sourced from: https://www.hightable.com/infographic/42332
Title III of the JOBS Act

US Jumpstart Our Businesses Act was signed into law April 5, 2012 and included Title III, the Crowdfunding Act
Title III: Crowdfunding Exemption

1 Limited to $1MM/12-months

2 Single investor can invest:

If income is below $100k:
- $2,000
- 5% of income

If income is above $100k:
- Up to $100k
- 10% of income

Graphics Sourced From: https://www.hightable.com/infographic/42332
Title III: Funding Portal Overview
The Rulemaking Process

27

Comments
Goal of Legislation: Create Jobs

Crowdfunding to date is good at raising capital, so-so at creating jobs

Biggest crowdfunded projects:
  • Overseas imports: iPhone Doc and Pebble/Nano watches
  • Low job creating: video games / apps

CDFIs Create Jobs

- CDFIs would focus crowdfunded capital on the goal: US Job creation

- CDFIs have capacity & expertise to:
  - Find & fund *job creating* businesses
  - Focus on population groups with high levels of unemployment
  - Target more funding to underserved/under invested communities

- Over 1,000 CDFIs are active in communities nationwide
Challenges for CDFI Participation

Anticipated rules may prevent CDFIs & mission investors from meaningfully participating in crowdfunding for mission impact.
Investor Maximum Aggregate Lending

5% to 10%: compliance requires disclosure & tracking

- Tax Returns
- SSN
- Investor Tests
Limit on Marketing
CDFIs may get lost in the crowd
Prohibition on Portals Raising Funds
Privacy Protection Requirements
Liability

Portals and Issuers are liable for:

Material Misstatements

&

Omissions
Feedback on Mission-Driven Exemptions

Reducing barriers to entry for mission investors would drive substantially more job-creation & mission impact.

Broad exemptions w/o alternative controls create investor protection risks:
• Small dollar exemptions create exploitable loopholes
• Mission-focused exemptions hard for SEC to police

SEC may be open to creating a tightly defined safe harbor that will be:
• Dependable, financially sound, and have a proven track record
• Strong on investor protections, including privacy protections
“Suggestions include ensuring crowdfunding can fill the financing gap for projects supported by federally-regulated, 501(c)3 CDFIs, a clarification to ensure that CDFIs and issuers can make sure investors understand the mission and charitable aspects of investments, and fast treatment from the SEC and FINRA related to registration and membership.”

-Statement for the Record of Senator Jeff Merkley Regarding Crowdfunding in Title III of H.R. 3606 July 26, 2012
Proposed Rules to Facilitate Mission Capital Formation

Key rulemaking areas:

Instead of a broad exemption, create a targeted alternative set of strong investor protections appropriate for mission investors through a new type of portal, a “CDFI Jobs Portal”

Reduce barriers to entry for mission-driven capital formation:
• Loosen personal disclosure requirements for aggregate tracking
• Clarify marketing limitations
• Allow for faster registration
Bright Future but Uncertain Present

Despite challenges new law has promise

Donation sites are best bets for now:

CDFI Peer-to-Peer site soon to become active:

CapNEXUS
Appendix
CDFI Jobs Portal

An alternative investor protection model for mission investors that:

- Requires “skin in the game” from issuer and a sophisticated CDFI investor
- Limits investors to small dollar, low yield debt
- Ensures safety and soundness of Participating CDFIs

Typically structured as ‘gap financing’
Proposed CDFI Jobs Portal: Ensuring Investor Protection & Mission Capital Formation

1. Jobs Portals must be operated by **federally regulated, 501c3, certified CDFIs**, ensuring privacy protection, fiscal responsibility, accountability, & mission focus.

2. Every issuer must come through **approved Sponsor CDFIs** that meet **high performance standards**.

3. Issuers must have ‘skin in the game’ & **co-investment from a Sponsor CDFI**, ensuring soundness of investment.

4. May limit to **small-dollar, low-yield** debt investments, avoiding any ‘get rich quick’ temptation.
A simple, transparent interface
## Investor Protections: Jobs Portal & Standard Portal

<table>
<thead>
<tr>
<th>Investor Protections</th>
<th>Jobs Portal</th>
<th>Standard Portal</th>
</tr>
</thead>
<tbody>
<tr>
<td>Issuer “skin in the game”</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Can be restricted to low rate of return</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Sophisticated co-investor “skin in the game”</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Strict standards &amp; ongoing quality control of co-investors</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Subject to Gramm-Leach-Bliley privacy rules ensuring investor privacy protection</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Proven financial strength overseen by Federal regulators</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Investor personal data disclosure for maximum aggregate tracking</td>
<td>Yes after $500</td>
<td>Yes</td>
</tr>
</tbody>
</table>
Investor Maximum Aggregate Tracking Requirement

Currently:
Portals responsible to ensure compliance with investor maximum aggregate investment limits
  • $2,000, or 5% - 10% of income/net worth (up to $100K)

Challenge for CDFIs:
Aggregate tracking will likely require of personal data (tax returns; SSN)

Barrier to Participation:
Small-dollar mission investors won’t have same tolerance for personal disclosure as will larger dollar, profit maximizing investors
Investor Maximum Aggregate Tracking Requirement

Proposed rule for CDFI Jobs Portals:

- Portal-Level Tracking Requirement for:
  - Debt instruments offering returns below 5%, and
  - Below $500 total, with
  - Language indicating below market mission investment
- Aggregate tracking required above $500

Rationale:

- Investor protection built in by structure:
  - *Small dollar amounts & low returns remove ‘get rich quick’ temptation*
  - *Federally regulated CDFI portal ensure quality of CDFI sponsors*
  - *CDFI sponsors verify legitimacy of issuers & have “skin in the game”*
Clarify Limits on Marketing

Currently:

- No advertising the terms of the offering, except for notices directing investors to portal

Proposed Rule for CDFIs:

- Permit advertising mission elements of the transaction
  - Jobs created, Green impact, Children educated
  - 135c parallel?

Rationale:

- Mission elements are non-financial, draw interest that is not profit-seeking, and should not be subject to regulation
SEC Authority within the Act

Portals
- Section 4A(a)(8): Authority to determine method of tracking with respect to investor limits
- Section 4A(a)(9): Authority to determine how to ensure protection of investor privacy
- Section 4A(a)(12): General authority to establish rules for investor protection and the public interest

Issuers
- Section 4A(b)(5): General authority to establish rules for investor protection and the public interest with respect to issuers, including advertising

Rulemaking
- Section 4A(c): Broad authority to establish rules for investor protection
Where We Are

• Published Merkley comments have defined an approach creating an opportunity for CDFIs

• Investor protection advocates support approach with regulated CDFIs, privacy protections, skin-in-the-game, low-return

• Federal Reserve Banks helping to drive attention

• Ongoing meetings with SEC

• Potentially excellent jobs story
Next Steps

• Secure formal CDFI Fund & Treasury support

• Express unified voice of support behind Merkley approach among:
  • CDFI community
  • Job creation/mission investment communities
  • Investor protection community & securities experts

• Meet with SEC, get feedback, and provide comments/recommendations
Potential Points of Support

- CDFIs have a track record of responsibly providing capital creating jobs and enhancing underserved communities
- Crowdfunding represents a meaningful new way for people to invest in their communities but there are barriers for mission investors
- CDFIs can responsibly channel capital to these communities
- CDFI sector supports the concepts introduced by Sen Merkley and supported by investor protection advocates and securities experts to provide an alternative set of investor protections that works for mission investors
CDFIs and the Crowdfunding Rules

“The SEC should be receptive to concepts CDFIs may bring that could aid in accomplishing the job-creating goals of the legislation, while protecting investors. It should consult with CDFI’s and the CDFI Fund at the Treasury Department on how best to maximize the social and jobs potential for investing through crowdfunding and CDFIs”

-Statement for the Record of Senator Jeff Merkley
Regarding Crowdfunding in Title III of H.R. 3606 July 26, 2012
On A Safe Harbor for CDFIs

“...because of the types of businesses CDFI’s work with, the types of low returns that might be derived, and the particular financing gaps that might be filled through crowdfunding...**mission-driven, CDFI-supported crowdfunding may yield better results for investors and positive job creation for communities if the rules reflect the particular work they do.**”

-Statement for the Record of Senator Jeff Merkley
Regarding Crowdfunding in Title III of H.R. 3606 July 26, 2012
On Creating Safe Harbors

“The SEC is ... fully empowered by the law to take actions to protect investors – and this is essential, especially at the early stages, when reputational risk to the crowdfunding market is very high. At the same time, I encourage it to approach this marketplace with a spirit of smart, careful experimentation and regular review and adjustment....

It was envisioned that the SEC might even adopt safe harbors for simple, investor-friendly structures.”

-Statement for the Record of Senator Jeff Merkley Regarding Crowdfunding in Title III of H.R. 3606 July 26, 2012
On Tracking and Lowering Barriers to Entry

“...The SEC might [allow] ordinary investors that remain within an amount below the default aggregate, for example $500, on any one platform [to be] presumed compliant across other unaffiliated platforms. This streamlining may be particularly useful for...those that want to engage in community-based crowdfunding, including those serving the CDFI community.”

-Statement for the Record of Senator Jeff Merkley Regarding Crowdfunding in Title III of H.R. 3606 July 26, 2012
On CDFIs and Filling Financing Gap

“CDFIs are lenders and partners to businesses in underserved communities. They tend to obtain low rates of return on mission-driven investments, and frequently encounter financing gaps that might be filled through mission-driven crowdfunding...”

-Statement for the Record of Senator Jeff Merkley
Regarding Crowdfunding in Title III of H.R. 3606 July 26, 2012
Summarizing topline consensus items from July 26th, 2012 event:

“Coupling securities crowdfunding with...community development financial institution financing could benefit all involved parties. This partnership would allow crowdfunded businesses to benefit from the expertise of sophisticated investors.”

“Crowdfunding: Promoting the Promise and Minimizing the Peril”, summarizing July 26th, 2012 event. Posted August 2nd, 2012