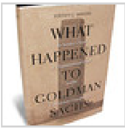

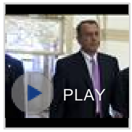

OPINION | October 9, 2013, 7:55 p.m. ET

An SEC Rule Change Opens a New Era for Crowdfunding

A recent rule change will allow entrepreneurs seeking investors to reach a much broader audience.

By JONATHAN MEDVED

Potential investors will soon begin seeing opportunities pop up in their Facebook news feeds and in their email inboxes thanks to a major rule change from the Securities and Exchange Commission. In September, the agency removed the decades-old ban on public solicitation for private investments. This means private investments can now be marketed to the general public, which will allow entrepreneurs to reach a much broader audience than securities law used to allow.

The nascent crowdfunding market, which uses the Internet to pool small investments from many investors, stands to benefit significantly from this rule change. Right now, crowdfunding sites like Kickstarter and Indiegogo are not subject to securities laws because they allow people to give money to support projects and individual initiatives, not invest in them. In the roughly four years they've been in existence, these two sites have raised close to $1 billion in contributions for thousands of projects.

Startups and businesses have taken notice. They have begun to use similar online crowdfunding platforms—but to gather investments. And thanks in part to the SEC's new rule, the equity crowdfunding market is poised for rapid growth over the next decade. Deloitte expects all forms of crowdfunding to hit $3 billion globally this year and to grow at a compound annual growth rate of 100% over the near term. Equity crowdfunding is expected to perform even better, with a compound annual growth rate of 114%, according to the crowdfunding advisory firm Massolution.

To be sure, the SEC's change to Rule 506 doesn't allow just anyone to invest. Only "accredited" investors—with a net worth of more than $1 million, or who earn at least $200,000 a year—can continue to participate in equity crowdfunding. The new rules require proof, whereas self-attestment sufficed previously. Many hope that the SEC will issue additional regulations that would let smaller investors get in on the action.

Meanwhile, accredited investors are responding. Equity crowdfunders for accredited investors—including FundersClub, Angelist, CircleUp and my company, OurCrowd—are bringing in tens of millions of dollars for private investments through online platforms. And now that the SEC has removed restrictions on the companies' public advertising, sites will at last be able to speak directly to customers.

The resources that might be tapped are staggering. The Royal Bank of Canada estimates that more than $45 trillion of capital sits in the pockets of high-net-worth individuals world-wide. Roughly $10 trillion is held by about five million U.S. households, according to the private-equity firm Carlyle estimates. Without public solicitation or Web-based crowdfunding portals, there was no way to reach beyond a small percentage of investors.

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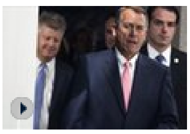
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This money wants to move. According to April's Northern Trust survey of high-net-worth investors, more than half of them are actively seeking new investments. And 30% are more inclined to consider alternative investments than they were five years ago.

A new class of angel investors, affluent individuals who invest personal funds in companies, is another byproduct of the burgeoning crowdfunding movement. These angel investors are no longer just former startup founders. They're a younger, broader class of Internet-savvy investors ready to evaluate and pick deals online.

Managing these new angels will require "venture education." Some crowdfunders post numerous deals and rely on the wisdom of the crowd to weed out the bad ones. Other platforms offer limited options to maintain credibility with potential investors. This presents some challenges for sound portfolio management. Should angels invest in multiple private deals to spread out risk and retain enough capital to cover losses? Those running crowdfunding platforms will need to give advice and support to angels to help them avoid taking big losses on one or two opportunities.

Professional investors know that they must provide value to companies beyond the capital they invest. Inexperienced angel investors may be less aware of that obligation. The equity crowdfunding portals will need to facilitate investor involvement. Investors have to find ways to sit on boards and become mentors to help companies handle growth, hire the right people and make good strategic decisions.

The crowdfunding model allows investing to move beyond Silicon Valley and Wall Street to Main Street. The next generation of angels is likely to include successful doctors, lawyers, contractors and real-estate professionals who want their share of the next Apple or Microsoft. The real question is if government regulation can continue to keep up with this rapid innovation.

Mr. Medved is the CEO of OurCrowd, an equity-based crowdfunding platform based in Israel.

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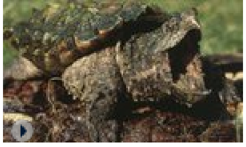

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