Crowdfunding: Online Do-It-Yourself Fundraising

May 2016

Crowdfunding allows individuals to raise capital from single donors using social media or internet crowdfunding platforms. While many have heard of Kickstarter, one of the largest crowdfunding platforms, few people understand the risks associated with crowdfunding.

In higher education, students, faculty, and staff all use crowdfunding. From raising funds to pay tuition, closing funding gaps for research projects, to offsetting program costs; crowdfunding facilitates endless funding ideas. Moreover, the resulting donations can range from one dollar to a gift of thousands of dollars. In one instance, for example, a professor reported raising several thousand dollars through crowdfunding to purchase special research animals.

Without effective institutional oversight, however, crowdfunding can create risks for the donor, the fund recipient, and the institution.

Setting aside incidences of outright fraud, without performing due diligence, donors may find that the recipient did not use the accumulated funds for the stated intention. When donors believe they have been defrauded, it creates a risk for individual and class action law suits against fund recipients and perhaps their institutions.

Risks for fund recipients vary depending on the platform they use. When they use a platform not owned by their affiliated institution, recipients may increase their risk by not understanding the business standards and legal regulations with which they may have to comply.

As an example, many crowdfunded projects involve intellectual property (IP) and public disclosure of IP may have a significant legal impact. If a fund recipient posts information about an idea they may wish to patent, he or she has up to one year only from the date of posting to patent the idea. Without understanding this nuance, fund recipients risk losing the rights to their ideas. Trademarks have similar stipulations; whoever first files for a trademark has rights to that mark. Those posting project ideas for funding purposes on a crowdfunding site should know that copyright protections do not apply to the idea until the project is complete.

Further, if someone offers a suggestion for an improvement or enhancement to a crowdfunded project, the suggestion may warrant attribution or create an ownership issue.

Beyond legal issues surrounding posting projects, crowdfunding has tax implications. Depending on the circumstances, including whether the fund recipients established a legal not-for-profit entity, the funding recipients may not know their tax obligations on donor funds.

Also, "financial return crowdfunding", in which the recipient offers equity in exchange for funds in a start-up venture or seeks peer-to-peer lending, may violate state and federal securities laws. The Securities and Exchange Commission (SEC) and individual states regulate peer-to-peer lenders, and the *Jumpstart Our Business Startups* Act of 2012 regulates equity crowdfunding.[I]

We're here to empower results

Leta Finch
National Practice Leader,
Higher Education
1.802.264.4703
leta.finch@aon.com

I Source: "The Risks of Crowdfunding," Risk Management, Nicolas Wells, March 14, 2013

Regulation Crowdfunding, Title 111 of the Act, allows for university start-ups to attract unaccredited investors. However, it restricts the amount of money fund recipients can raise under the crowdfunding exemption. Among other regulatory requirements, it also includes disclosure requirements and regulates the portals that transact funding.

Title 111 also stipulates that funding portals must register with the SEC effective January 29, 2016. Although the law provides multiple exemption options for crowdfunding, each exemption has different benefits, costs, and compliance issues. Sponsored program departments, university technology transfer offices, campus business incubators, and innovation centers should seek legal counsel before creating a portal for equity funding purposes.[II]

Colleges and universities raising funds in this manner should also consult with their insurance broker to confirm what coverages are in place and/or available to them. Most Directors and Officers/Educators Legal Liability policies, for example, contain exclusions for certain public offerings.

Crowdfunding, and its associated risks, will continue to evolve as more colleges and universities create their own platforms. Among those that have already done so include Cornell University, Iowa State, Michigan State, University of Arizona, University of California, and University of Colorado Boulder. They are also developing operating policies to guide users. For an example of a crowdfunding operating policy, University of Colorado Boulder ("CU-Boulder") has theirs posted at http://www.colorado.edu/sites/default/files/attached-files/cu boulder_crowdfunding_procedures_dec_2015.pdf

Crowdfunding is a fast evolving activity bringing with it new risks. As with all risk issues impacting colleges and universities, Aon will watch this one for any up-to-the-minute developments.

Ed: Cameron Dewing

II Source: CFO December 2015/cfo.com