



FACILITATING EQUITY CROWDFUNDING IN THE ASEAN REGION

REPORT PREPARED FOR ASEAN CONNECTIVITY THROUGH
TRADE AND INVESTMENT

JULY 2017

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In January 2017, as part of the research for this Report, a field trip was undertaken by Professor Ramsay and Thitapha Wattanapruttipaisan, SME Development Lead, ASEAN Connectivity through Trade and Investment, to Malaysia and Thailand where meetings were held with government officials, regulators, platform operators, issuers and investors. We thank those who participated in the meetings for the helpful information they provided.

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Acronyms

ACA	<i>Corporations Act 2001</i>
AEC	ASEAN Economic Community
AFSL	Australian Financial Services Licence
AMS	ASEAN member state
APRA	Australian Prudential Regulation Authority
ASEAN	Association of Southeast Asian Nations
ASIC	Australian Securities and Investments Commission
ASX	Australian Securities Exchange
CAMAC	Corporations and Markets Advisory Committee
CMSA	<i>Capital Markets and Services Act 2007</i>
COBS	Conduct of Business Sourcebook
ECF	Equity crowdfunding
EU	European Union
FCA	Financial Conduct Authority
FDI	Foreign direct investment
FINRA	Financial Industry Regulatory Authority
FMA	Financial Market Authority
FSMA	<i>Financial Services and Markets Act 2000</i>
GDP	Gross domestic product
IFC	International Finance Corporation
IMF	International Monetary Fund
IOSCO	International Organization of Securities Commissions
LCF	Lending crowdfunding
MAI	Market for Alternative Investment
MAS	Monetary Authority of Singapore
MSME	Micro and small to medium enterprise
OECD	Organisation for Economic Co-operation and Development
QMI	Qualified matching investor
RBA	Reserve Bank of Australia
RMO	Recognized market operator
SEA	<i>Securities and Exchange Act B.E. 2535 (1992)</i>
SEC	Securities and Exchange Commission
SET	Stock Exchange of Thailand
SME	Small to medium enterprise
TSEC	Securities and Exchange Commission (Thailand)
UK CA	<i>Companies Act 2006</i>
US-ACTI	ASEAN Connectivity through Trade and Investment
VC	Venture capital

Executive Summary

The objectives of this report are to (1) provide information and recommendations for member states in the Association of Southeast Asian Nations (ASEAN) which have not yet introduced equity crowdfunding (ECF) on the key issues they should consider in designing a regulatory framework for ECF; and (2) for those ASEAN member states which have introduced a regulatory framework for ECF, provide information on developments in the regulation of ECF in other jurisdictions.

ECF is quickly emerging as an important mechanism to help bridge a major funding gap for small businesses. ECF provides an opportunity for these businesses to leverage technological advances that provide access to funds from a wider range of potential investors, including those retail investors who may previously not have participated in investing.

ECF is gathering pace across the world, including in Asia. This provides an opportunity for ASEAN and its member states to develop ECF regimes that enhance economic growth. Important considerations in developing a regulatory framework for ECF include encouraging innovation and economic growth and providing appropriate protection for retail investors.

This report (1) defines ECF; (2) compares ECF to other forms of crowdfunding; (3) outlines the roles of the main participants in the ECF process (issuers, investors, and platform operators); (4) discusses the economic background to ECF including the main justifications for the introduction of ECF into ASEAN; (5) identifies the benefits and risks associated with ECF; and (6) provides detailed analysis of ECF in four jurisdictions – two ASEAN member states (Malaysia and Thailand) and two jurisdictions which are not members of ASEAN (the United Kingdom and Australia) together with briefer discussion of developments in ECF regulation in the United States, New Zealand, Canada, China, Hong Kong, and Singapore.

This analysis of how ECF is regulated in a number of jurisdictions leads to a series of recommendations regarding the key issues that should be considered in designing a regulatory framework for ECF. In relation to ECF platform operators, each of the jurisdictions analysed in this report divides regulation of ECF platform operators into two broad categories. First, the jurisdictions set out a number of prerequisites that ECF platform operators must meet in order to be permitted to act as an intermediary in the ECF process. Second, once they have received approval, the jurisdictions require that ECF platform operators comply with certain obligations that aim to protect investors as well as to ensure the efficiency of the ECF process. The regulatory issues regarding ECF platform operators that are the subject of recommendations in this report are (1) licensing and incorporation requirements; (2) service and product offering; (3) due diligence requirements; (4) oversight of investors; (5) disclosure requirements; (6) education requirements for investors; (7) regulation of conflicts of interest; (8) liability issues; (9) handling investor funds; and (10) dispute resolution.

In relation to issuers, the regulatory issues that are the subject of recommendations in this report are (1) permitted issuers; (2) limitations on the amount that issuers can raise using ECF; (3) disclosure requirements; (4) advertising and marketing restrictions; (5) oversubscriptions; (6) requirements when a material adverse change occurs while the ECF offer is underway; (7) completing the offer; and (8) liability issues. In relation to investors, the regulatory issues that are the subject of recommendations in this report are (1) distinguishing between different types of investors and limitations on the amount that investors can invest in ECF; and (2) cooling-off periods.

ECF is still evolving as the analysis in this report demonstrates. The recommendations in this report seek to ensure the flexibility required in the regulatory process to adapt as ECF develops and as more is learned about how ECF operates in practice. The recommendations aim to promote ECF, promote clarity and simplicity in the ECF process, ensure that the relevant actors act in a manner that ensures there is confidence in the operation of ECF, and protect vulnerable retail investors.

Chapter 1: Introduction: Scope of the Report

Micro and small to medium enterprises (referred in this report as MSMEs or SMEs) form the backbone of economic activity in ASEAN, but they face severe funding constraints in traditional lending and capital markets. ASEAN has recognised that alternative funding sources offer an important way for MSMEs to obtain funding they require for start-up purposes or to undertake innovative new projects that would be difficult to fund through traditional channels.

One alternative funding source is equity crowdfunding (referred to in this report as ECF). To promote understanding and development of ECF, a comparative study (this report) has been undertaken on an enabling regulatory framework for ECF in the ASEAN region with support from ASEAN Connectivity through Trade and Investment (US-ACTI).

This report compares the regulatory frameworks established for ECF in two ASEAN member states – Malaysia and Thailand – as well as two non-member states – the United Kingdom and Australia. The aim, as stated by US-ACTI, is that the report “provides informed, useful, and practical inputs for consideration of the regulatory authorities and other concerned stakeholders in ASEAN member states currently with or without an updated or new regulatory framework on equity crowdfunding”. The report may also, according to US-ACTI, provide “the basic ingredients for preliminary discussion and negotiation among ASEAN Member States to align regulatory frameworks between jurisdictions and/or to achieve mutual recognition agreements within ASEAN”.

This report comes at an opportune time, with several ASEAN jurisdictions either just having introduced regulatory frameworks for ECF or considering doing so. This means that ECF is a relatively new and still evolving form of corporate capital raising. A comprehensive analysis of some of the key developments provides a useful framework from which ASEAN and its member states can develop regulatory regimes to encourage the use of ECF, and, in so doing, improve prospects for innovation and economic growth.

In brief, the ECF process allows businesses, commonly referred to as “issuers” to raise funding (“seed” funding) by offering an equity interest in their company to a group of investors (collectively referred to as the “crowd”) through the internet (referred to as “portals” or “platforms”). Intermediaries operate the platform and in this report will be referred to as ECF platform operators. ECF is an increasingly popular mechanism adopted across the globe to assist MSMEs obtain seed funding, and consequently to encourage economic growth in an environment when bank lending has tightened.

In comparing the various jurisdictions, this report focuses on the effect of ECF on the three main actors in the process; the ECF platform operators, the issuers, and the crowd. As these are the three key actors in the process, the report also focuses on the various regulations that have been introduced as they relate to each actor. However, the regulation relating to each actor is considered in light of the dual goals of ECF regulation: the promotion of economic growth and innovation, and the protection of investors with little knowledge or experience in purchasing securities.

Further, this report is concerned with the provision of equity (or shares) as consideration for payment received from the crowd. As such, it does not consider in great detail the numerous other sources of crowdfunding that are increasingly being relied on to receive funding from the crowd. These sources of crowdfunding are only discussed in this report as a framing and comparative device to emphasise the operation of ECF. It should be noted that in many jurisdictions, crowdfunding involving shares is regulated together with crowdfunding where the consideration provided is a debt security. In those jurisdictions, this report will refer to ECF, but regulation may apply more broadly to cover all forms of securities offered to the crowd over a platform.

Finally, while most current regulation is jurisdiction specific, this report takes into account ASEAN's regional economic growth, integration and development goals when considering ECF. The report pays particular attention to the economic goals set out in ASEAN's economic foundational documents such as the *ASEAN Economic Community 2025*, as well as how ECF may serve as a means to achieve the goal of Narrowing the Development Gap (NDG) set out in the *ASEAN Concord II*.

The report adopts the following structure:

Chapter 2: Economic Background and the Need for ECF. Chapter 2 provides the background to the report. The main aim of the chapter is to illustrate the economic context in which ECF is being considered and the main justifications for the introduction of ECF into ASEAN.

Chapter 3: Defining ECF and Exploring its Benefits and Risks. Chapter 3 defines ECF. The chapter also discusses ECF in relation to other forms of crowdfunding and explores in detail the key actors in the process and their main motivations. Finally, Chapter 3 explores the benefits and risks associated with ECF.

Chapter 4: ECF Regulation in Key Jurisdictions. Chapter 4 provides an analysis of the four key jurisdictions that form the foundation of this report – Malaysia, Thailand, the United Kingdom, and Australia. The chapter considers the regulatory environment in which ECF regulation was introduced for each jurisdiction and the regulation of each of the three main actors for each, namely ECF platform operators, issuers, and investors. As far as is possible, the review of each jurisdiction considers similar issues to enable comparison in Chapter 5. In order to provide additional information to readers of this report, the authors have also included in Chapter 4 a brief discussion of some other developments in ECF regulation in the United States, New Zealand, Canada, China, Hong Kong, and Singapore. For each of the four key jurisdictions considered, the regulations are set out in some detail, although the language adopted is modified where required to provide consistency throughout this report.

Chapter 5: Comparative Analysis and Key Recommendations. Chapter 5 takes the information provided for each jurisdiction in Chapter 4 and provides a comparative analysis of the major issues that each jurisdiction deals with. The chapter takes the major regulatory issues as they relate to each of the key actors and explores how each jurisdiction deals with the issue either in a similar or in a different manner. This comparative analysis forms the

basis of the recommendations contained in Chapter 5 for regulation regarding each of the issues.

Chapter 6: Concluding Remarks. Chapter 6 is the final chapter and provides concluding remarks that summarise key aspects of the report.

Some Examples of ECF

Before examining the economic background and need for ECF and the legal frameworks for ECF in the key jurisdictions, it is useful to provide some examples of successful ECF campaigns in Malaysia, which was the first ASEAN country to introduce a regulatory framework for ECF.

Fruiti King – Helping SME Regional Expansion

Fruiti King is a Malaysian start-up that sells ice cream. It sought to raise RM1 million through Crowdplus.Asia, one of the six ECF platforms approved by Securities Commission of Malaysia. Its campaign to raise funds explained its product as follows:



The company had managed, through a limited production capacity and distribution network, to obtain a strong local following, but had limited opportunities for expansion. Fruiti King succeeded in raising RM1.5 million via its ECF campaign. Its success in raising this initial funding led to a second round of funding of RM3.5 million from a venture capital firm.

Fruiti King has plans to use the funds to support its overseas expansion and penetration of markets that have shown an interest in importing and distributing its products, including China, Hong Kong, Singapore, and South Korea, among others.

Fruiti King's owners spoke positively of their experience with the EFC process:

Gideon Leong is optimistic about the future: "I am glad to have met the dedicated team at

CrowdPlus.asia and given ECF a go. We have a regional sales pipeline of up to RM6.5 million for fiscal year 2017, and the funding raised via CrowdPlus.asia will definitely assist us in meeting this B2B [business to business] demand and accelerate our plan in setting up our first flagship store in the second half of year 2017.

The case provides a useful example of two of the benefits of ECF. First, Fruiti King's successful fundraising through the ECF process and its desire to use these funds to expand its operations illustrates how ECF can assist SMEs to obtain funds and contribute to economic growth. The company's desire to expand in countries within the region also illustrates how this economic expansion can have a region-wide effect. Second, the RM1.5 million initially raised through ECF, followed by a second round of venture capital funding of RM3.5 million, shows how ECF can form part of an ongoing strategy to access funds through a number of sources.

Source: CrowdPlus.Asia, "CrowdPlus.Asia's Latest Round Up: Successful Equity Crowd-Funded Deals And Future Prospects: Fruiti King Raises Rm5 Million To Go Regional", (Blog), 28 October 2016, available at: <http://blog.crowdplus.asia/crowdplus-asias-latest-round-successful-equity-crowd-funded-deals-future-prospects/>.

Kakitangan.com – Exceeding all Fundraising Expectations

Kakitangan.com is a Malaysian Human Resources platform startup that offers services such as payroll, leave, employee database, and benefits. It successfully raised over RM1.5 million using the ECF platform PitchIn (well in excess of its minimum target of RM203,280). The company's target funds were reached within hours of the campaign and meant that it exceeded its minimum target by 485 percent.

The funds allow Kakitangan.com to improve its customer experience and to increase its user base and to engage in its plans to expand in the Southeast Asian market within the next five years. The campaign generated interest from a cross-section of investors and was heavily promoted on social media. Investors ranged from 18 year-olds (with one 18 year-old encouraged to invest by his father to learn the value and potential of long term investment) to 69 years. Further, although most investors were Malaysian, there were some foreign investors who also participated in the fundraising.

This case study illustrates the many advantages of ECF, including, importantly, how the process can assist in bringing into the investment environment a broad range of investors.

Sources: Tanu Pandey, "Malaysia: HR Startup Kakitangan Raises \$240K via Crowdfunding Platform Pitching", DealStreetAsia, 28 September 2016, available at: <http://www.dealstreetasia.com/stories/54318-54318/>; PitchIN, Successful Offers: Kakitangan.com, available at: <https://equity.pitchin.my/businesses/kakitangancom>.

Polyseed – The Use of ECF for Social and Environmental Purposes

Polyseed SSD Sdn Bhd is ASEAN's first social and environmental impact ECF offer. It owns an exclusive additives technology that converts all conventional plastic into eco-friendly biodegradable plastic. The company met its fundraising target of RM400,000 using the ECF platform operator CrowdPlus.Asia, which will allow it to increase its stock holding and support the sales for the Wilayah Green Initiative Program (a joint program with the Malaysian government).

The ECF process allowed the company to further its environmental aims by offering an avenue to raise capital. Polyseed's participation in the ECF process enabled it to raise funds from small investors who may have an interest in assisting the promotion of businesses with an environmental objective.

The ECF process therefore worked in this instance to raise funds for a company that might otherwise have had difficulty raising needed funds, and also acted as a mechanism to raise awareness and provide education in relation to important social matters.

Source: CrowdPlus.Asia, "CrowdPlus.Asia's Latest Round Up: Successful Equity Crowd-Funded Deals And Future Prospects: Polyseed Raises RM400,000 To Expand Its Green Plastic Business", (Blog), 28 October 2016, available at: <http://blog.crowdplus.asia/crowdplus-asias-latest-round-successful-equity-crowd-funded-deals-future-prospects/>.

Chapter 2: Economic Background and the Need for ECF

A: The ASEAN Economy: Seeking Growth, Development, and Integration

ASEAN is a dynamic region consisting of 10 fast-growing and diverse states, each at different stages of economic and financial development (as illustrated through the data in Table 1). The region has a combined population of over 622 million people, and, if considered a single entity, constitutes the seventh largest economy in the world with a combined gross domestic product (GDP) of just under US\$2.5 trillion.¹ ASEAN's economy continues to grow with real year-on-year GDP growth within the region of 4.5–5 percent.² By 2050, it is thought that ASEAN will constitute the fourth largest economy in the world,³ with projections that ASEAN will surpass the European Union in growth if its economies manage to integrate in accordance with policies explored in further detail below.⁴

Table 1: Select Economic Data for ASEAN Member States

Country*	Population (million)	GDP Per Capita#	GDP Billions	Economic Growth (annual variation %)	Investment (annual variation %)	Unemployment Rate	Stock market (annual variation %)
Brunei Darussalam	0.4	41,411 [^]	17.1 [^]	-2.3 [^]	N/A	3.8 [^]	N/A
Cambodia	15.5	1,096 [^]	16.8 [^]	7.1 [^]	N/A	N/A	N/A
Indonesia	255	3,379	862	4.8	5.1	6.2	-12.1
Lao PDR	7.0	1,739 [^]	12.0 [^]	7.5 [^]	N/A	N/A	N/A
Malaysia	30.8	10,222	298	5.0	3.7	3.3	-1.3
Myanmar	51.8	1,228 [^]	63.1 [^]	8.5 [^]	N/A	3.3	N/A
Philippines	101	2,877	292	5.8	14.0	6.3	-3.9
Singapore	5.5	53,004	293	2.0	-1.0	1.9	-14.3
Thailand	68.8	5,732	395	2.8	4.7	0.7	24.1
Viet Nam	91.6	2,036	186	6.7	9.3 [^]	3.3	N/A

Source: FocusEconomics, Economic Snapshot for ASEAN, 16 November 2016 (Countries, ASEAN). *All data is for the year 2015 unless otherwise stated. #All figures are in US\$. [^]2014 data.

¹ ASEAN Secretariat, "Fact Sheet: ASEAN Economic Community" (December 2015); Wolfgang Lehmacher, "The ASEAN Economic Community: What You Need to Know", World Economic Forum, 31 May 2016, available at:

<https://www.weforum.org/agenda/2016/05/asean-economic-community-what-you-need-to-know/>.

² GDP growth in ASEAN for Q3 (third quarter) of 2016 was at 4.5 percent, although this was down from 4.7 percent in the previous quarter. FocusEconomics, "Economic Snapshot for ASEAN", 16 November, 2016, available at: <http://www.focus-economics.com/regions/asean>. FocusEconomics projects, however, that ASEAN GDP will grow by 4.8 percent in 2017. The Organisation for Economic Co-operation and Development (OECD) projects growth of 5.2 percent over 2016–2020. OECD, "Economic Outlook for Southeast Asia, China and India 2016: Enhancing Regional Ties (Overview)".

³ Vinayak H.V., Fraser Thompson, and Oliver Tonby, "Understanding ASEAN: Seven Things You Need to Know", May 2014, available at: <http://www.mckinsey.com/industries/public-sector/our-insights/understanding-asean-seven-things-you-need-to-know>. HIS Markit projects significant growth in ASEAN: HIS Markit, "Emerging Markets in Asia Pacific Offer Brightest Prospects for Global FDI, IHS Study Finds", 14 April 2016, available at: <http://news.ihsmarkit.com/press-release/economics-country-risk/emerging-markets-asia-pacific-offer-brightest-prospects-global->.

⁴ Rajeshni Naidu-Ghelani, "Asean Economic Growth 'to outdo EU'", BBC (online), 20 April 2015, available at: <http://www.bbc.com/news/business-32387376>.

In addition to its increased GDP, ASEAN trade increased between 2007 and 2014 by US\$1 trillion, foreign direct investment (FDI) has risen significantly from US\$85 billion to US\$136 billion, and ASEAN's large population base makes it the world's third largest market and the third largest labour force.⁵ These statistics illustrate that ASEAN is an increasingly powerful economic force in Asia and the world and an important driver of the global economy.

While there are many positive indicators of economic growth in ASEAN, the region, as with much of the rest of the world, faces challenges over the next few years. However, as these developed economies face economic challenges, there has been renewed emphasis on the ability of the less developed markets such as Lao PDR, Myanmar, and Viet Nam to contribute to economic growth within the region.⁶ Integration is seen as a key factor in facilitating ongoing economic success within the region. As the World Economic Forum has noted:

ASEAN has to boost intra-regional trade to reduce the vulnerability to external shocks. This requires a common regulatory framework to address infrastructure gaps and the simplification of administrative policies, regulations and rules ...

Provided the agreement is well managed over the next decade, the AEC [ASEAN Economic Community] could boost the region's economies by 7.1% between now and 2025 – which is more than ASEAN's growth of 5.4% from 2004 to 2014. It could also generate 14 million additional jobs, according to a study by the International Labour Organization and Asian Development Bank.⁷

The OECD has similarly noted the need for further integration efforts in ASEAN as follows:

... ASEAN countries need to take active steps to realise a single economic market by 2015 and beyond, and make additional efforts, including: i) co-ordinating between regional initiatives and national agendas, and regional and sub-regional initiatives, avoiding duplication and moving in the same direction; ii) reducing disparities in the region by supporting the further development of the CLM countries [Cambodia, Lao PDR and Myanmar]; iii) moving towards a "Global ASEAN" that is integrated in the global economy and stronger ties with the ASEAN+3 [ASEAN and China, Japan, and South Korea] and ASEAN+6 [ASEAN+3 and Australia, India, and New Zealand] frameworks; and iv) strengthening monitoring capacity through better indicators and peer learning to make the regional agenda more effective.⁸

In assessing integration efforts in the ASEAN region, the OECD has provided a snapshot that sets out the progress to date and areas where there may be improvement:

⁵ Lehmacher, note 1.

⁶ Luke Hunt, "The Changing Face of ASEAN: Myanmar, Laos, and Vietnam Offer an Unlikely Breath of Fresh Air", *The Diplomat* (online) 15 September 2016.

⁷ Lehmacher, note 1.

⁸ OECD, note 2.

Table 2: Summary: Assessment of Progress in Integration in Key Policy Areas

Policy area	Assessment of progress
Trade in goods	Intra-regional tariffs are falling and intra-regional trade is increasing. Trade agreements are being made, and trade facilitation is improving, but non-tariff measures remain a challenge.
Trade in services	Progress in facilitating services trade has been uneven, and deeper reforms are needed in some countries.
Investment and capital market liberalisation	Liberalisation has been uneven by country and sector, and investors remain concerned by high costs of doing business, weak intra-ASEAN banking facilities, though the Chiang Mai Initiative Multilateralisation and Asian Bond Market Initiative are promoting regional stability and financial integration.
Competition and consumer protection	ASEAN members are sharing best practices, but work remains to be done on policy harmonisation and the establishment of regional-level initiatives.
Intellectual property (IP)	Co-operation between IP offices has improved and work is being done to further develop local capacities.
Infrastructure and connectivity	Slow progress is being made on road, rail and maritime connectivity, and institutional barriers are being addressed gradually.
Small- and medium-sized enterprises (SMEs)	Several major programmes offer support to SMEs in operating domestically or internationally, but access to finance and technology is a challenge for these firms in some countries.
Food, agriculture and forestry	Regional frameworks are improving food security, but more could be done to protect fisheries, forestry and wildlife.
Tourism	Co-operation is progressing on tourism promotion, the establishment of common standards and visa facilitation.
Human and social development	Education system harmonisation and collaborative research initiatives have been established, and co-operation through broader regional frameworks is progressing.
Initiative for ASEAN Integration (IAI) A large number of projects are planned under the IAI, though implementation rates are low.	

Source: OECD, "Economic Outlook for Southeast Asia, China and India 2016: Enhancing Regional Ties (Overview)"

Although efforts at integration are ongoing, ASEAN has long recognized the significance to the region of economic growth and development, and has accordingly undertaken numerous initiatives to enhance economic opportunities. ASEAN illustrated its commitment to achieving these goals very early on in the *Treaty of Amity and Cooperation* of 1975 (Treaty). Article 6 of the Treaty for instance, identifies the significance of acceleration of economic growth as a contributor towards strengthening the foundation for a prosperous and peaceful community of the states in the region. Similarly, Article 7 of the Treaty commits ASEAN's members to the intensification of economic cooperation to help achieve the goals of social justice and to help raise the standard of living for the people of the region. The adoption of the 1992 *Framework Agreement on Enhancing ASEAN Economic Cooperation*, which called for the establishment of an ASEAN Free Trade Area (AFTA) within 15 years of the agreement with a Common Effective Preferential Tariff (CEPT) scheme, was another major contributor towards enhancing economic growth and integration in the region.

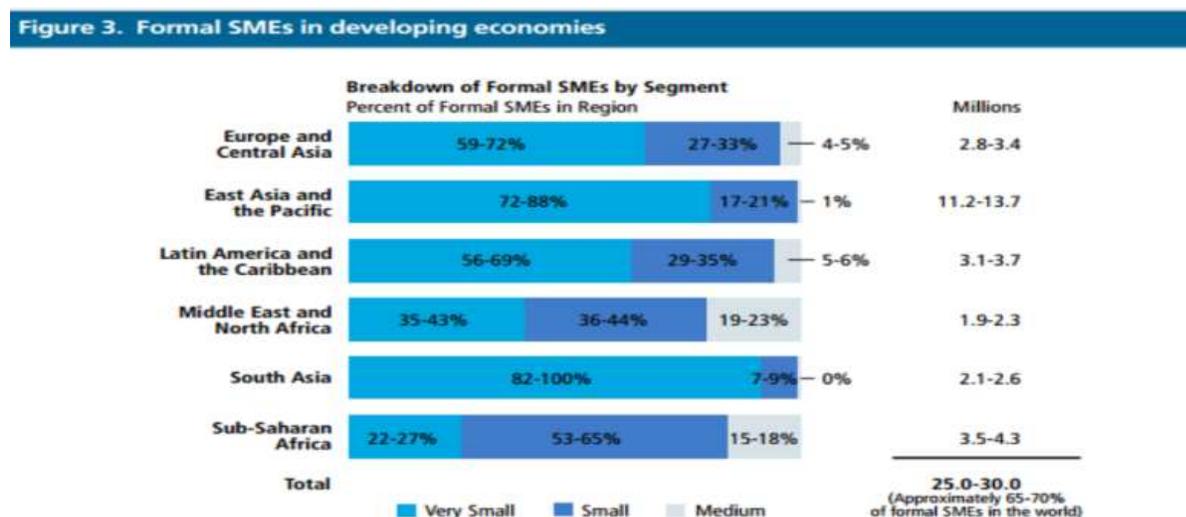
More recently, ASEAN has moved towards the creation of a cohesive, single economic market through the adoption of the ASEAN Economic Community (AEC). In the *Asian Vision 2020*, ASEAN sets out a vision that includes "... a stable, prosperous and highly competitive ASEAN Economic Region in which there is a free flow of goods, services and investments, a freer flow of capital, equitable economic development and reduced poverty and socio-economic disparities." The establishment of the AEC in 2015 aimed to promote economic, political, social, and cultural cooperation across ASEAN. The goal of the AEC is to move ASEAN towards a globally competitive single market and production base, with a free flow of goods, services, labour, investments, and capital across the region. These goals were reiterated in the *AEC Blueprint 2025* which sets out the vision for ASEAN over the next decade and includes the following goals:

- (a) a highly integrated and cohesive economy;
- (b) a competitive, innovative, and dynamic ASEAN;
- (c) enhanced connectivity and sectoral cooperation;
- (d) a resilient, inclusive, people-oriented, and people-centred region; and
- (e) a global ASEAN.

Of particular importance to this report is the commitment made by ASEAN to financial liberalisation and cooperation in the area of financial policy that is considered a key driver of these economic goals. A report by Deloitte, *Digital Banking for Small and Medium-Sized Enterprises: Improving Access to Finance for the Underserved*, sets out the importance of the MSME sector in the ASEAN-5 states (Indonesia, Malaysia, the Philippines, Singapore, and Thailand), noting that at least one-third of GDP and 70 percent of employment are attributed to MSMEs.⁹ ASEAN has itself recognized the vital role of MSMEs to the economy in the region. It also notes on its website in relation to SME developments in ASEAN that:

They constitute the largest number of establishments and contribute significantly to the labour force of ASEAN Member States (AMS). SMEs account for between 88.8% and 99.9% [of] total establishments in AMS and between 51.7% and 97.2% of total employment. The contribution of these enterprises to each AMS' GDP is between 30% and 53% and the contribution of SMEs to exports is between 10% and 29.9%. Hence, these enterprises are important in terms of income and employment generation, gender and youth empowerment through their diverse business participation, and their widespread presence in the non-urban and rural areas. SMEs are thus the backbone of ASEAN and SME development is fundamental towards achieving long-run and sustainable economic growth and narrowing the development gap.¹⁰

The International Finance Corporation (IFC) has provided the following graph to illustrate the significance of SMEs in the developing world:



Source: IFC Enterprise Finance Gap Database (2011)

ASEAN has undertaken several initiatives, considered in the following section, that illustrate commitment to enhancing the role of MSMEs in economic growth. This includes the *AEC Blueprint 2025*, which provides that:

⁹ Deloitte, "Digital Banking for Small and Medium-sized Enterprises: Improving Access to Finance for the Underserved", available at: <https://www2.deloitte.com/kh/en/pages/financial-services/articles/digital-bank-small-medium.html>.

¹⁰ ASEAN, "SME Developments in ASEAN", available at: <http://asean.org/asean-economic-community/sectoral-bodies-under-the-purview-of-aem/small-and-medium-enterprises/>.

MSMEs are the backbone of the ASEAN economies. However, globalisation, advances in technologies and communications, trade liberalisation and the evolution of the production processes pose challenges which need to be better addressed as ASEAN continues to deepen its economic integration. Work has focused mainly on enhancing networking, information flows and capacity building for government agencies working on issues and capabilities building in the following dimensions: access to finance, technology and innovation, markets, human resource development and enabling policy and regulatory environment.

In relation to access to finance for these MSMEs, the *AEC Blueprint 2025* refers specifically to the need to:

increase access to finance by developing and enhancing the institutional framework in respect of improving understanding and strengthening traditional financing infrastructure as well as the policy environment and measures that foster *alternative and non-traditional financing*, promote financial inclusion and literacy and the ability of MSMEs to be better engaged in the financial systems; and enhance tax and other incentive schemes. (emphasis added)

Further, any economic initiatives of the region need to take into account the commitment towards Narrowing the Development Gap (NDG) that acknowledges the vast differences in economic development among member states and seeks to encourage economic policies that will bridge this gap so as to reduce pockets of underdevelopment. It is within this context that ECF has come to take on an important role in policy reform, and in the next section, this report considers perhaps the most significant justification for the creation of an ECF regulatory framework: closing the funding gap.

B: Closing the “Funding Gap”

While ASEAN and individual member states have sought to support the economic activities of MSMEs, they continue to face significant challenges. According to a report produced by the World Bank, *Small and Medium Enterprises (SMEs) Finance* (1 September 2015), MSMEs are less likely to obtain bank loans than larger companies, and must as a result rely more on “personal” funds (such as borrowing from family and friends) to launch their enterprises. This limits the availability of funding opportunities for this vital sector of the economy, and in turn presents problems for ongoing growth and innovation in the economy in general.

According to a joint report conducted by the International Finance Corporation and McKinsey & Company, *Two Trillion and Counting: Assessing the Credit Gap for Micro, Small, and Medium-Size Enterprises* (October 2010), the difficulties that MSMEs face in obtaining credit in the developing world have resulted in a large funding gap of approximately US\$250–310 billion in East Asia for MSMEs and US\$30–40 billion in South Asia for MSMEs. More broadly, the Business Advisory Council of the Asia–Pacific Economic Cooperation forum notes that East Asia faces a funding gap in the range of US\$900 billion to US\$1.1 trillion while South Asia is experiencing a funding gap of up to US\$370 billion. This funding gap becomes increasingly concerning in light of significant

economic challenges faced in the region.¹¹ For instance, a recent study conducted by the *Financial Times* found that slowing economic growth was hurting employment prospects within the ASEAN region.¹² The funding gap in ASEAN jurisdictions is illustrated in Table 3.

Table 3: SME Funding Gap in ASEAN

Country	Total Funding Gap (US\$ Billions)	Average Credit Value Gap per Enterprise (US\$)
Brunei Darussalam	7.2	736,000
Cambodia	0.4	50,000
Indonesia	11.8	29,000
Lao PDR	0.2	13,000
Malaysia	8.0	126,000
Philippines	2.0	59,000
Singapore	7.1	856,000
Thailand	11.8	126,000
Viet Nam	4.3	42,000
Myanmar	Data Not Included	Data Not Included

Source: Ganeshan Wignaraja, *SMEs Financing in Developing Asia: Opportunities and Constraints* (Symposium on Financial Activity of Households and SME Sector and the Regional Economy, Osaka, Japan, 30 October 2014)

Lack of adequate funding has provided the justification for the introduction of ECF-specific regulatory regimes in jurisdictions outside of ASEAN, particularly in those jurisdictions where the global financial crisis resulted in greater obstacles for MSMEs in accessing funding through traditional financial channels. In Europe for instance, the availability of bank loans and the willingness of banks to lend to SMEs declined sharply after the financial crisis with banks increasing interest rates and requiring greater collateral from borrowers.¹³ In several large European countries, including France, Germany, Italy, Spain, and the United Kingdom, the resulting funding gap is expected to increase to €2.5 trillion by 2020 while many less developed countries face even greater funding gaps.¹⁴ This has seen greater reliance on funding from local communities, family, and friends.¹⁵

Recent data produced by the International Finance Corporation (IFC) indicates that the size of the gap in funding is in excess of US\$2 trillion, and that an estimated one-half to two-thirds of MSMEs lack proper access to finance.¹⁶ Two graphs provided by the IFC illustrate the considerable funding gap in various regions of the world:

¹¹ The funding gap signifies the difference between the formal credit provided to companies, including MSMEs, and the estimated potential need for formal credit by these companies.

¹² FT Confidential Research, "Survey – Asean's Increasingly Tough Job Market", 11 January 2016, available at: <https://www.ftconfidentialresearch.com/Sectors/Macro/Employment/Survey-Asean-s-increasingly-tough-job-market>.

¹³ Oliver Gajda and Nick Mason, "Crowdfunding for Impact in Europe and the USA", TONIIC and the European Crowdfunding Network, 2013 at 11, available at: <http://www.toniic.com/toniic-institute/crowdfunding-for-impact/>.

¹⁴ Ibid.

¹⁵ Ibid.

¹⁶ International Finance Corporation, "Closing the Credit Gap for Formal and Informal Micro, Small, and Medium Enterprises", (2013), available at:

Figure 4. Formal SME sector—Total credit gap

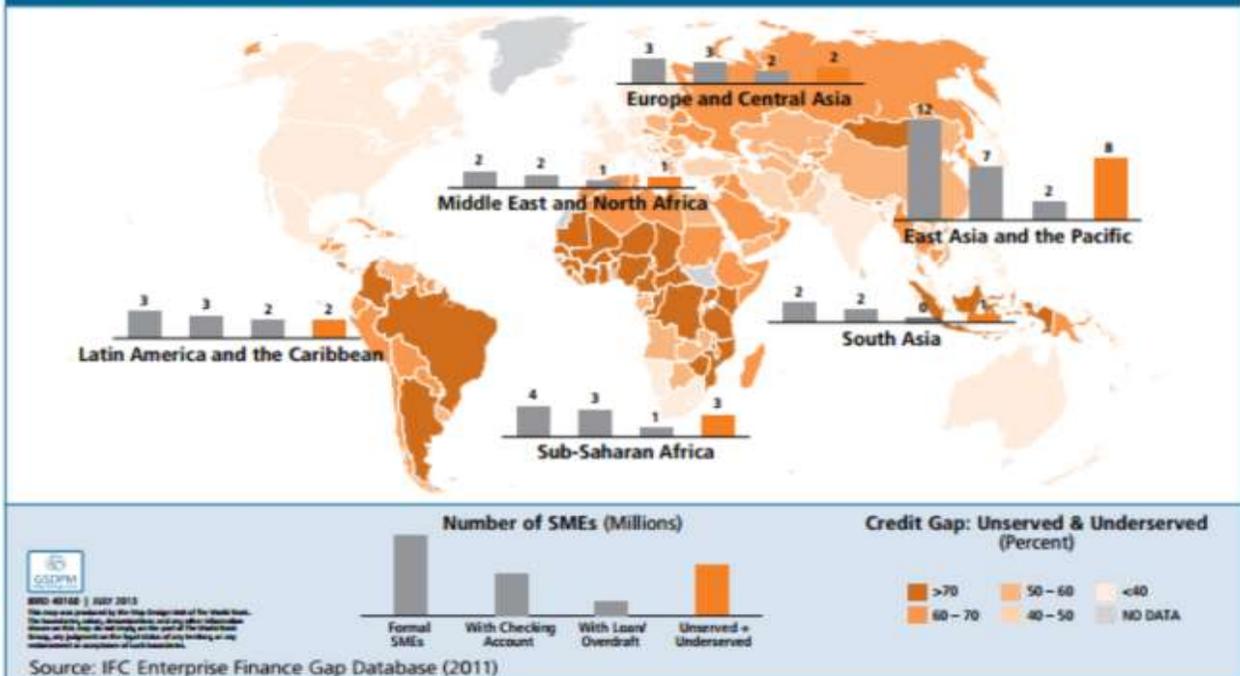
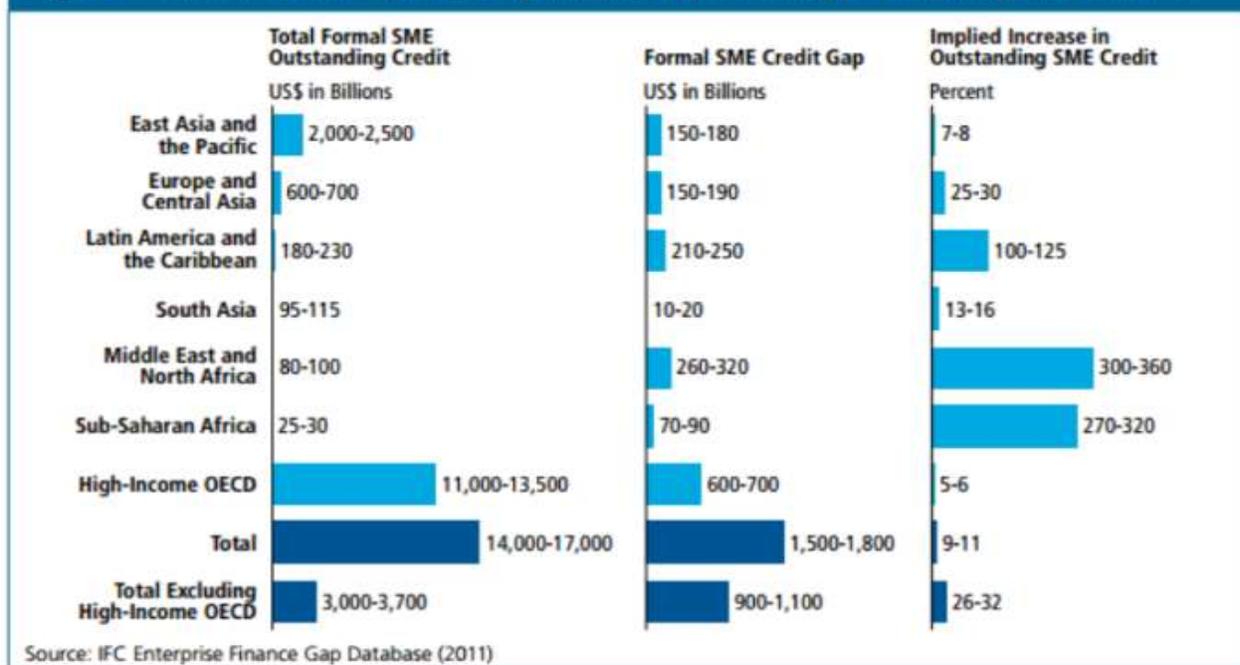


Figure 5. Formal SME sector—Total credit gap relative to outstanding SME credit, regional variations



As we explore in Chapter 4, this gap has led several of these jurisdictions to introduce initiatives, including regimes for ECF, to assist in reducing the funding gap and to move away from reliance on sources of funding that are difficult to access. Individual member states and ASEAN have also

<https://www.ifc.org/wps/wcm/connect/4d6e6400416896c09494b79e78015671/Closing+the+Credit+Gap+Report-FinalLatest.pdf?MOD=AJPERES>.

recognized the problems associated with this funding gap, and have accordingly sought to create a regulatory framework that addresses some of the difficulties faced by MSMEs. This includes initiatives such as those undertaken in the Philippines to bring domestic MSMEs within the mainstream of manufacturing, production, and services that a global production chain requires.¹⁷

Efforts have also been made by member states through ASEAN, in accordance with the goals set out in the *AEC Blueprint 2025*, to address problems regarding MSME funding in a coordinated manner. The ASEAN Coordinating Committee on MSME has, for instance, set out goals in the ten-year *ASEAN Strategic Action Plan for SME Development* (SAPSMED 2016–2025) under the post-2015 ASEAN Vision: (1) promote technology, productivity, and innovation; (2) increase access to finance; (3) enhance market access and internationalisation; (3) enhance the policy and regulatory environment; and (4) promote entrepreneurship and human capital development. The goals set out as part of the SAPSMED 2016–2025 seek to strengthen MSME engagement, and support MSME growth and development through the vision of “Globally Competitive and Innovative SMEs.” The ultimate aim is that by 2025, ASEAN will have created through these processes more globally competitive and resilient MSMEs.

Further, financial inclusion is one of the three strategic, finance-related objectives in the *AEC Blueprint 2025*. It is to be achieved by, for instance, expanding the number and scope of financial intermediary facilities such as crowdfunding with the aim of better serving underserved communities, including MSMEs across the AEC. All of these considerations suggest that ECF may come to play an increasingly important role in helping ASEAN and its individual member states to achieve their economic goals over the next 10 years.

Having considered the need for additional funding to promote innovation and economic growth, Chapter 3 explains the process of fundraising through ECF, as well as setting out some of the benefits and risks of the process.

¹⁷ Department of Trade and Industry Philippines, “Understanding the ASEAN Economic Community: A Primer”, 28 March 2014, available at: http://www.philembassymadrid.com/wordpress/wp-content/uploads/Images/AEC_Primer_Ebook2.pdf.

Chapter 3: Defining ECF and Exploring Advantages and Disadvantages

A: What is ECF and What is the Context in which it Exists?

There is no commonly accepted legal definition of ECF that applies across the world. In essence however, ECF is one of several mechanisms that allow companies to obtain funding from a large number of investors using the internet (although, as we will see in Chapter 4, the United Kingdom's ECF regime is media neutral, meaning that mechanisms other than the internet are included within the definition). The primary factor that distinguishes ECF from other forms of crowdfunding is the provision by companies of an equity interest in their company in return for investment, although here again, several jurisdictions regulate all securities (i.e., equities and bonds) purchased through crowdfunding under the same regulatory regime. For the purposes of this report, unless noted otherwise, ECF refers to a process that involves a potentially large number of people making small investments in a company through an online intermediary known as a portal or a platform, in exchange for an equity share in the company.

ECF has emerged as a source of finance through a series of innovations that have taken place over recent decades. As such, ECF is part of a broader universe of financial innovations leveraging technological advances, particularly the explosive growth of the internet, to get funds to those who need them. These innovations are collectively referred to as "FinTech" and include among them, crowdsourcing, the concept from which crowdfunding is derived. Crowdsourcing refers to the solicitation of contributions in the form of services, ideas, or content from a large group of people, usually over the internet.

ECF takes this idea of using the internet to obtain small contributions from a large number of people, and substitutes financial contributions for contributions of services, ideas, and content. The process is often considered as part of an escalation of funding options. ECF sits somewhere in between initial funding from private sources, such as family and friends, and funding obtained through borrowing in the official financial sector or raising capital through an initial public offering (IPO). The European Commission provides a graph that sets out the position of ECF in the funding escalator:



Source: European Commission DG Communications Networks, Content and Technology (2014). "Crowdfunding innovative ventures in Europe: The financial ecosystem and regulatory landscape." Brussels: DG Communication Networks, Content and Technology, available at: <https://ec.europa.eu/digital-single-market/en/news/crowdfunding-innovative-ventures-europe-financial-ecosystem-and-regulatory-landscape-smart>.

ECF is just one type of crowdfunding that relies on the internet as a means to obtain funding from a large number of people. The International Organization of Securities Commissions (IOSCO) treats

crowdfunding as an umbrella term for the use of small amounts of money obtained from a large number of people or organizations to fund a project or business, or to provide a personal loan through an online platform.¹⁸ The commonly accepted different forms of crowdfunding are briefly set out below:

Rewards Crowdfunding: backers typically invest small amounts and receive certain “rewards” in return. These rewards are often the item being produced. Rewards crowdfunding is perhaps the most publicized form of crowdfunding, raising US\$2.56 billion in 2015.¹⁹ It is targeted primarily at start-ups, particularly those operating in creative fields that do not qualify for traditional small-business loans.

There are generally no restrictions imposed on who can invest through rewards crowdfunding and amounts raised through this form of crowdfunding tend to range between US\$1,000 and US\$100,000. The only costs associated with rewards crowdfunding are the fees paid to platform operators and these can range anywhere between 7 percent and 12 percent of the funds raised. Although there are relatively few requirements imposed on those seeking funding through rewards crowdfunding, it is common for some platforms to provide that if a pre-determined funding threshold is not reached, then no funds are released.

Popular rewards crowdfunding platforms include Indiegogo, Kickstarter, and GoFundMe. Kickstarter publishes statistics regarding funds raised on its website.²⁰ As of 9 December 2016, the total amount of funds successfully raised through Kickstarter was just over US\$2.7 billion for 116,613 projects. These funds were raised from 12,133,859 backers who made 34,940,709 pledges. Although there has been significant success in raising funds through Kickstarter, 209,061 projects have been unsuccessful in raising funds.

The most successful campaign on Kickstarter was conducted by smartwatch maker, Pebble, which sought funding for its Pebble Time watch. The campaign raised US\$1 million in less than an hour (its initial goal was US\$500,000), and ultimately succeeded in raising approximately US\$20.33 million through 78,471 backers. Rewards offered for donations included one Pebble Time watch for a pledge of US\$159 (an “early bird” offer, which usually would require a pledge of US\$179). A number of other rewards in the form of Pebble watches were offered for different amounts pledged. The most that could be pledged was US\$5,000 for 10 Pebble Time watches in each of the three colours available.²¹ The following screenshot provides an example of the interface adopted by Kickstarter for its funding campaigns:

¹⁸ Eleanor Kirby and Shane Worner, “Crowd-funding: An Infant Industry Growing Fast”, OICV-IOSCO Staff Working Paper: [SWP3/2014], available at: https://www.iosco.org/research/?subSection=staff_working_papers.

¹⁹ See CrowdExpert.com, “Massolution Crowdfunding Industry 2015 Report”, 31 March 2015 (citing, Massolution/Crowdsourcing.org 2015CF Crowdfunding Industry Report), available at: <http://crowdexpert.com/crowdfunding-industry-statistics/>.

²⁰ Kickstarter, “Stats”, available at: <https://www.kickstarter.com/help/stats?ref=footer>.

²¹ Kickstarter, “Pebble Time - Awesome Smartwatch, No Compromises”, available at: https://www.kickstarter.com/projects/597507018/pebble-time-awesome-smartwatch-no-compromises?ref=most_funded.

Campaign Updates ³¹ Comments ^{3,000} Community [Share this project](#) *

About this project



Pebble Time - Awesome Smartwatch, No Compromises

Palo Alto, CA Product Design

Our Kickstarter campaign is over! It's been an amazing month. We're looking forward to getting Pebble Time and Pebble Time Steel onto your wrist.

To learn more and order a Pebble Time, head on over to pebble.com

Support this project

Pledge \$159 or more

EARLY BIRD: Your choice of one Pebble Time watch in any of the three colors. Regular retail price will be \$199.

ESTIMATED DELIVERY	SHIPS TO
May 2015	Anywhere in the world

Reward no longer available
10,000 backers

Pledge \$179 or more

Your choice of one Pebble Time watch in any of the three colors. Regular retail price will be \$199.

ESTIMATED DELIVERY	SHIPS TO
May 2015	Anywhere in the world

Limited
22,991 backers

\$20,338,986
pledged of \$500,000 goal

78,471
backers

Donation Crowdfunding: relies on the provision of small donations from a large number of “donors”. As the name suggests, unlike rewards crowdfunding, the donor generally does not expect to receive anything in return for their donation. Donation crowdfunding raised a similar amount of funds in 2015 to reward crowdfunding – US\$2.85 billion.²² This form of crowdfunding is popular with not-for-profit and charitable organizations. GoFundMe and Kiva.org are popular examples of donation crowdfunding platforms. Fees are charged for the use of the service, with GoFundMe charging 7.9 percent of the funds raised plus US\$0.30 for each donation in a charity campaign.²³ Over US\$3 billion has been raised through GoFundMe, ranging from campaigns to help sew teddy bears for children across the world, to campaigns to assist an elderly man obtain 24-hour home care so that he can continue living at home and many other similar campaigns.²⁴

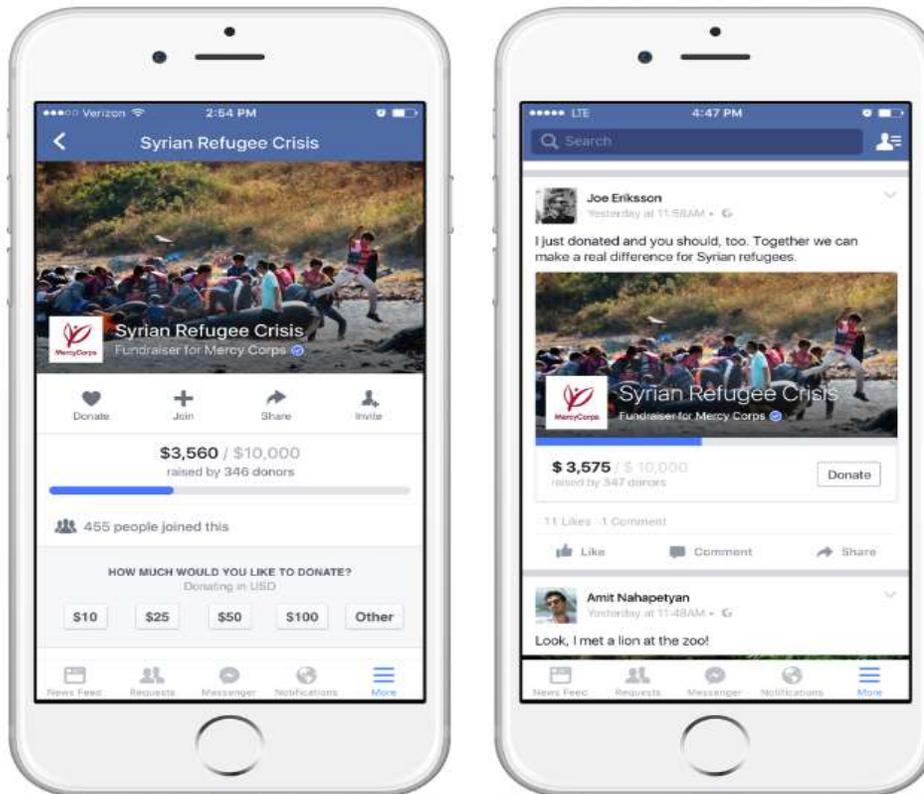
Facebook has also entered the donation crowdfunding industry through “fundraisers”. Through the use of a “donate” button, Facebook users can donate to charities through their Facebook account. The project seeks to leverage the large Facebook user base and the over 150 million people around the world who are in some way connected to a cause. Through fundraisers, non-profits can raise funds from their page for a specific cause. The following screenshot made

²² CrowdExpert.com, note 19.

²³ GoFundMe, “Pricing and Fees”, available at: <https://au.gofundme.com/pricing>.

²⁴ GoFundMe, “Success Stories”, available at: <https://au.gofundme.com/success> (stories available on this page as of 9 December 2016).

available by Facebook when launching the service,²⁵ provides an example of how donations are made through fundraisers:



Investment Crowdfunding: this term is sometimes used to refer to two forms of crowdfunding: lending crowdfunding and securities crowdfunding (which is itself divided into debt and equity crowdfunding, although these forms of crowdfunding are sometimes included under a common regulatory regime).²⁶ Lending crowdfunding and securities crowdfunding have in common the provision of funding with the expectation of some form of commercial return. Each of these two forms of crowdfunding is explored below:

Lending Crowdfunding (LCF) (also referred to as Peer-to-Peer): relies on contributions from lenders. As with normal loans, lenders make the loan with the expectation that the loan will be repaid with interest payments made in the meantime. This is similar to receiving a loan from a bank with the major difference being that instead of receiving one large loan from

²⁵ Facebook, "Introducing New Tools for Nonprofits", 18 November 2015, available at: <http://newsroom.fb.com/news/2015/11/introducing-new-tools-for-nonprofits/>.

²⁶ The European Commission has adopted a slightly different classification of investment crowdfunding. It includes under this umbrella term the offer of equities and debt. Lending crowdfunding is considered a separate source of crowdfunding. Further, in addition to the forms of crowdfunding outlined in this section, the European Commission includes two further categories: invoice trading crowdfunding and hybrid crowdfunding (see European Commission, "Crowdfunding in the EU Capital Markets Union", Commission Staff Working Document, SWD(2016) 154 final, 3 May 2016, available at: https://ec.europa.eu/info/publications/crowdfunding-eu-capital-markets-union_en). As Chapter 4 notes, the United Kingdom has also adopted this classification.

an institution such as a bank, the company seeking the loan receives multiple small loans from many lenders. For this reason, LCF is often considered an alternative source of funding to traditional commercial banking. Investors may consider LCF as an attractive investment because it offers a fixed return on the investment and is traditionally secured against a company's assets, making it less risky (although also less profitable than unsecured debts where the interest payable is higher).

There are a number of platforms offering LCF services, helping to make it the largest source of crowdfunding with US\$25.1 billion raised in 2015.²⁷ Two of the largest LCF platforms are Prosper and Lending Club. Lending Club explains the process for LCF as follows:

- Customers interested in a loan complete a simple application at LendingClub.com
- We leverage online data and technology to quickly assess risk, determine a credit rating and assign appropriate interest rates. Qualified applicants receive offers in just minutes and can evaluate loan options with no impact to their credit score
- Investors ranging from individuals to institutions select loans in which to invest and can earn monthly returns
- The entire process is online, using technology to lower the cost of credit and pass the savings back in the form of lower rates for borrowers and solid returns for investors.²⁸

The Lending Club website offers a dedicated page for business loans that is fairly common:

²⁷ CrowdExpert.com, note 19.

²⁸ Lending Club, "How Does an Online Credit Market Place Work?" available at: <https://www.lendingclub.com/public/how-peer-lending-works.action>.



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Use it whenever you want.
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Equity Crowdfunding (ECF):²⁹ investors provide small amounts of money (although generally more than is given in either donation or reward crowdfunding) and in return receive a small piece of equity in the company. The benefit of this form of crowdfunding for investors is the potential to receive dividends out of the company's profits or the possibility to sell the shares at a higher price than the initial investment. Importantly, while LCF is often considered an alternative to borrowing from banks, ECF is viewed as a potential alternative or perhaps a complement to receiving seed funding from angel investors and venture capitalists.

Some major ECF platform operators include AngelList, CircleUp, FundersClub, and OurCrowd. An interesting example of how different crowdfunding mechanisms may be used in combination to fund projects is provided through the use by Neil Young of both Kickstarter (rewards crowdfunding) and Crowdfunder (ECF) to fund his project, PonoMusic. PonoMusic seeks to improve the quality of highly compressed, poor quality music files using digital technology. After an initially successful Kickstarter campaign, which raised US\$6.2 million from 18,220 backers, PonoMusic raised over US\$5 million more through an ECF campaign (although this ECF campaign was conducted through a U.S. ECF platform operator before the full ECF regime was in place in the United States).³⁰ It is a useful example of how initial funding through reward crowdfunding provided the impetus for later growth through ECF.

AngelList is one of the oldest and most successful ECF platform operators in the world. Companies are generally required to provide company-created start-up profiles that are visible to the general public, and these companies are required to maintain an active profile indefinitely. Those who may invest in an issuer are restricted to registered investors, and unless otherwise noted, the minimum threshold that can be invested is US\$1,000. There are three ways that an investor can invest through AngelList: (1) syndicates, which are single-deal venture capital (VC) funds created to invest in a specific start up; (2) funds, which allow investors to invest in 50-100 start-ups with a single payment (with funds managed by AngelList); and (3) the professional investor program for individuals and institutions that plan to invest over US\$1 million through the platform.³¹ A screenshot of a select number of publically available companies that raise funds through AngelList is provided below:

²⁹ ECF is often included within the same regime as securities more broadly, which include for example, the issuance of bonds. This report considers ECF as the main form of investment crowdfunding, but in many instances, regulations referred to apply equally to the issue of other forms of securities through crowdfunding.

³⁰ Kickstarter, "PonoMusic – Where Your Soul Rediscovered Music", available at: <https://www.kickstarter.com/projects/1003614822/ponomusic-where-your-soul-rediscovered-music>; JD Alois, "Updated: Neil Young's PonoMusic is Now Equity Crowdfunding Following \$6.2 Million Kickstarter Hit", Crowdfund Insider, 13 August 2014, available at: <http://www.crowdfundinsider.com/2014/08/46650-neil-youngs-ponomusic-equity-crowdfunding-following-6-2-million-kickstarter-hit/>.

³¹ AngelList, "Syndicates/For Investors", available at: <https://angel.co/syndicates/for-investors>.

304,473 Companies

Company	Signal	Joined	Location	Market	Website	Employees	Stage	Total Raised
 Boomerang (Baydin) Email management that actually ...		Jul '10	Mountain View	Productivity Software	boomeranga...	11-50	Seed	\$412,000
 Adaptly The Easiest Way to Advertise Acr...		Jul '10	New York City	Social Media Marketing	adaptly.com	-	Series B	\$13,200,000
 Graphicly an automated ebook publishing a...		Aug '10	San Francisco	Content Creators	graphicly.com	11-50	Acquired	\$9,237,500
 Flavors.me Social media-based web presenc...		Aug '10	New York City	Networking	flavors.me	-	Acquired	-
 Krossover Friday Night Lights meets Money...		Aug '10	New York City	Social Games	krossover.com	1-10	Series B	\$38,024,000
 Appstores App Distribution Platform		Aug '10	San Francisco	App Stores	appstores.com	-	Acquired	\$1,155,000
 eVenues Online Marketplace & Booking E...		Aug '10	Seattle	Hospitality	evenues.com	11-50	Seed	-
 Aktana SaaS Sales Analytics Platform for...		Aug '10	San Francisco	Big Data Analytics	aktana.com	11-50		\$17,500,000

ECF is finding increasing support among jurisdictions, raising US\$2.56 billion in 2015.³² FundedByMe, a Swedish crowdfunding platform, provides useful data on ECF offered through its platform: the average price of a share is €149; the median amount of investors per campaign is 46; the average amount of equity offered is 14 percent; the median investment is €551; and the average investment is €5,935. Further, the platform indicates that the compound annual growth rate of ECF between 2012–2014 was 449 percent, which confirms the significant growth in ECF over the last few years more broadly. This is discussed in more detail below.³³

Of all these forms of crowdfunding, it is investment crowdfunding that receives most regulatory attention. However, in light of the relatively recent widespread use of investment crowdfunding, there remains considerable debate regarding the appropriate regulatory framework for LCF and, in particular, ECF. This has led to different approaches adopted across the world, with jurisdictions creating regulatory frameworks that emphasise to differing extents either the promotion of innovation and economic growth through relaxed regulatory frameworks or the protection of vulnerable investors through more rigid regulation.

These risks are considered in Section C below, but it is worth noting that despite the difficulties in determining the right regulatory balance, the economic impact of crowdfunding is significant and growing. In a report, Massolution predicted that crowdfunding would raise approximately US\$34.4

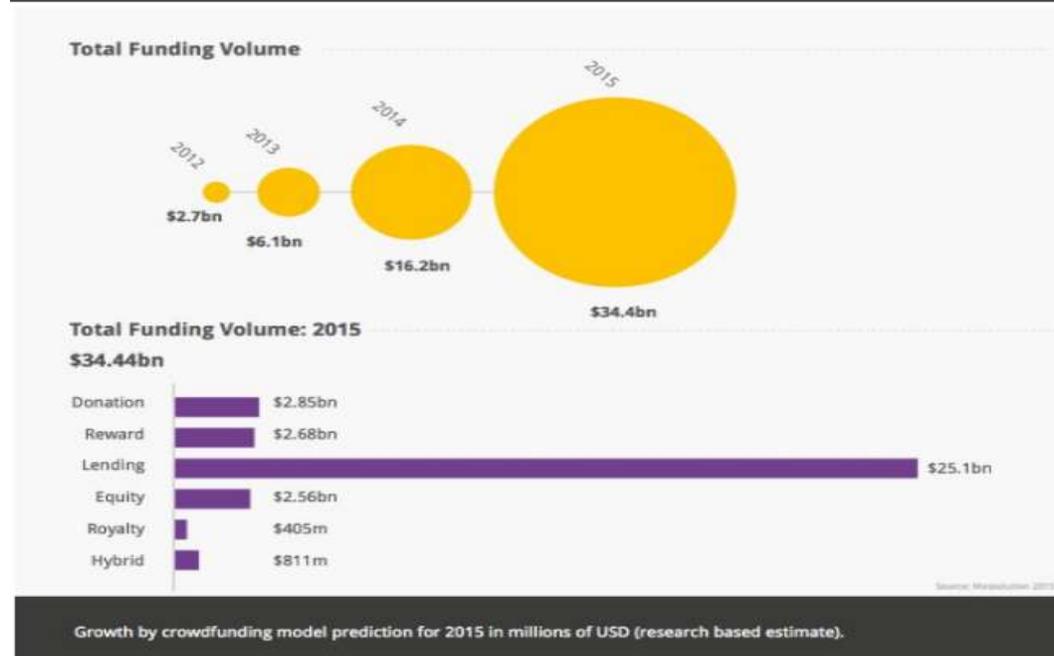
³² CrowdExpert.com, note 19.

³³ FundedByMe, "Successful Equity Crowdfunding Campaigns – A Nordic Review", prepared by Alina Lundquist and Michal Cromeck, June 2015, available at: <http://www.mynewsdesk.com/se/fundedbyme/pressreleases/nordic-secrets-of-successful-equity-crowdfunding-campaigns-a-report-1191399>.

billion globally in 2015.³⁴ This was more than double the US\$16.2 billion that was raised through crowdfunding only one year earlier in 2014 (itself more than double the US\$6.1 billion raised in 2013). Growth in crowdfunding in Asia has been particularly impressive, raising US\$3.4 billion in 2014: an increase of 320 percent from the previous year, and passing Europe as the second largest crowdfunding market in the world. The graphs below provide a visual illustration of the extent of crowdfunding around the world.



Growth by crowdfunding region prediction for 2015 in millions of USD (research based estimate)



Growth by crowdfunding model prediction for 2015 in millions of USD (research based estimate).

Source: Massolution/Crowdsourcing.org, 2015 Crowdfunding Industry Report

³⁴ See Erin Hobey, "Massolution Posts Research Findings: Crowdfunding Market Grows 167% in 2014, Crowdfunding Platforms Raise \$16.2 Billion", Crowdfund Insider (online), 31 March 2015, available at: <http://www.crowdfundinsider.com/2015/03/65302-massolution-posts-research-findings-crowdfunding-market-grows-167-in-2014-crowdfunding-platforms-raise-16-2-billion/>; Chance Barnett, "Trends Show Crowdfunding To Surpass VC In 2016", Forbes (online), 9 June 2015, available at: <http://www.forbes.com/sites/chancebarnett/2015/06/09/trends-show-crowdfunding-to-surpass-vc-in-2016/3/#adb85a6078f> (both citing: Massolution, "Crowdfunding Industry Report" (2015), Los Angeles: Massolution).

MSMEs have heavily relied on crowdfunding with US\$6.7 billion raised globally by these companies in 2014.³⁵ The World Bank, in its 2013 report on crowdfunding, *Crowdfunding's Potential for the Developing World*, notes that investors in developing countries could contribute approximately US\$96 billion per year in crowdfunding investments by 2025.

The Massolution Crowdfunding Report also sets out the importance of ECF on a global scale with projected raisings worth approximately US\$2.5 billion in 2015.³⁶ It is worth noting that the average amount raised for companies on an ECF platform such as SeedInvest was US\$500,000, compared to the average of US\$7,825 for the rewards crowdfunding platform, Kickstarter.³⁷ Therefore, although ECF may not currently be the largest source of crowdfunding revenue raising, it offers an important source of funding for MSMEs that may require larger amounts of funding than are commonly provided through other crowdfunding mechanisms.

B: Who Are the Key Actors Involved in ECF?

As previously noted, there are three key actors in the ECF process:

- (a) *issuers* who are looking to raise funds through the internet by selling shares;
- (b) *investors* (or the crowd) who wish to purchase shares; and
- (c) *intermediaries*, or as referred to in this report, ECF platform operators, who provide the facilities over which the shares are purchased and sold.

Each of these actors has different motivations for involvement in the ECF process and different levels of expertise with the process. These differences are important as they form the foundation for regulation that will be explored in Chapters 4 and 5. Before turning to these regulatory concerns however, we explore in greater detail the role of each of the three main actors in the process followed in Section C by a consideration of the benefits and risks associated with ECF.

(i) *Issuers*

An issuer in the context of ECF is a company (generally a MSME) that is seeking seed funding to initiate or grow its business enterprise. These companies may experience difficulties in obtaining funds through normal lending channels as they are just starting out and may not be able to prove that they can repay a loan. They may also struggle to obtain seed funding from the normal investment channels open to MSMEs including angel investors and venture capitalists. These investors may provide certain benefits (such as expertise), but they also may require too large a stake in the company or they may be reluctant to provide funds to unproven start-ups.

³⁵ See also, OECD, "Financing SMEs and Entrepreneurs 2016: An OECD Scoreboard", OECD Publishing, Paris, 2016, available at: <http://www.oecd.org/cfe/smes/financing-smes-and-entrepreneurs-23065265.htm>.

³⁶ See Anthony Zeoli, "Crowdfunding: A Look at 2015 & Beyond!" Crowdfund Insider (online), 31 December 2015, available at: <http://www.crowdfundinsider.com/2015/12/79574-crowdfunding-a-look-at-2015-beyond/> (citing Massolution, 'Crowdfunding Industry Report' (2015), Los Angeles: Massolution).

³⁷ SeedInvest, "Equity Crowdfunding by the Numbers", 2015, available at: <https://www.slideshare.net/seedinvest/equity-crowdfunding-by-the-numbers>.

Further, MSMEs are sometimes limited in their ability to raise funds through public offerings either because they are precluded under current securities regulations or because these regulations make it an unattractive option for a small start-up (i.e. onerous disclosure requirements). Even where ECF is an option, the small companies that are the intended beneficiaries of the process often have to learn how to deal with complex issues that they are unfamiliar with including how to deal with shareholders.

Despite such concerns, there are obvious benefits associated with greater access to funding as well as benefits associated with greater access to information provided through the process. Investors with information obtained through platforms are able to make more informed decisions, while issuers can obtain signals regarding interest in their proposed product from prospective investors. The increase in publicly available information may, however, raise concerns for companies that previously have sought funding through private channels to avoid release of information to the public at an early stage.

The analysis above illustrates that there are both benefits associated with ECF for issuers as well as some concerns. The growth of crowdfunding in Asia discussed in the previous section has raised the issue of regulation to enhance the benefits while minimizing the risks as much as possible. Regulatory considerations include disclosure requirements, caps on the amount of investment that issuers can obtain through the ECF process, and potential exemptions from current securities and other regulations.

(ii) The Crowd

The crowd refers to a group of investors who are seeking, in the case of ECF, an equity interest in a company in exchange for their investment. The investors that make up the crowd may be retail investors or industry investors. There is, for instance, evidence that angel investors and venture capitalists are beginning to realize the benefits available to them through the ECF process. Venture capitalists and angel investors can assess interest in a product or service through its success in raising funds through the ECF process. ECF platform operators are also able to cater to these more experienced investors by offering specific investment packages suited to their needs.

Retail investors, however, generally have less experience in making such investments, but may be willing to provide small amounts of capital as this reduces the risk of making large losses. The different classification of potential investors raises questions regarding whether different standards should be applied to each category of investor or, in some instances, whether retail investors should be permitted to invest through ECF at all.

Where retail investors can invest through ECF, mechanisms of differentiation, such as caps for investors not considered “sophisticated”, are common. Further, different disclosure requirements and information or education requirements may also be relevant in ensuring protection of those investors with less experience or with less assets to invest. Where ECF is made available, in addition to the potential financial returns available to investors, there are benefits associated with increased information disclosures as is the case with issuers.

(iii) ECF Platforms

ECF platforms are the intermediaries in the ECF process. They allow issuers to solicit funding, typically through an internet platform, and also allow the crowd to respond by purchasing shares in the issuers that are soliciting funds through the platform. Many jurisdictions impose significant obligations on ECF platform operators. This includes the requirement to obtain a licence, as well as ongoing obligations regarding due diligence and disclosure so as to ensure the appropriate use of the platform and the protection of those investors considered vulnerable.

ECF platform operators obtain the majority of their income by charging fees contingent on the total value of the funds raised through an offer. There is therefore considerable economic incentive for them to ensure that issuers using their platform are successful and honest, and that there is enough interest in the platform from investors to make raising funds through the platform worthwhile for successful issuers. As a result, among the major concerns for ECF platform operators is that companies that wish to issue shares through their platform meet certain due diligence requirements.³⁸ These business incentives are generally enhanced through regulatory requirements.

A number of ECF platform operators have recently started to service the ASEAN region. In Malaysia, six ECF platform operators have been registered as market operators for ECF.³⁹ One of these ECF platform operators, CrowdPlus.Asia, has taken advantage of Malaysia's early adoption of regulation for ECF to market their brand across Malaysia, Thailand, and Viet Nam (within ASEAN), as well as in China and Hong Kong.

ECF can be expected to continue growing in the ASEAN region as regulation is put in place to encourage this form of investment, and as industry actors and the community more generally become familiar with the process. Although these efforts are growing, ECF in Asia and much of the rest of the developing world is still in the early stages, with most of the activity in ECF coming from the developed world.⁴⁰ Despite this, there have been encouraging signs of the increased acceptance of the practice in developing regions, including in Asia. In South Asia, between 2006 and 2010, one crowdfunding platform was launched each year, but several crowdfunding platforms were launched in 2011 alone. A number of these have been focused on entrepreneurial endeavours that are the basis of ECF.⁴¹

C: What are the Key Benefits and Risks Associated with ECF?

Some of the benefits and the risks associated with ECF have already been mentioned in Section B when outlining the role of each actor involved in the process. Owing to the very recent introduction of ECF however, particularly in the developing world, it is difficult to set out with precision the benefits and the risks that ECF presents. The commentary exploring ECF has

³⁸ Nyshka Chandran, "Equity Crowdfunding Gains Traction in Asia", CNBC (online), 9 November 2015, available at: <http://www.cnbc.com/2015/11/09/equity-crowdfunding-gains-traction-in-asia.html>.

³⁹ Securities Commission Malaysia, "List of Registered Market Operators for ECF", available at: <https://www.sc.com.my/digital/equity-crowdfunding/list-of-registered-market-operators-for-ecf/>.

⁴⁰ Chandran, note 38.

⁴¹ infoDev, "Crowdfunding's Potential for the Developing World", Finance and Private Sector Development Department, Washington, DC: World Bank, 2013, available at: https://www.infodev.org/infodev-files/wb_crowdfundingreport-v12.pdf.

mentioned several of these benefits and risks, but it remains to be seen how these will play out in practice. In the meantime however, ECF regulation in many jurisdictions continues to be constructed in a flexible manner. The discussion below considers some of the current thinking regarding the benefits and risks that have to date informed ECF regulation.⁴²

(i) The Benefits

There has generally been very strong support for the introduction of regulation to facilitate ECF. This support has generally relied on the economic benefits that arise through the expansion of sources of finance for business. A number of specific benefits have been put forward in support of ECF including the following:

(1) Bridging the Funding Gap

This benefit has already been discussed at length in Chapter 2 of this report, but is worth repeating as perhaps the most significant justification for ECF. The ECF process is just one important aspect of a broader agenda to encourage growth and innovation in the small business sector and is often accompanied by tax incentives. To put it simply, the goal is to reduce the burden that MSMEs often encounter in getting their business started and in growing the business. This includes a reduction in burdens associated with funding enterprises.

MSMEs that are able to obtain seed funding will be able to use this to build their business and leverage their success to obtain funding from other sources and to grow. These small businesses have to date often been able to use ECF to raise anywhere between US\$500,000 (sometimes less) and US\$1 million.⁴³ This in turn produces economy-wide benefits in terms of growth and employment.

A number of issuers have already successfully raised funds in ASEAN through the ECF process. For instance, several issuers have raised funds over the Malaysian registered ECF platform, PitchIN. Three of these are Tripviss Technology, Running Man Delivery, and Kakitangan.com. The most successful of these was Kakitangan.com, a human resources company which raised over RM1.5 million despite having a funding goal of only RM203,208. Just one investor provided more funds, RM299,520, than the original funding goal. The company offered 15.87 percent of its shares through the process, which went to 63 investors.⁴⁴ PitchIN provides a page for its ECF issuers, including Kakintangan.com:

⁴² A number of resources have been useful in determining the perceived benefits and risks associated with ECF. This includes the Australian Corporations and Markets Advisory Committee, "Crowd Sourced Equity Funding: Report" (CAMAC Report), May 2014, 14, available at:

<http://www.camac.gov.au/camac/camac.nsf/0/3dd84175efbad69cca256b6c007fd4e8.html>; European Commission, note 26; Kirby and Worner, note 18.

⁴³ infoDev, note 41 at 14.

⁴⁴ PitchIn, "Successful Offers" (Kakitangan.com), available at:

<https://www.equity.pitchin.my/businesses/kakitangancom#fndtn-panel-business-info>.

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RM203,280 (2.66% Equity)
Minimum Funding Target

15.87%
Total Equity Offered

RM1,551,174
Total Target Amount

63
Number of Investors

RM299,520
Largest Investment

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(2) Intermediation for the 21st Century

One of the primary functions of the financial sector is to provide intermediation services. This allows funds to be channelled most efficiently within the economy as intermediaries are able to match savers/investors with those seeking funding. ECF builds upon this traditional role of intermediaries by using the internet to find investors for those seeking funding. The "crowd" consists of retail investors who may have been previously locked out of the market for start-ups but importantly also provides a way for more sophisticated investors, such as venture capitalists and angel investors, to determine how to best allocate their funds.

ECF platform operators devise mechanisms to encourage sophisticated investors to provide funding to start-ups through the ECF process. For instance, CrowdPlus.asia has created a category of "Qualified Matching Investors" (QMIs).⁴⁵ QMIs are successful entrepreneurs (people who either hold a management position in a company or have an entrepreneurship track record and experience) who mentor start-ups and fledgling businesses. QMIs benefit from the program by

⁴⁵ CrowdPlus.asia, "Qualified Matching Investors" available at: <https://www.crowdplus.asia/qmis.php>.

receiving a first right to view companies that have qualified to use the ECF platform before they are listed on the platform and are given the option to subscribe for shares of the issuer.

ECF platform operators therefore play an important role in matching start-ups with angel investors and venture capitalists using the power of the internet. Where these investors may have previously been reluctant to invest in small businesses for which there was little evidence of potential success, ECF acts as a source of information disclosure that facilitates investment online. Where investment through these sources used to take anywhere up to 12 months or in some cases longer, investment through ECF can take weeks, days, or in some cases even hours. The standardization of terms and conditions further reduces the time taken to reach agreement.

(3) Funding Efficiencies

Depending on the regulation introduced to oversee ECF, there are several efficiencies that ECF offers in the funding process. Where jurisdictions allow platforms to pool the funds raised through ECF into a single investment, start-ups have the option of having one point of contact in terms of reporting to shareholders. This is a particularly attractive feature for MSMEs that are disinclined to issue shares to many investors because of the administrative burdens associated with investor management.

ECF may also offer advantages in terms of competition within the financial sector that drive efficiencies. Established financial institutions may be encouraged as a result of the extra competition offered by the ECF sector to lower the cost of lending in an attempt to remain competitive in the MSME lending market.

(4) A Useful Source of Information

ECF offers several benefits outside of the direct financial benefits discussed above. One such benefit may fall under the heading of "information". Where MSMEs attempting to develop an innovative product or service may have previously struggled to prove the potential demand or utility of their product or service, gauging interest through an ECF issue may fill this gap. This in turn may assist in attracting investment from sophisticated investors who may previously have been reluctant to expend funds on untested products or services.

ECF may also provide information to entrepreneurs on the efforts that they should expend on a particular product or service. A lack of interest in such a product or service at the ECF stage may act as an indication that there is little value in continuing with a project. If, however, a product or service is successful, ECF may act as a useful marketing tool.

(ii) The Risks

While much of the commentary has focused on the prospective benefits of ECF, there has been a general consensus that regulation is important so as to address a number of risks associated with ECF. The discussion below outlines a number of these risks that have been important in determining the regulatory framework introduced to promote ECF.

(1) Investor Vulnerability

Just as bridging the funding gap is the reason most often cited in support of promoting ECF, investor vulnerability is the most often cited risk associated with ECF and the reason provided for enacting restrictions that safeguard investors. These concerns relate primarily to investments made by “unsophisticated” retail investors, generally referring to those who have either little knowledge in financial investments, those who have few resources to expend in investments, or a combination of both. Concerns regarding vulnerable retail investors that regulation seeks to address include:

- the temptation to invest without understanding the risks associated because of the small amounts generally involved;
- reliance on personal biases as a reason to invest, as opposed to financial experience; and
- the contribution of such biases towards herd behaviour that leads to sub-optimal outcomes⁴⁶ (this herd behaviour is in turn exacerbated through social network aspects of ECF with retail investors potentially making investment decisions because others have invested in a product or service⁴⁷).

Regulation addresses these risks through disclosure and education requirements as well as investment caps.

These risks are magnified by the generally illiquid nature of shares purchased through ECF, as they generally cannot be sold through a secondary market, and the potential for dilution of shares as enterprises grow and continue to issue additional shares to fund ongoing operations. Where investors lose part of their capital or do not receive the benefits they expected, unlike with listed companies, there is little they can do. With many MSMEs failing,⁴⁸ insolvency of issuers is a significant concern as investors will not realize the benefits associated with their investment.

This concern has been evident in the United Kingdom. For instance, at the beginning of 2016, Rebus, an issuer that had raised over GBP800,000 through the ECF platform, Crowdcube, went into bankruptcy administration, becoming the largest failure of a U.K. crowdfund company.⁴⁹ More than 100 investors, each of which invested between GBP5,000 and GBP135,000 are likely to lose the investment they had made eight months before the company collapsed.⁵⁰ Rebus’ ECF funding offer noted that the company projected that pre-tax profits would rise from a pre-tax loss of GBP1.4

⁴⁶ Ajay Agrawal et al., “Are Syndicates the Killer App of Equity Crowdfunding”, Feb 2015, available on SSRN.com at: https://papers.ssrn.com/sol3/Papers.cfm?abstract_id=2569988. See also Thomas A. Martin, “The Jobs Act of 2012: Balancing Fundamental Securities Law Principles with the Demands of the Crowd”, April 2012, available at SSRN.com at: https://papers.ssrn.com/sol3/Papers.cfm?abstract_id=2040953.

⁴⁷ Kirby and Worner, note 18 at 30.

⁴⁸ There is not a great deal of consistency among reports regarding the rate of failure for SMEs. However, it is generally accepted that the failure rate is very high and, as a result, there is a high expectation of loss of investment. This is the generally accepted view of the U.K. securities and market conduct regulator, the Financial Conduct Authority (see Financial Conduct Authority, “A Review of the Regulatory Regime for Crowdfunding and the Promotion of Non-readily Realisable Securities by Other Media”, FCA Review Document, February 2015, available at: <https://www.fca.org.uk/publication/thematic-reviews/crowdfunding-review.pdf>).

⁴⁹ Adam Palin and Aime Williams, “Rebus Becomes Largest Crowdfunded Failure”, Financial Times, 4 February 2016, available at: <https://www.ft.com/content/804d41c2-ca6d-11e5-be0b-b7ece4e953a0>.

⁵⁰ Ibid.

million in 2015 to a pre-tax profit of GBP12 million by 2017-2018.⁵¹ Rebus also stated that investors could expect to make between 6.4 and 10.6 times their investment by 2018.

(2) Loss of Privacy and Control

One of the benefits of ECF is the provision of information that may provide for more informed investment decisions. However, this may be considered a drawback for those MSMEs that have maintained their "private" status (i.e. they have not raised funds through share markets) because they want to maintain the private nature of their enterprise. In addition to the administrative burden that arises with information disclosure, there is a potential for these disclosures to place at risk the intellectual property protection of business ideas, with competitors able to access information regarding an idea that may not previously have been available. Start-ups that rely on this privacy for the success of their business may therefore be deterred from relying on ECF.

Founders of start-ups may also be concerned that the issue of shares may reduce their control over the direction of the company. For those entrepreneurs who wish to control the company, other sources of crowdfunding may offer a more attractive mechanism for funding, although the large number of shareholders investing in the ECF offer or offering a small percentage of the total number of shares of the company for an ECF offering may dilute or limit the influence of shareholders overall and this may prove enough of a protection for an entrepreneur.

(3) Diversion of Funding

While ECF may offer a useful mechanism to determine which businesses to fund, there is the possibility that in some cases ECF may divert funds from worthwhile businesses and lead instead to the allocation of funds to companies that fail or are not the best companies to invest in. This would prove both detrimental to individual investors who lose out on making better investment decisions as well as leading to increased opportunity costs at a broader level, threatening the potential economic benefits that are supposed to accompany ECF.

(4) Information Related Concerns and Other Concerns

There are also concerns regarding the possible provision of insufficient information that would allow investors to correctly price the shares invested in, or misinformation, both at the pre-investment phase and over the lifetime of the investment.

Further, as with any online activity, there are concerns regarding information privacy. The online operating mechanism raises concerns regarding cyberattacks and platform failures that put at risk the information of investors as well as their investment. Other concerns regarding possible fraudulent use of platforms have been mentioned in some publications discussing ECF.

⁵¹ Ibid.

Chapter 4: ECF Regulation in Key Jurisdictions

This chapter provides an analysis of ECF regulation in four jurisdictions: Malaysia, Thailand, the United Kingdom, and Australia. The chapter considers the regulatory environment in which ECF regulation was introduced for each jurisdiction and the regulation of each of the three main actors: ECF platform operators, issuers, and investors for each. As far as is possible, the review of each jurisdiction considers similar issues to enable comparison in Chapter 5. In order to provide additional information to readers of this report, the authors have also included in this chapter brief discussion of some other developments in ECF regulation in the United States, New Zealand, Canada, China, Hong Kong, and Singapore.

A: Malaysia

(i) *Background to Securities and ECF Regulation*

The Malaysian financial system is regulated predominantly by Securities Commission Malaysia (SC Malaysia) and the Bank Negara Malaysia (Malaysia's central bank). Pursuant to the *Securities Commission Malaysia Act 1993*, SC Malaysia has regulatory authority over Malaysia's capital markets, including oversight of the equity capital markets. Most of the rules regarding capital markets in Malaysia are contained in legislative instruments, including, most relevantly for the purposes of ECF, the *Capital Markets and Services Act 2007* (CMSA). SC Malaysia has authority under the CMSA to make binding regulations and issue guidelines and practice notes on products and services (sections 377 and 378). The legislative instruments have been supplemented with secondary legislation in areas of SC Malaysia's authority, including ECF.⁵²

The issue of shares in listed markets in Malaysia is generally carried out through the Bursa Malaysia Securities exchange, a subsidiary of the Bursa Malaysia Berhad (a holding company authorized under the CMSA) operating under authorization granted by the relevant Minister. Two equity markets exist under this regime; the Main Market (for established companies with a profit track record of three to five full financial years or companies with a sizeable business) and the ACE Market (an alternative, sponsor-driven market designed for companies of all business sectors that have good growth potential but insufficient history to qualify for the Main Market).

In their 2013 Financial Sector Stability Assessment report, the International Monetary Fund (IMF) and the World Bank noted that Malaysia, both by regional standards and in comparison to other emerging markets, had a large listed equity market. The ratio of market capitalization relative to GDP was higher than most other high-income countries or other countries in Asia.⁵³ In 2015, the market capitalization of listed domestic companies in Malaysia was US\$382.977 billion with 892

⁵² International Monetary Fund, "Malaysia: Publication of Financial Sector Assessment Program Documentation — Detailed Assessment of Implementation of IOSCO Objectives and Principles of Securities Regulation", IMF Country Report No. 13/59, March 2013, available at: <https://www.imf.org/en/Publications/CR/Issues/2016/12/31/Malaysia-Publication-of-Financial-Sector-Assessment-Program-Detailed-40376>.

⁵³ International Monetary Fund, "Malaysia: Financial Sector Stability Assessment", Country Report No. 13/52, February 2013, available at: <https://www.imf.org/external/pubs/ft/scr/2013/cr1352.pdf>.

listed domestic companies.⁵⁴ This is a significant increase from 1981 when market capitalization of listed domestic companies was approximately US\$15.30 billion from 181 companies.⁵⁵

Malaysia was the first ASEAN country to enact regulations with the specific aim of facilitating ECF. The ECF regime operates within the broad confines of equities regulation set out above, but also has regulations that are specific to ECF. SC Malaysia set out its proposed regulatory framework for ECF in a consultation paper published on 21 August 2014: *Public Consultation Paper: No. 2/2014 Proposed Regulatory Framework for Equity Crowdfunding* (SC Malaysia Consultation Paper). The SC Malaysia Consultation Paper emphasised the potential for crowdfunding to facilitate innovation, productivity and growth by encouraging the creative potential of SMEs. In particular, the SC Malaysia Consultation Paper noted that ECF could assist SMEs to bridge the funding gap that exists in Malaysia, which acts as a barrier to their success. The SC Malaysia Consultation Paper also pointed to the potential for increased competition among suppliers of capital that could lower the cost of capital for all issuers. There were 20 responses to the SC Malaysia Consultation Paper, with most respondents generally agreeing with the approach to ECF set out in the SC Malaysia Consultation Paper. These responses and the approach of SC Malaysia to ECF are set out in a public response paper: *Public Response Paper No. 2/2014: Proposed Regulatory Framework for Equity Crowdfunding* (SC Malaysia Public Response Paper).

The ECF consultation process resulted in the amendment of the CMSA through the *Capital Market Services Act (2015)* in May 2015. This permitted SC Malaysia to publish guidelines for the operation of ECF (among other things). SC Malaysia issued the *Guidelines on Recognized Markets* (SC-GL/6-2015 (R1-2016)) (Guidelines)⁵⁶ pursuant to section 377 of the CMSA (read together with subdivision 4, division 2 of Part II CMSA), to set out the operation of ECF; since then, it has approved six platforms to operate in Malaysia.⁵⁷ As of 30 April 2017:⁵⁸

- there have been 25 ECF issuers;
- 21 of these issues have been successful, with three ongoing;
- a total of RM14 million has been raised by these issuers;
- the smallest amount of funds raised per issuer is RM130,000 and the largest is RM2.6 million, with the median being RM327,000;
- the highest number of investors for an ECF issuer is 131; and

⁵⁴ World Bank, "Data: Market Capitalization of Listed Domestic Companies: Malaysia", available at: <http://data.worldbank.org/indicator/CM.MKT.LCAP.GD.ZS?locations=MY>.

⁵⁵ Ibid.

⁵⁶ This replaced the Guidelines on Regulation of Markets under section 34 of CMSA.

⁵⁷ The list of "Registered Market Operators" for ECF is provided on the SC Malaysia website: <https://www.sc.com.my/digital/equity-crowdfunding/>.

⁵⁸ The following data is drawn from by B Chung, "Equity crowdfunding in Malaysia", presentation at the roundtable meeting on promoting and facilitating equity crowdfunding in ASEAN, 11-12 May 2017, Kuala Lumpur, Malaysia.

- the industries of successful ECF issuers include education (four issuers), retail (three issuers), digital human resources (two issuers), and e-commerce (two issuers).

This is a significant increase over the 11 Malaysian ECF issuers that had raised a total of RM8 million via these platforms as of November 2016.⁵⁹ CrowdPlus.asia aims to use the advantage provided by Malaysia's early adoption of ECF regulations to have a footprint in other markets when they also regulate ECF.⁶⁰ The remainder of this section explores the regulation of ECF in Malaysia as it relates to the key actors in the process.

(ii) ECF Platforms

At the broadest level, the Guidelines set out two requirements for the regulation of ECF platform operators. The first relates to registration of an ECF platform operator, and the second deals with their ongoing regulation once registered. The Guidelines set out the requirements regarding the registration of recognized market operators (RMOs).⁶¹ This includes, in accordance with paragraph 12.01, those who operate an ECF platform.⁶² The criteria for registration are set out in paragraph 3.01 of the Guidelines and provide that registration will be granted where SC Malaysia is satisfied of certain matters, including:

- (a) the applicant will be able to operate an orderly, fair and transparent market ... through its electronic facilities;
- (b) the applicant's board, chief executive, controller, and any person who is primarily responsible for the operations or financial management of the body corporate are fit and proper;
- (c) the applicant will be able to manage risks associated with its business and operation including demonstrating the processes and contingency arrangement in the event the applicant is unable to carry out its operations;
- (d) the applicant will appoint at least one responsible person as required under Chapter 4 of the Guidelines;
- (e) the applicant will be able to take appropriate action against a person in breach including directing the person in breach to take any necessary remedial measure;

⁵⁹ Securities Commission Malaysia, "SC Announces Six Peer-to-Peer Financing Operators", Press Release, 3 November 2016, available at: https://www.sc.com.my/post_archive/sc-announces-six-peer-to-peer-financing-operators/.

⁶⁰ Liz Lee, "Malaysia: CrowdPlus Launches ASEAN's First Equity Crowdfunding Platform", Deal Street Asia (online), 15 November 2015, available at: <http://www.dealstreetasia.com/stories/malaysia-launches-as-first-asean-ecf-platform-crowdplus-asia-19605/>.

⁶¹ An RMO must be a body corporate or a limited liability partnership. An application to operate an RMO is considered an application to operate an electronic exchange in accordance with the CMSA.

⁶² Securities Commission Malaysia, "Guidelines on Recognized Markets SC-GL/6-2015 (R1-2016)", available at: <https://www.sc.com.my/legislation-guidelines/recognizedmarkets/>.

- (f) the rules of the recognized market make satisfactory provisions–
- (i) for the protection of investors and public interest;
 - (ii) to ensure proper functioning of the market;
 - (iii) to promote fairness and transparency;
 - (iv) to manage any conflict of interest that may arise;
 - (v) to promote fair treatment of its users or any person who subscribes for its services;
 - (vi) to promote fair treatment of any person who is hosted, or applies to be hosted, on its platform;
 - (vii) to ensure proper regulation and supervision of its users, or any person utilising or accessing its platform, including suspension and expulsion of such persons; and
 - (viii) to provide an avenue of appeal against the decision of the RMO; and
- (g) the applicant has sufficient financial, human, and other resources for the operation of the recognized market, at all times.

While paragraphs 3.02 and 3.03 permit registration of foreign operators, paragraph 12.04 requires that all operators of an ECF platform be locally incorporated. Further, ECF platform operators are not permitted to provide regulated activities that would require them to hold a Capital Markets Services Licence under section 58 of the CMSA. The combined effect of section 58(2) and Schedule 3 of the CMSA is that an RMO (which includes an ECF platform operator) does not have to hold a license under section 58 where any regulated activities (which would include securities dealing and provision of investment advice) are incidental to its offering the registered market.

Second, the Guidelines establish ongoing requirements that are applicable to RMOs. Chapter 12 of the Guidelines sets out requirements that relate specifically to ECF in Malaysia, although the Guidelines in their entirety apply to ECF, unless otherwise stated in Chapter 12.

Every operator of an ECF platform must comply with the following obligations set out in paragraph 12.05:

- (a) carry out a due diligence exercise on prospective issuers planning to use its platform. [Paragraph 12.06 sets out the requirements of this due diligence as follows: (i) conduct background checks on the issuer to ensure they, their board of directors, senior management and controlling owner are fit and proper; and (ii) verify the business proposition of the issuer];
- (b) monitor and ensure compliance of its rules;
- (c) carry out programs for investor education;

- (d) ensure the issuer's disclosure document lodged with the ECF operator is verified for accuracy and made accessible to investors through the platform;
- (e) inform investors of any material adverse change to the issuer's proposal [defined in paragraph 12.10 as follows:⁶³ (i) the discovery of a false or misleading statement in the disclosure document in relation to the offer; (ii) the discovery of a material omission of information required to be included in the disclosure document; or (iii) there is a material change or development in the circumstances relating to the offering or the issuer];
- (f) ensure that the fundraising limits imposed on the issuer [set out in paragraph 12.21] are not breached;
- (g) ensure that the investment limits imposed on the investors [set out in paragraph 12.26] are not breached;
- (h) obtain and retain self-declared risk acknowledgement forms from investors prior to them investing on an ECF platform; and
- (i) have in place processes to monitor anti-money laundering requirements.

Each ECF platform operator must, in accordance with paragraph 12.12, establish a framework with policies and procedures that set out how it will efficiently and effectively manage conflicts of interest. Malaysia does not preclude ECF platform operators or their directors and shareholders from investing in issuers. However, if an ECF platform operator does invest in an issuer, it must, in accordance with paragraph 12.13, disclose the following:

- (a) if it holds any shares in any of the issuers hosted on its platform; or
- (b) if it pays any referrer or introducer, or receives payment in whatever form, including payment in the form of shares, in connection with an issuer hosted on its platform.

Where an ECF platform operator holds shares of an issuer hosted on its platform, it may only hold up to 30 percent of the shares of the issuer. Further, ECF platform operators are not permitted to provide financial assistance to investors investing in an issuer hosted by the ECF platform operator.

ECF platform operators must also display prominently on their platform information regarding ECF including:

- (a) information relating to issuers [as specified under paragraph 12.23];
- (b) investor education materials and an appropriate risk disclosure;
- (c) information on how the platform facilitates the investor's investment including providing communication channels to permit discussions about issuers hosted on its platform;
- (d) a general risk warning regarding participation in ECF;

⁶³ The obligation to maintain a trust fund and to operate it in a manner that ensures the safety of money invested is contained in Rules 12-07-12.10.

- (e) information on the rights of investors relating to participation in ECF;
- (f) information about the complaints handling or dispute resolution process and its procedures;⁶⁴
- (g) fees, charges and other expenses that the ECF platform operator may charge to or impose on an issuer or investor; and
- (h) information on processes and contingency arrangements in the event the ECF operator is unable to carry out its operations or ceases its business.

Any disclosures made by the prospective issuer must be accurate and must not contain false or misleading statements. Where an ECF platform operator does disclose information that contains false or misleading statements, section 92A(2) of the CMSA provides that they may be liable to a fine not exceeding RM3 million or to imprisonment for a term not exceeding 10 years, or both.

Finally, the Guidelines set out rules regarding the handling by the ECF platform operator of trust funds. Paragraph 12.09 provides that an ECF platform operator must establish and maintain in a licensed institution one or more trust accounts designated for the funds raised by an issuer hosted on its ECF platform. This trust money may only be released by an ECF platform operator to the issuer once a pre-set targeted amount has been reached, when there is no material adverse change made to the offer during the relevant offer period, and when a cooling-off period of six days has expired.

(iii) Issuers

Malaysia imposes several restrictions on the type of company that may raise funds by issuing common shares (ordinary and preference shares) through ECF and how they may use the system. In accordance with paragraph 12.16, the ECF regime in Malaysia is restricted to locally incorporated, private limited companies (excluding certain exempt private companies). Private limited companies must restrict the transfer of their shares, can only have up to 50 non-employee shareholders, and cannot invite the public to subscribe for any shares in the company unless it is an ECF offering.⁶⁵ Companies wanting to use ECF can have more than 50 non-employee shareholders by using a nominee structure for their shareholders.

Commercially or financially complex structures, publicly listed companies that are subsidiaries, companies with no specific business plan or with a business plan to merge or acquire an unidentified entity, companies (other than microfunds)⁶⁶ that propose to use the funds raised through ECF to provide loans or invest in other entities, companies (other than microfunds) with paid up share capital exceeding RM5 million, and any other entity that SC Malaysia specifies are

⁶⁴ This requirement satisfies the provision in section 379 of the CMSA regarding the ability of the regulator to make provision for the settlement of disputes. In the SC Malaysia Consultation Paper and the SC Malaysia Public Response Paper, SC Malaysia was of the view that ECF platform operators must provide an internal dispute resolution mechanism.

⁶⁵ *Companies Act 2016*, section 43.

⁶⁶ The requirements that microfunds must meet to participate in the ECF system are set out in Rule 12.20.

expressly precluded from raising funds through ECF, in accordance with paragraph 12.17. Companies that are permitted to raise funds through ECF are limited to using one ECF platform at a time.

In addition to these restrictions, paragraph 12.21 sets out limits on the amount that may be raised by an issuer through ECF as follows:

- (a) an issuer can only raise up to RM3 million within a 12-month period, irrespective of the number of projects an issuer may seek funding for during the 12-month period; and
- (b) an issuer can only utilize the ECF platform to raise a maximum amount of RM5 million in total, excluding the issuer's own capital contribution or any funding obtained through private sources.

The Guidelines do not preclude oversubscriptions, and both the SC Malaysia Consultation Paper and the SC Malaysia Public Response Paper envisage that issuers can accept funds in excess of original funding targets.

Issuers must also comply with a number of disclosure requirements. Before an issuer may be hosted on an ECF platform, they must provide the ECF platform operator with the following information (at a minimum):

- (a) information that explains the key characteristics of the company;
- (b) information that explains the purpose for raising the funds and the amount that the issuer seeks to raise;
- (c) information relating to the company's business plan; and
- (d) financial information relating to the company, that includes:
 - (i) for offerings below RM500,000:
 - (A) audited financial statements where applicable (e.g. where the issuer has been established for at least 12 months); and
 - (B) where audited financial statements are unavailable (e.g., the issuer is newly established), certified financial statements or information by the issuer's management; and
 - (ii) for offerings above RM500,000: audited financial statements of the company.

Both the SC Malaysia Consultation Paper and the SC Malaysia Public Response Paper suggested that the regime would include restrictions that prohibited advertisement other than reference to the disclosure document. The SC Malaysia Public Response Paper provided that an issuer would be prohibited from promoting its offering to the public except through the ECF platform. In this context, any notice used by the issuer as a form of advertising its offerings should always be

redirected to the standardised disclosure document that has been lodged with the ECF operator and is made available on the platform.

Further, the SC Malaysia Public Response Paper notes that where an issuer does advertise an offering, the advertisement must not contain advice that may trigger the requirement to obtain a Capital Markets Services License under section 58 of the CMSA. This license is required in Malaysia to provide services regarding, among other things, securities dealings, investment advice, and financial planning.

(iv) Investors

Many of the regulations that are imposed on ECF platform operators and on issuers have as their aim the protection of investors. For instance, requirements regarding disclosure and conflicts of interest are imposed on ECF platform operators and issuers for the benefit of investors. However, the Malaysian ECF regulatory framework also includes important limits in paragraph 12.26 on the amount that both domestic and foreign investors can invest through ECF as a measure to protect particular groups of investors. The restrictions placed on different groups of investors are set out as follows:

- (a) sophisticated investors:⁶⁷ no restrictions on investment amount;
- (b) angel investors:⁶⁸ a maximum of RM500,000 within a 12-month period; and
- (c) retail investors: A maximum of RM5,000 per issuer with a total amount of not more than RM50,000 within a 12-month period.

Sophisticated investors include, in accordance with Schedule 6 of the CMSA, high net worth individuals as follows:

- (a) individuals whose total net personal assets, or total net joint assets with his or her spouse, exceed RM3 million or its equivalent in foreign currencies, excluding the value of the individual's primary residence;
- (b) individuals who have a gross annual income exceeding RM300,000 or its equivalent in foreign currencies per annum in the preceding 12 months; or
- (c) individuals who, together with his or her spouse, have a gross annual income exceeding RM400,000 or its equivalent in foreign currencies per annum in the preceding 12 months.

Further, paragraph 3.01(e) requires that a prospective ECF platform operator be able to direct a person in breach of ECF rules to take any necessary remedial action.

⁶⁷ Paragraph 1.17 defines a sophisticated investor as follows:

...any person who falls within any of the categories of investors set out in Part 1, Schedule 6 and 7 of the CMSA and includes a Venture Capital corporation, Venture Capital Management Corporation, Private Equity Corporation and Private Equity Management Corporation registered with SC Malaysia.

⁶⁸ An angel investor is defined in paragraph 12.01 as an investor accredited by the Malaysian Business Angels Network as an angel investor.

B: Thailand

(i) Background to Securities and ECF Regulation

Thailand's securities regime is overseen by the Securities and Exchange Commission (TSEC). The majority of TSEC's regulatory authority in relation to securities is provided through the *Securities and Exchange Act B.E. 2535 (1992)* (SEA).⁶⁹ Sections 14–16 of the SEA provide TSEC's board and the Capital Markets Supervisory Board, respectively, with authority to issue orders, rules, regulations, notifications, and directions under the SEA. The issue of securities through public offerings requires approval from TSEC. This approval is contingent on a prospective issuer complying with various requirements relating to the issuer's qualifications as well as disclosure and corporate governance requirements as set out in the SEA and the relevant notifications. A secondary market for share trading is operated by the Stock Exchange of Thailand (SET). This secondary market is reserved predominantly for large companies, although the SET runs a market for smaller companies; the Market for Alternative Investment (MAI).⁷⁰

While Thailand's equity market has increased significantly since the Asian financial crisis (from 24 percent of GDP in 1997 to 97 percent of GDP at the end of 2012),⁷¹ the lack of a capital market for promoting entrepreneurial start-ups and technological innovators has been identified as a key limitation in the system.⁷² Thailand has sought to address this problem through the creation of a regulatory regime catering specifically to ECF. The ECF regulatory framework has been set out by the Capital Markets Supervisory Board, predominantly in two regulations that have been in effect since 16 May 2015: (1) *Notification of the Capital Market Supervisory Board (No. TorJor. 7/2558, Re: Regulations on Offer for Sale of Securities through Electronic System or Network* (ECF Notification); and (2) *Notification of the Securities and Exchange Commission (No. KorJor. 3/2558 Re: Exemption from Filing of Registration Statement for Securities Offered through Provider of Electronic System or Network*) (Exemption Notification).⁷³

Despite having issued these notifications, no prospective ECF platform operator has to date become an approved ECF crowdfunding portal in Thailand. The key obstacle was that the ECF Notification in its original form only allowed escrow agents to hold investors' subscription funds and there was insufficient interest by escrow agents in participating in ECF. TSEC amended the ECF Notification in 2016 to address this issue by also allowing the following entities to perform this role: (1) intermediaries (securities or derivative business operators) that are able to perform asset keeping functions; and (2) reliable parties under the supervision of a lead regulator (i.e. the Bank of

⁶⁹ Other important legislative instruments confer authority on TSEC, including: the *Derivatives Act B.E. 2546 (2003)*, the *Provident Fund Act B.E. 2530 (1987)*, the *Trust for Transactions in Capital Market Act B.E. 2550 (2007)*, and the *Royal Enactment on Special Purpose Juristic Persons for Securitisation B.E. 2540 (1997)*.

⁷⁰ The paid up capital of companies listed on the SET and the MAI must not be less than 300 million Baht and 50 million Baht respectively.

⁷¹ Asian Development Bank, "Country Partnership Strategy: Thailand 2013–2016, Sector Assessment (Summary): Finance" October 2013, available at: <https://www.adb.org/documents/thailand-country-partnership-strategy-2013-2016>.

⁷² Ibid.

⁷³ A third notification sets out some criteria regarding offers of shares in general that apply to share offers through ECF. TorChor. 8/2558 regarding rules, conditions, and procedures for offering for sale of shares by shareholders of limited companies provides further information.

Thailand) which have a secured financial condition and approval from TSEC. According to information provided by TSEC, discussions are ongoing with prospective ECF platform operators, potential entities to perform the role of holding investors' subscription funds and regulators, and promising developments for ECF in Thailand are expected.

The explanation of the ECF regime set out below is taken predominantly from the English translation of the ECF Notification provided on TSEC's website, supplemented by information provided by TSEC.

(ii) ECF platforms

The ECF Notification sets out the requirements for registration of an ECF platform (Chapter 3) and the ongoing conduct of an ECF platform (Chapter 4). Clauses 12 and 13 of Chapter 3 provide that a prospective operator of an ECF platform must:

- (a) file an application with TSEC in the prescribed form and pay the relevant application fee;
- (b) be incorporated under Thai law;
- (c) have paid up registered capital of not less than 5 million Baht;
- (d) illustrate that there are not reasonable grounds to believe that they are experiencing financial difficulties or that there is any other deficiency that would make them unsuitable as an operator of an ECF platform;
- (e) consist of directors and managers who are not prohibited from taking part in the operation of a capital market business;⁷⁴
- (f) demonstrate that they have put in place the systems necessary to operate the platform in accordance with certain requirements set out in the ECF Notification; and
- (g) where the prospective operator operates another business, demonstrate that this business is related, beneficial, or supportive of the ECF business, and ensure there is no conflict of interest involved in operating that other business and operating the ECF platform.

Clauses 15 to 17 set out the approval process for TSEC and specify that approval of an ECF platform will not exceed 5 years from the date that notice of approval was provided to the applicant. However, the approval is renewable with the filing of a new application.

Chapter 4 of the ECF Notification provides rules regarding the ongoing supervision by TSEC of ECF platform operators. The Thai regime places an onus on ECF platform operators to ensure the protection of investors. Part 1 of Chapter 4 sets out expected conduct of ECF platform operators. This includes a general requirement that ECF platform operators, among other things, act honestly, with due diligence and in absence of conflicts of interest, when carrying out their functions in

⁷⁴ These requirements are set out in Notification of the Capital Market Supervisory Board concerning Rules on Personnel in the Capital Market Business.

accordance with the ECF Notification. Part 2 of Chapter 4 sets out requirements for the management structure, operating system, and personnel of ECF platform operators. Clauses 23 and 24 provide in particular that an ECF platform operator must put in place:

- (a) a system to prevent access to information concerning the offering of shares through an ECF platform by anyone who is not a member⁷⁵ of the ECF platform;
- (b) a system that allows the ECF platform operator to identify investors and to verify their qualifications as retail or non-retail investors before investing through the ECF platform;
- (c) a system that allows the ECF platform operator to test the knowledge of a prospective investor as required by the ECF Notification [considered below, when discussing regulation of investors];
- (d) a system that sets out requirements regarding holding subscription funds;
- (e) a system that permits the disclosure of sufficient and reliable information through the ECF platform;
- (f) a system that allows communication through electronic means among members of the ECF platform and between members and issuers (so long as the ECF platform operator monitors the communications to ensure that investors do not use the system to offer their shares for sale);
- (g) a system for the back-up of information, including a requirement that information regarding offerings on the ECF platform and post-offering disclosure be retained for at least 2 years;
- (h) a system for the automatic electronic transmission of information;
- (i) a system to support business continuity;
- (j) a system that allows the ECF platform operator to supervise the services provided over the platform;
- (k) a complaints handling system for investors; and
- (l) in accordance with Clause 24, a written policy regarding conflicts of interest. Conflicts of interest are defined in the ECF Notification to include the following:
 - (i) the interest of an investor and an ECF platform operator and persons related to the ECF platform operator; and

⁷⁵ TSEC requires prospective investors to subscribe to an ECF platform and become a member of the ECF platform before being able to access information on and invest in ECF offerings via that ECF platform.

(ii) the interest between different investors or between investors and clients of an ECF platform operator, in cases where the ECF platform operator provides many types of services whereby conflicts of interest may arise.

Part 3 of Chapter 4 contains requirements on advertising the services offered by an ECF platform operator, including the following:

- (a) any information contained in an advertisement must not be false, misleading or conceal relevant information;
- (b) the information must not urge investors to use the ECF platform or to make investment decisions;
- (c) an advertisement must not imply or guarantee returns on investments except where TSEC has permitted it to do so;
- (d) a risk warning must be displayed in a manner that is “noticeable” regarding risks associated with investments made through the ECF platform and information must be provided on where a prospective investor can receive further information regarding the ECF platform operator’s services and the investments; and
- (e) where information included in the advertisement comes from a third party, the ECF platform operator must ensure that the information comes from a reliable source, is up-to-date, and the source of the information is clearly attributed.

Parts 4 and 5 impose on an ECF platform operator certain obligations regarding their interactions with potential investors. Clause 28 provides that ECF platform operators must enter into agreements with prospective investors that at a minimum ensure that investors understand that the service offered through the ECF platform is for investment purposes and that the operator is not providing the services of a broker or agent; the agreement must also include an acknowledgment by investors that they understand the ECF platform operator is operating subject to requirements set out in the ECF Notification. Clause 29 provides that ECF platform operators must provide information regarding the following areas to new investors using the ECF platform:

- (a) general information regarding the ECF platform;
- (b) the type of services offered to investors;
- (c) how services are provided and the channels of communication available through the ECF platform;
- (d) the rights, duties, liabilities, and conditions that apply to investors upon using the ECF platform operator’s services;
- (e) any conflicts of interest; and
- (f) practices between the ECF platform operator and its members in accordance with laws, relevant notifications, and rules of practice specified by the ECF platform operator.

Part 5 imposes obligations on the ECF platform operator to obtain information that allows the operator to identify investors, to ensure that the investor is placed in the appropriate category of investor, and to make a determination regarding the ability of the investor to comply with the service agreement between the investor and the ECF platform operator.

Part 6 then sets out the oversight obligations of ECF platform operators concerning issuers.⁷⁶ This includes the requirement that the ECF platform operator ensure that a prospective issuer has complied with certain obligations in the 2 years preceding the proposed offer (including not making false or misleading statements and not disclosing information that the issuer is required to disclose) and that the issuer has agreed to comply with certain requirements before using the ECF platform. These obligations are set out in Clause 36(4) of the ECF Notification and are explored below when considering the obligations of issuers. ECF platform operators have an obligation to ensure that issuers comply with requirements of the agreement.

There are a number of other obligations and rules that ECF platform operators must comply with. These include, in accordance with Clause 19, the requirement that ECF platform operators do not seek to exclude or limit their liability for damage suffered by an investor as a result of a failure by the ECF platform operator to carry out its business in accordance with the rules of the ECF Notification. This liability obligation extends to the directors, managers, and any other persons with management responsibilities related to the ECF platform operator.

Clause 39 provides that subscription money must be held in escrow or by a custodian and can only be released to an issuing company when the amount the issuer has sought to raise through the issue is reached and any cancellation periods available to the investor have expired.

(iii) Issuers

The ECF regime in Thailand makes a distinction between two types of companies: public limited companies and limited companies. Section 24 of the *Public Limited Companies Act B.E. 2535* provides that a public limited company may offer shares for sale to the public or to any person, so long as the offer is made in accordance with relevant laws regarding securities and the stock exchange.⁷⁷ A limited company is a privately held company and is precluded under section 1102 of Book II of the *Thailand Civil and Commercial Code* from making an invitation to subscribe for shares to the public.⁷⁸ The ECF regime allows both types of companies to issue shares⁷⁹ through ECF if clause 5 is satisfied. The requirements of clause 5 are that the company must be incorporated under Thai law; have a business plan and intend to operate its business with the funds raised through the ECF platform; must have never issued shares via a private placement or public offering; and must not have its shares listed on the Stock Exchange of Thailand.

Companies that issue shares through an ECF platform must comply with the following cap requirements set out in Clause 7(1):

⁷⁶ Some of the obligations provided under Part 6 are explored in the sections that follow.

⁷⁷ *Public Limited Companies Act B.E. 2535* (1992).

⁷⁸ Thailand Civil and Commercial Code.

⁷⁹ The ECF Notification refers to securities rather than shares, but clause 2(3) of the ECF Notification defines securities as shares. The unofficial English translation of the ECF Notification does not further define shares.

(a) Retail investors:

(i) the value of the securities offered must not exceed 20 million Baht during the 12 months from the time of the first offer, and must not exceed 40 million Baht in total from the time of the first offer;

(ii) an offer for the issue of shares to each retail investor must not exceed 50,000 Baht for each issuer;

(iii) offers may only be oversubscribed where the total amount offered during the 12 months from the time of the first offer does not exceed 20 million Baht, provided that the company making the offer must not offer the portion for oversubscription in an amount larger than 25 percent of the offering amount and the total offering amount from the time of the first offer does not exceed 40 million Baht.

(b) Non-Retail Investors: the caps set out for retail investors do not apply to institutional investors, private equity trusts, venture capital businesses, and qualified investors (discussed in the section below dealing with investor regulation).

The more onerous obligations imposed on public limited companies under generally applicable company regulations require some amendments to allow public limited companies to raise funds using the ECF regime. For instance, issuers that raise funds outside of the ECF regime must comply with *Notification of the Capital Market Supervisory Board No. TorChor. 39/2559 Re: Application for and Approval of Offer for Sale of Newly Issued Shares* and *Notification of the Capital Market Supervisory Board No. TorChor. 30/2551 Re: Filing of Registration Statement for Securities Offering*. These Notifications require a public limited company to disclose certain information, file a registration statement and a draft prospectus with TSEC, and comply with the procedures specified in the Notifications. For public limited companies wishing to raise funds using the ECF regime, the ECF regime exempts the company from filing a registration statement and a draft prospectus with TSEC so long as (1) the value of the securities being offered to retail investors does not exceed 20 million Baht during the 12 months from the time of the first offer being made; (2) the value of the securities being offered to retail investors does not exceed 40 million Baht in total from the time of the first offer; and (3) the value of securities offered to each retail investor does not exceed 50 thousand Baht for each issuer.

Issuers are also bound to certain obligations through mandatory entry into an agreement with ECF platform operators. Entry into such an agreement is a pre-condition to an issuer being permitted to raise funds through an ECF platform. Clause 36(4) of the ECF Notification sets out the obligations that must be included in this agreement as follows:

(a) Duties regarding disclosure through the ECF platform before an offer of securities is made and after the offer has been made. The information must be disclosed in a manner that is clear, easy to understand, and in a manner that is not misleading. The duty of continuous disclosure may be terminated in accordance with any guidelines issued by TSEC.

(b) Investors must have a right to cancel the purchase of shares at any time (the cooling-off period), except when there is less than 48 hours remaining in an offer.

(c) When there are significant changes regarding information disclosed by an issuer, the issuer must notify the ECF platform operator without delay so that the ECF platform operator can disclose the changes. When such a change is made and less than 48 hours remain in an offer, investors have the right to cancel their purchase of shares within five days from the date that the ECF platform operator notifies investors of the change.

(d) The issuer must disclose to the ECF platform operator the progress that it is making in using the funds it has raised from the offer.

(iv) Investors

There are a number of provisions that expressly seek to protect investors under the Thai regime, including restrictions on amounts that can be invested depending on the category of investor, requirements regarding self-accreditation, and education requirements.

As is common among jurisdictions with a specific ECF regime, there are caps on the amount that investors can invest through ECF. In accordance with the ECF Notification, these caps are drafted as limitations on the amounts that issuers can raise from certain investors and have therefore been set out in the above section dealing with issuers. As noted above, there are two overarching categories of investors: retail investors and non-retail investors. Clause 7(2) of the ECF Notification provides that the following non-retail investors are not subject to the caps on investments set out in clause 7(1) of the ECF Notification: (1) institutional investors, (2) private equity trusts, (3) venture capital businesses, and (4) qualified investors.

These four types of investors are defined in clause 2 by reference to various notifications issued by TSEC. Although it is beyond the scope of this report to set out in detail the definitions of each of the four categories of investors outlined above, the definition of institutional investors provides some guidance on the approach adopted in Thailand. Institutional investors are those investors set out in clause 2 and high net worth investors set out in the *Notification of the Securities and Exchange Commission No. KorChor. 4/2560 Re: Determination of Definitions of Institutional and High Net Worth Investors*. The list of institutional investors includes, for example, commercial banks, securities companies, life insurance companies, and the Government Pension Fund.

ECF platform operators have an obligation to confirm under which category an investor falls and to provide more onerous oversight of retail investors, including the amount that retail investors are permitted to invest during any 12-month period. Pursuant to clause 36(5), ECF platform operators must keep track of the value of investments made by each investor, but in relation to retail investors operators must also ensure that they do not invest more than 500,000 Baht during any 12-month period. An ECF platform operator's obligation is fulfilled through a self-declaration made by retail investors before each investment they make. The effect of clause 36(5) is to provide an additional cap on the amount that individual retail investors may invest to those set out in clause 7(1) regarding how much issuers can receive from retail investors as a category of investors.

Clause 37 also provides that investors must receive certain information from ECF platform operators. This includes:

- (a) information of an educational nature, including:
 - (i) how to subscribe for shares through the ECF platform;
 - (ii) the risks associated with shares offered through an ECF platform and the risks arising from the different types of the securities offered through the ECF process;
 - (iii) disclosure of information regarding the issue of shares through the ECF platform;
 - (iv) the limitations on investment applicable to each investor;
 - (v) the right of investors to cancel their subscription of shares [which is set out in clause 36(4) as follows: (i) at any time up until 48 hours before the offer closes; and (ii) where there is a significant change regarding disclosures made by an issuer and there are less than 48 hours remaining on the offer, issuers must give investors the right to cancel the subscription of shares within 5 days as from the date on which the ECF platform operator notifies such information to investors];
 - (vi) warnings that shares purchased through the ECF process are illiquid because there is no secondary market or because they may be subject to transfer restrictions;
- (b) information where an investor receives a subscription form setting out:
 - (i) the features of the shares;
 - (ii) the subscription money to be paid for the shares and any associated fees or expenses;
 - (iii) the price of the shares;
 - (iv) the name of the issuer; and
 - (v) the right of the investor to cancel the shares they have purchased.

Clause 38 requires that retail investors that have not been tested within three months of the proposed subscription and qualified investors that do not express an intention to forgo testing undertake a test to assess their level of investment knowledge. ECF platform operators must ensure that the test covers at least the following issues:

- (a) the high risk of failure of companies issuing shares through the ECF process;
- (b) the potential that an investor may not obtain a return on their investment if an issuer is liquidated;

- (c) knowledge that there is no secondary market for shares purchased through the ECF process and that restrictions may apply on the transfer of the shares (meaning that the shares are illiquid);
- (d) the payment of dividends or any other benefit is contingent on the issuer's articles of incorporation or the terms and conditions set out by the issuer;
- (e) any profit sharing arrangement and voting right of existing shareholders may be affected if the issuer issues new shares to increase capital (dilution);
- (f) acknowledgment that information regarding the offer of shares provided by the ECF platform operator is based on the information disclosed to the operator by the issuer (self-declaration); and
- (g) acknowledgment that investors under the ECF regime are not entitled to claim compensation under the SEA in cases where an issuer discloses materially false or incomplete information.

C: United Kingdom

(i) Background to Securities and ECF Regulation

The United Kingdom's financial regulatory framework was comprehensively reformed in response to the global financial crisis. It has now adopted a "twin peaks" model of regulation, with the Bank of England responsible, through a number of committees, for monetary policy, financial stability, and prudential regulation.⁸⁰ The second "peak" of the system, market conduct and securities regulation, is overseen by the Financial Conduct Authority (FCA). Most of the FCA's powers and duties are set out in the *Financial Services and Markets Act 2000* (FSMA), including the authority to enact rules regarding equities and consequently rules regarding ECF.⁸¹

This regulatory framework oversees one of the world's largest, most complex, and integrated financial systems, including a developed market for securities. As of October 2016, there were 2,286 companies listed on the London Stock Exchange, with a total market value of approximately GBP4,392 trillion.⁸² The vast majority of shares in the United Kingdom are owned by overseas

⁸⁰ Monetary policy is the responsibility of the Monetary Policy Committee, while financial stability is the responsibility of the Financial Policy Committee. The responsibilities of these committees are found in the *Bank of England Act 1998*. Prudential regulation is the responsibility of the Prudential Regulation Authority which was created as a committee of the Bank of England by the *Financial Services Act 2012*. The duties of the authority are set out in the FSMA.

⁸¹ For a concise explanation of the UK financial regulatory framework see Paul Fisher, "The Financial Regulation Reform Agenda: What has been Achieved and How Much is Left to Do?" (Speech, given at Richmond, the American International University, London, 30 September 2015, available at: <http://www.bankofengland.co.uk/publications/Pages/speeches/2015/845.aspx>).

⁸² London Stock Exchange, "Companies and Securities: List of All Companies", October 2016, available at: <http://www.londonstockexchange.com/statistics/companies-and-issuers/companies-and-issuers.htm> (this data does not distinguish between equity and debt securities).

investors, who accounted for 54 percent of share ownership during 2014.⁸³ The IMF has noted the importance of the U.K. equity markets as a platform for the trade of foreign shares, particularly European shares:

In 2014, 11 U.K. based exchanges and [Multilateral Trading Facilities] held a 45 percent market share in all on-platform equity trading in Europe. At the same time, the eight U.K. based “dark” (non-pre-transparent) trading platforms dominated European dark trading with an 85 percent market share. In addition, many U.K. based brokers (banks and investment firms) operate their own electronic crossing networks whose trades are reported as over-the-counter (OTC).⁸⁴ [citations omitted]

Despite the advanced nature of UK financial markets, crowdfunding was introduced as a means to address a gap in the demand and supply of funding for smaller businesses.⁸⁵ The U.K. crowdfunding regime was first proposed by the FCA in a consultation paper published in October 2013: *The FCA’s regulatory approach to crowdfunding (and similar activities)* (FCA Consultation Paper).⁸⁶ The proposals for crowdfunding contained in the FCA Consultation Paper formed part of broader efforts in the United Kingdom to assist businesses to raise funds through alternative financial channels after the global financial crisis. For instance, in April 2014 the London Co-Investment Fund announced that it would invest GBP5 million of public money through an ECF platform, Crowdcube, to assist London-based start-ups operating in the digital, technology, and science sectors to obtain necessary funding through equity.⁸⁷ The regime proposed in the FCA Consultation paper provided the FCA with responsibility over two forms of crowdfunding.⁸⁸

⁸³ Office for National Statistics, “Ownership of UK Quoted Shares: 2014”, Statistical Bulletin, 2 September 2015, available at: <http://www.ons.gov.uk/economy/investmentspensionsandtrusts/bulletins/ownershipofukquotedshares/2015-09-02>.

⁸⁴ International Monetary Fund, “United Kingdom: Financial System Stability Assessment”, Financial Sector Assessment Program, IMF Country Report No. 16/167, June 2016, 8, available at: <https://www.imf.org/en/Publications/CR/Issues/2016/12/31/United-Kingdom-Financial-Sector-Assessment-Program-Financial-System-Stability-Assessment-43978>.

⁸⁵ Great Britain Department for Business, Innovation and Skills, “Breedon Report: Boosting Financial Options for Business”, 16, 2012, available at: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/32230/12-668-boosting-finance-options-for-business.pdf.

⁸⁶ Financial Conduct Authority, “Consultation Paper CP13/13: The FCA’s Regulatory Approach to Crowdfunding (and Similar Activities)”, available at: <https://www.fca.org.uk/publications/consultation-papers/cp13-13-fca’s-regulatory-approach-crowdfunding-and-similar>.

⁸⁷ Paul Langley, “Crowdfunding in the United Kingdom: A Cultural Economy”, *Economic Geography* 92: 3, 301-321, 2016 at 313, available at: <http://dro.dur.ac.uk/16443/1/16443.pdf?DDD14+qxsj65+dul4eg>. The U.K. government has also considered several tax incentives that would encourage investment through crowdfunding platforms, including ECF. *Ibid*.

⁸⁸ Other types of crowdfunding, such as rewards-based crowdfunding and donation-based crowdfunding are not regulated by the FCA. For a description of the different crowdfunding categories, see Financial Conduct Authority, Policy Statement 14/4, “The FCA’s Regulatory Approach to Crowdfunding Over the Internet, and the Promotion of Nonreadily Realisable Securities by Other Media”, FCA Policy Statement, March 2014, available at: <https://www.fca.org.uk/publications/policy-statements/ps14-4-fca%E2%80%99s-regulatory-approach-crowdfunding-over-internet-and>.

- loan-based crowdfunding platforms through which investors are able to lend money to issuers in the hope of a financial return in the form of interest payments and a repayment of capital over time (this excludes some business-to-business loans),⁸⁹ and
- investment-based crowdfunding platforms, through which investors can invest in unlisted shares or debt securities of issuers. ECF falls within the category of investment-based crowdfunding in the United Kingdom.

These two forms of crowdfunding had previously been undertaken in the United Kingdom in accordance with regulations generally applicable to loans and the issue of securities. By creating a specific regime for crowdfunding, the U.K. government sought to overcome restrictions in their use that would make them a more attractive option.⁹⁰

The FCA Consultation Paper captured two overarching features that define crowdfunding in the United Kingdom. First, despite the stated attempt to help businesses raise funds through alternative means, the FCA proposed a restricted regime for investment-based crowdfunding (including ECF) that places a primary emphasis on protecting consumers. This restrictive approach conforms to the consumer protection objectives of the FCA: (1) securing an appropriate degree of protection for consumers; and (2) promoting effective competition in the interests of consumers.⁹¹ The restrictive approach was proposed by the FCA because it views crowdfunding as a significant risk to investors who are not considered “sophisticated”. According to the FCA, the high risks associated with investment-based crowdfunding include:⁹²

- The high failure rate of start-ups. Between 50 and 70 percent of start-ups fail. As a result, the FCA considers it very likely that investors will lose 100 percent of their investment.
- There is a risk that providers of investment-based crowdfunding services could provide unauthorized investment advice to investors, which, if provided outside of the crowdfunding context, would require that such providers obtain authorization from the FCA before providing the advice.
- It is likely that professional investors are in a better position to select the best investments, leaving only high risk investments to non-professional investors. This requires that particular attention be given to requirements that non-professional investors using crowdfunding portals receive adequate information on which to base their investments.
- The unlisted nature of shares in these start-ups means that even if the company does not fail, investors risk never receiving a return on their investment if those controlling the company decide not to pay dividends. Further, if subsequent shares are issued, the value of the shares held by original shareholders may be diluted.
- There is only a limited secondary market for the shares.

⁸⁹ The United Kingdom also uses the terms “peer-to-peer” and “peer-to-business” lending to refer to loan-based lending.

⁹⁰ FCA Consultation Paper, note 86 at para 1.10.

⁹¹ FCA Consultation Paper, note 86.

⁹² FCA Consultation Paper, note 86 at 15.

The second feature of the proposal set out in the FCA Consultation Paper was the adoption of rules that were neutral on the form of platform used to obtain funds from the crowd (meaning that both online and offline mechanisms are captured), as well as the integration of the rules for crowdfunding into the broader regulatory mandate of the FCA rather than the creation of a separate regulatory framework for crowdfunding. The regulatory regime is therefore not self-contained; ECF platform operators, issuers, and investors must consult and comply with regulations that apply more broadly to lending and investment. The FCA adopted this approach because it considered it to be a fair, proportionate, media-neutral regulation that would apply in the same way to all competing firms, whether directly authorized or an appointed representative of an authorized firm, and whether using the internet or other media to communicate with their clients.⁹³

These considerations informed the rules ultimately adopted by the FCA for crowdfunding. The FCA's rules for loan-based and investment-based crowdfunding are set out in a number of instruments. The authority for the FCA to promulgate rules, including for crowdfunding, is contained in the FSMA. The rules applicable to crowdfunding are set out in the FCA Handbook, which was amended in accordance with the *Crowdfunding and the Promotion of Non-Readily Realisable Securities Instrument 2014* (UK Crowdfunding Instrument). The UK Crowdfunding Instrument itself is Attachment 1 to the FCA's policy statement of March 2014 in response to submissions to its Consultation Paper: *The FCA's regulatory Approach to Crowdfunding over the Internet, and the Promotion of Nonreadily Realisable Securities by Other Media* (FCA Policy Statement).⁹⁴ While the FCA Handbook, the Instrument, and the FCA Policy Statement set out the rules regarding crowdfunding and offer reasoning behind these specific rules, ECF platform operators must also comply with rules that apply more broadly to the issue of shares where they are relevant.⁹⁵

This complex U.K. crowdfunding regime regulates one of the largest crowdfunding systems in the world.⁹⁶ On February 2015, the FCA released its review document for regulated crowdfunding: *A Review of the Regulatory Regime for Crowdfunding and the Promotion of Non-readily Realisable Securities by Other Media* (FCA Review Document).⁹⁷ The FCA Review Document notes that in 2015 an estimated GBP2.7 billion was invested on regulated crowdfunding platforms. This was an increase from GBP500 million in 2013. The amount raised through investment-based crowdfunding was expected to be GBP84 million. While only a fraction of the overall funding obtained through

⁹³ FCA Policy Statement, note 88 at 35.

⁹⁴ FCA Policy Statement, note 88. The FCA is reviewing these standards. See FCA, "Call for Input to the Post-implementation Review of the FCA's Crowdfunding Rules", last updated 9 September 2016, available at: <https://www.fca.org.uk/publications/calls-input/post-implementation-review-fca-crowdfunding-rules>.

⁹⁵ Crowdfunding operators may also be subject to the code of practice of the U.K. crowdfunding industry organization: the UK Crowdfunding Association. See UK Crowdfunding, "Code of Practice", available at: <https://www.ukcfa.org.uk/code-of-practice-2/>.

⁹⁶ Langley, note 87 at 306; Jonathan Moules, "London Emerging as World Leader in Crowdfunding", Financial Times, 15 August 2014, available at: <https://www.ft.com/content/8e5be7d0-23c2-11e4-8e29-00144feabdc0>. See also, Andy Davis, "Beyond the Banks: Innovative Ways to Finance Britain's Small Businesses", National Endowment for Science, Technology and the Arts, September 2011, available at: https://www.nesta.org.uk/sites/default/files/beyond_the_banks_innovative_ways_to_finance_britains_small_businesses.pdf.

⁹⁷ FCA Review Document, note 48. See also, Financial Conduct Authority, "FCA Launches Call for Input on Crowdfunding Rules", 8 June 2016, available at: <https://www.fca.org.uk/news/press-releases/fca-launches-call-input-crowdfunding-rules>.

crowdfunding, this was a threefold increase from the GBP28 million raised in 2013. ECF in particular grew by 201 percent in 2014 and the average amount raised through ECF was GBP199,095.

By the time of the FCA Review Document, 100 crowdfunding platforms had either started operating in the United Kingdom or sought authority to operate from the FCA, with 35 firms operating in the investment-based crowdfunding sector. Despite the positive growth, the FCA Review Document also noted several areas of concern, including the propensity of platform operators to downplay risks associated with investment through investment-based crowdfunding and the offering of unclear and complex financial product offerings that increased risks to unsophisticated investors. Although the U.K. government may make significant changes to the regulatory regime on the basis of these findings, it has yet to make any amendments. As a result, the regime discussed in the following sections relates to the regime as reflected in the FCA Policy Statement.

(ii) ECF Platform Operators

Unlike many other jurisdictions, the FCA's regulatory framework for ECF is media-neutral: it applies to all intermediaries marketing offers for "non-readily realizable securities" (meaning securities that are not listed on regulated stock markets and for which there is no secondary market) whether using online portals or off-line mechanisms. The FCA states that:

[t]his was done with [the FCA's] competition objective in mind and in order to provide appropriate protection for all investors however they invest ... In our view, the same protection should apply to investors whether they engage with firms online or offline as a result of direct marketing or through telephone-selling of investments.

The FCA regulations apply as a result to any provider who offers a service which allows people to invest in new and established businesses by buying shares (and debt). Where a person or business plans to offer such services, they must first obtain authorization from the FCA to operate in accordance with sections 19 and 21 of the FSMA. This includes prospective ECF platform operators as they would be offering services subject to the FCA's regulatory authority. As far as ECF platform operators are concerned, these regulated services would include, at a minimum, arranging dealings in investment (i.e., arranging for another person to buy securities).⁹⁸ The process for obtaining authorization is set out in Part IV of the FSMA and section 41 requires that certain threshold conditions, set out in Schedule 6 of the FSMA, be met.

The authorization process for ECF platform operators places much of the onus on applicants to establish that they should be authorized. As previously noted, to obtain authorization, ECF platform operators must show, to the satisfaction of the FCA that they meet certain threshold requirements. The FCA Review Document sets out the following steps in the authorization process that it considers necessary for crowdfunding platform operators to show they have met the threshold requirements:⁹⁹

⁹⁸ *Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (SI 2001/544)*, Article 25.

⁹⁹ See FCA Review Document, note 48 at 6. See also Financial Conduct Authority, "Apply for Authorisation", last updated 20 June 2016, available at: <https://www.fca.org.uk/firms/authorisation/apply-authorisation>. Schedule 6 of the FSMA sets

- Submit a suitable and detailed regulatory business plan setting out the planned activities (and related risks), budget and resources (human, systems, and capital) – i.e., not a funding pitch.
- Have adequate non-financial resources (i.e., the management board has adequate knowledge and experience of financial regulation).
- Have adequate financial resources when submitting the application (i.e., not looking at future fundraising to reach the requirement).
- Have a website that is either up-and-running or at a suitably advanced stage (including a test site or app, or screen shots of a planned website or app, that would demonstrate the user interface and functionality available to users) to demonstrate how it will operate should the firm be authorized.
- Understand the requirements for FCA authorization and the permission profile for which they wish to apply, then submit a complete application (including an outline of which regulated activities the firm plans to conduct).

As the final point shows, it is the responsibility of the applicant to set out the activities that it will conduct, the regulations that are relevant to these activities, and how it will comply with these regulations. Despite the lack of prescription in the process, the FCA has noted that it is updating its guidance to show which regulated activities crowdfunding may be caught by, and which firms would fall within the regulatory scope of the FCA.¹⁰⁰

Once authorized, ECF platform operators and their representatives must comply with the requirements set out in the FCA Handbook (both those rules that apply specifically to crowdfunding and those that apply more broadly that are relevant to the activities conducted by a particular platform operator). Apart from conducting some basic checks (i.e., that an issuer is in fact incorporated and the persons acting on behalf of the issuer are in fact corporate officers), platform operators are not required to conduct due diligence checks of issuers that use their websites. Instead, they must disclose information to the FCA that provides sufficient detail to give a balanced indication of the benefits and risks involved in the service provided, including whether due diligence has been carried out on an issuer, the extent of that due diligence, and the outcome of the analysis. Concerns regarding the vagueness of this process were raised and addressed in the FCA Policy Statement. The FCA justifies its current non-prescriptive approach to risk management on the following basis:

In order to create a proportionate framework that balances regulatory costs against benefits, we are not prescribing how firms should address or disclose the relevant risks [involved in crowdfunding]. Nor are we proposing to set requirements for minimum standards of due diligence at this stage. At present, it is for firms to determine the risks present in their business models and to develop appropriate processes to deal with them.

out various threshold conditions that firms must meet in order to become authorized and to remain authorized. These conditions include matters such as suitability and location of offices and adequate resources.

¹⁰⁰ Financial Conduct Authority, "Authorisation: Banks and Lending Alternatives", last updated 15 June 2016, available at: <https://www.fca.org.uk/firms/apply-authorisation/banks-lending-alternatives>.

While the FCA considers that this approach provides adequate investor protection and the flexibility needed so that issuers can arrange finance for SMEs, it notes that prescription is an option that may be considered in the future depending on how the market evolves. The compliance requirements of ECF platform operators in the United Kingdom are therefore not prescriptive and depend on the business model adopted by each ECF platform operator and the activities and services that they will engage in.

Taking into account the nature of ECF, most ECF platform operators need to comply with a number of important rules found in the FCA Handbook. Perhaps the most important of these rules are found in the Conduct of Business Sourcebook (COBS). COBS 2.1 for instance, sets out rules regarding the conduct of business in a fair, honest, and professional manner in accordance with the best interests of clients. This includes a prohibition on excluding or restricting liability that may arise under the regulatory framework. COBS 2 and COBS 4 provide guidance on the requirements for communications with clients. For instance, COBS 2.2 requires that firms provide appropriate information in a comprehensive form to clients (meaning both issuers and investors) before they provide a service,¹⁰¹ including guidance on warnings regarding risks of investments. This must be provided in a form in which it would be reasonable for a client to understand the nature of the risks associated with the specific investment and to therefore make investment decisions on an informed basis. COBS 4.2 requires that any communication made to a client is fair, clear, and not misleading. COBS 4.5 sets out rules regarding communication with clients when providing information in relation to a designated investment business. Designated investment businesses include those that arrange deals in certain investments (including shares). Any communications that need to be made in compliance with COBS 4.5 must meet the following requirements:

- (a) they must include the name of the firm;
- (b) they must be accurate and in particular must not emphasize any potential benefits of a relevant business or a relevant investment without also giving a fair and prominent indication of any relevant risks;
- (c) they must be sufficient for, and presented in a way that is likely to be understood by the average member of the group to whom it is directed (in this case an investor), or by whom it is likely to be received; and
- (d) they must not disguise, diminish, or obscure important items, statements, or warnings.

ECF platform operators are expected to provide fair, clear and prominent risk warnings:

As the risks involved when investing in different non-readily realisable securities vary greatly, depending on the nature of the investment offered, it may not always be meaningful or helpful to present consumers with a single, uniform FCA-approved risk warning. Different warnings will be needed in differing circumstances, for different investments and audiences.

COBS 4.7 is particularly relevant to ECF platform operators as it requires certain disclosures to be made regarding the ECF platform operator's business and its services, the costs associated with the

¹⁰¹ Described below when discussing regulation of issuers and investors.

services, handling of money held by the ECF platform operator, a description of the nature of the risks, and the availability of a prospectus document when an issuer is required to provide one. When a prospectus does have to be issued, ECF platform operators, in addition to issuers themselves, must ensure that they meet any requirement to publish the prospectus or to satisfy themselves that an exemption applies.

A further requirement of the FCA Handbook and the FSMA that applies broadly to all those subject to the FCA's regulatory authority is the dispute resolution process made available to clients, as set out in the FSMA.

(iii) Issuers

The U.K. ECF regime is effectively limited to public companies as the crowdfunding regime does not provide an exemption to the prohibition against the public offer of private company shares set out in section 755 of the *Companies Act 2006* (UK CA). For a company to be classified as public, sections 761 and 763 of the UK CA require that the company does not have a nominal value of allotted share capital that is below GBP50,000.

Where a public company wants to issue shares through an ECF platform, it must comply with many of the same rules that are applicable to ECF platform operators. Companies that issue shares through an ECF platform are dealing with investments (in this case, shares). Unlike most other jurisdictions, ECF issuers are not restricted in the amount that they can raise through the ECF process. The main regulatory constraints that apply to issuers relate to disclosures and to limitations on who they can raise funds from. As the FCA clarified in the FCA Policy Statement:

In addition to complying with the disclosure and financial promotion requirements and restrictions in the FCA Handbook, it is for the firms operating crowdfunding platforms, *and the companies seeking finance through them*, to satisfy themselves that they are meeting any requirement to publish a prospectus (or satisfy themselves that an exemption is available). (emphasis added)¹⁰²

This means that issuers must publish a prospectus or other disclosure documents in accordance with the requirements set out in Part VI of the FSMA and set out in the FCA Handbook.¹⁰³ This approach takes into account the fact that in the United Kingdom, the crowdfunding regulatory framework deals with the direct sale of any form of security of any issuer, of whatever size, where the security does not have a secondary market. Without the use of caps for the ECF regime as is common in other jurisdictions, the exclusion of disclosure requirements in the United Kingdom for ECF might mean that public companies raising very large sums of money through the process may be doing so without being required to provide important information to prospective shareholders. U.K. corporate law does contain some exemptions for small securities issues, and issuers must ensure that if they want to take advantage of these exemptions they meet the necessary requirements set out in the FSMA and the FCA Handbook.

¹⁰² FCA Policy Statement, note 88 at 40.

¹⁰³ These implement the Prospectus Directive [2003/71/EC], as supplemented by the Prospectus Regulation (EC No. 809/2004).

The major constraint on ECF issuers in the United Kingdom relates to the type of investor that issuers can target. Here, the FCA provides that issuers may only communicate a direct offer financial promotion to a restricted number of investors (explored in further detail in the next section). Broadly speaking, those who can receive a direct offer financial promotion are: (1) professional clients: (2) retail clients who receive advice: (3) retail clients who are classified as corporate finance contractors or venture capital contractors: (4) sophisticated or high net worth retail clients: or (5) retail clients who confirm that they will not invest more than 10 percent of their net investible assets into shares acquired through ECF.

(iv) Investors

As is the case in most other jurisdictions, the United Kingdom makes a distinction between those investors who it considers “sophisticated” (and therefore require less protection), and retail consumers who may not fully understand the risks involved in the ECF process and therefore require greater protection. The FCA has outlined its approach as follows:

We believe that consumers looking to invest in crowdfunding offers should take care. Given the typical risks involved, under our regulations, firms are only allowed to promote illiquid securities to particular types of experienced or sophisticated investors, or ordinary investors who confirm that they will not invest more than 10% of their net investible assets in investments sold via investment-based crowdfunding platforms.¹⁰⁴

The key restraints in the United Kingdom on investors using ECF platforms therefore depend on their classification as either “sophisticated” or “non-sophisticated”. Experienced or sophisticated investors are able to invest as much as they want through the ECF process while non-sophisticated investors are permitted to invest but only within a cap that is determined in accordance with their net investible assets.

This division is set out in the FCA Policy Statement (and included in the FCA Handbook). In effect, the only investors who can invest in ECF in the United Kingdom (i.e., the only investors to whom ECF platform operators can communicate direct offer financial promotions) are:

- (a) Professional clients (who are expressly excluded from the definition of retail clients in the FCA Handbook).¹⁰⁵
- (b) Retail clients who are venture capital contactors or corporate finance contactors.¹⁰⁶
- (c) Retail clients who confirm that they will receive regulated investment advice or investment management services from an authorized person in accordance with COBS 9.¹⁰⁷

¹⁰⁴ FCA, “Crowdfunding”, last updated 10 June 2016, available at: <https://www.fca.org.uk/consumers/crowdfunding>.

¹⁰⁵ Those set out in COBS 3.5, which include institutions such as credit institutions and investment firms or those that are assessed as having expertise, experience and knowledge that will allow them to make their own investment decisions.

¹⁰⁶ COBS 4.7.8R(3).

¹⁰⁷ COBS 4.7.8R(1).

- (d) Retail clients who are certified or self-certify as sophisticated investors or who are certified as high net worth investors.¹⁰⁸ COBS 4.7.9R provides that these retail investors are individuals who have signed, within a period of 12 months ending on the day that a communication is made, a statement acknowledging the risk of losing all their investments and their right to seek advice from an authorized person and which:
- (i) for high net worth investors, confirms that they had a GBP100,000 annual income and net assets above GBP250,000 (excluding the primary residence and various other assets);¹⁰⁹
 - (ii) for certified sophisticated investors, is an investor who within the last 36 months has received a certificate from an ECF platform operator that they are an investor who understands the risks associated with the investment;¹¹⁰
 - (iii) for a self-certified sophisticated investors, is an investor who is either a member of a network or syndicate of business angels for at least the past six months, or has made more than one investment in an unlisted company in the 2 years prior to the date of the communication, or is working or has worked in the 2 years prior to the date of communication in a professional capacity in the private equity sector or in provision of finance to SMEs or is currently, or has in the past 2 years been a director of a company with an annual turnover of at least GBP1 million.¹¹¹
- (e) Certified restricted investors.¹¹² These retail investors are investors who have signed within a 12-month period before the date of the communication a statement that:¹¹³
- (i) in the 12 months preceding the date of communication, they have not invested more than 10 percent of their net assets in non-readily realizable securities; and
 - (ii) they undertake that in the 12 months following the date of the communication, they will not invest more than 10 percent of their net assets in non-readily realizable securities.

A number of points need to be mentioned regarding the above group of potential investors in ECF. First, if an investor falls within paragraphs (a)–(d) (inclusive), then they may receive a direct offer financial promotion, meaning they may receive an offer to invest through an ECF platform and there is no restriction on the amount they can invest. Retail clients who fall within paragraph (e) may also respond to a direct offer financial promotion, but they must first certify that they have not in the past 12 months and will not in the following 12 months, invest more than 10 percent of their net assets in illiquid (non-readily realizable) securities.

Second, in relation to retail investors covered under paragraphs (d) and (e), there is a requirement pursuant to COBS 4.7.7R(3) that an ECF platform operator must ensure that they satisfy an

¹⁰⁸ These categories are set out in COBS 4.7.7R(2)(a)–(c) inclusive.

¹⁰⁹ COBS 4.12.6R.

¹¹⁰ COBS 4.12.7R.

¹¹¹ COBS 4.12.8R.

¹¹² COBS 4.7.7R(d).

¹¹³ COBS 4.8.10R. These assets exclude, among others, a primary residence.

“appropriateness test” in accordance with COBS 10 before they may respond to a direct offer financial promotion. COBS 10.2.1 requires that:

- (1) When providing a service (including an ECF platform), an ECF platform provider must ask a prospective investor to provide information regarding their knowledge and experience in investing in the field so as to enable the ECF platform operator to assess whether it is appropriate for the prospective investor to invest through ECF.
- (2) When assessing if it is appropriate for the prospective investor to invest through ECF, an ECF platform operator must determine whether the prospective investor has the necessary experience and knowledge required to understand the risks involved in relation to investing through an ECF platform.¹¹⁴

COBS 10.2.2 then provides that information regarding an investor’s knowledge and experience in the investment field includes the nature and extent of the service to be provided and the type of product or transaction envisaged, including complexity and risks involved, and information on:

- (1) the types of service, transaction, and investment with which the prospective investor is familiar;
- (2) the nature, volume, and frequency of the prospective investor’s transactions in the relevant field and the period over which they have been carried out; and
- (3) the level of education, profession, or relevant former profession of the prospective investor.

COBS 10.3 provides that where an ECF platform operator is of the view that a prospective investor does not possess the relevant knowledge and experience after undertaking the appropriateness test or where insufficient information has been provided by the prospective investor to make this determination, then the ECF platform operator must provide the prospective investor with a warning. However, if a prospective investor requests that they be able to invest after receiving a warning, an ECF platform operator, may at its discretion, allow the prospective investor to invest through the ECF platform.

Third, if an investor who would otherwise fall within categories (d) and (e) receives regulated investment advice or investment management services in accordance with COBS 9, then they would be considered a retail investor under category (c), and, in accordance with COBS 4.7.8R(1), would not need to satisfy an appropriateness test in accordance with COBS 10.

D: Australia

(i) *Background to Securities and ECF Regulation*

¹¹⁴ COBS 10.2.1(2)(b) provides that a relevant firm may assume that a professional client has the requisite experience and knowledge. See also COBS 10.6.1G.

In March 2017 the Australian Parliament enacted the *Corporations Amendment (Crowd-sourced Funding) Act 2017* to introduce ECF. This act will commence on 29 September 2017. In May 2017, the Australian government released for public consultation draft legislation to extend the types of companies that can use ECF.

As with the United Kingdom, Australia adopts a form of “twin peaks” regulation for its financial system. Australia’s central bank, the Reserve Bank of Australia (RBA), is responsible for overseeing financial system stability and the payments system as well as monetary policy. The “twin peaks” element of Australia relates to the division between (i) prudential regulation and (ii) regulation of securities and market conduct between two independent regulatory authorities. The Australian Prudential Regulation Authority (APRA) has responsibility for prudential oversight of deposit-taking institutions such as banks and insurers and all large superannuation funds. The Australian Securities and Investments Commission (ASIC) is responsible for market conduct and consumer protection as well as oversight of securities regulation and as a result is responsible for oversight of the Australian ECF regulatory regime.¹¹⁵

The Australian financial sector has grown rapidly over the past few decades. Total credit in the financial sector grew from around 50 percent in the early 1980s to 160 percent just before the global financial crisis. Total assets of financial institutions increased from around 100 percent to 370 percent of GDP during that period. Australian equities have witnessed significant growth over the past several decades as well: increasing more than 70-fold from the mid-1980s to 2007 (compared to a sixfold increase in the size of the nominal economy).¹¹⁶ In 2015–2016, just under 1,900 domestic companies were listed on Australia’s major stock exchange, the Australian Securities Exchange (ASX), and total market capitalization of equities on the ASX in 2015–2016 was a little over A\$1.6 trillion.¹¹⁷

As with other countries, despite the advanced nature of Australia’s equity markets, concerns remain with obstacles faced by smaller businesses accessing much needed funds. In its submission to the Financial System Inquiry, the RBA discussed at length the funding requirements and funding difficulties encountered by small businesses in Australia.¹¹⁸ In particular, the RBA set out the state of equity financing by smaller businesses in Australia as follows:

Equity financing, like debt, tends to be more costly for smaller businesses. This is because smaller business equity investors (including the owners) require a higher average return on equity to compensate for the higher uncertainty of the return. Despite this higher cost of equity, small businesses use slightly more equity than larger businesses.

¹¹⁵ For a concise description of the Australian financial regulatory framework see International Monetary Fund, “Financial System Stability Assessment: Australia”, IMF Country Report No. 12/308, November 2012, 24.

¹¹⁶ Reserve Bank of Australia, “Submission to the Financial System Inquiry”, March 2014, RBA Submission to FSI.

¹¹⁷ Australian Financial Markets Association, “Australian Financial Markets Report”, 2016, at 5, 16, available at: <http://www.afma.com.au/annual-report>.

¹¹⁸ Reserve Bank of Australia, note 116. These problems are also outlined in Mihovil Matic, Adam Gorajek, and Chris Stewart, “Small Business Funding in Australia”, RBA Small Business Finance Roundtable, Sydney, 22 May 2012, available at: <http://www.rba.gov.au/publications/workshops/other/small-bus-fin-roundtable-2012/pdf/02-small-bus-funding-aus.pdf>.

Small businesses are likely to use a higher share of equity funding than larger businesses for a number of reasons. First, the higher volatility of small business' cash flows and higher bankruptcy 'wind up' costs may make equity more accessible than debt. Second, debt and equity finance provided by professional investors involve costly risk assessments, with associated sizeable fixed costs. Most small businesses do not have a great need for capital to expand, and borrow at a scale that does not always overcome these fixed costs. These small businesses use internal equity finance and external equity sourced from friends, family and business owners, which do not involve large transaction costs and are relatively inexpensive. Third, usually, little information is publicly available for small businesses so the owners have more information about their company's prospects, risks and value than outside investors. The cost of compensating external financiers for their incomplete information may lead small business owners to prefer internal equity over external finance.

There are a number of other forms of external equity funding for smaller businesses. For example, equity might be provided by 'business angels' – individuals who invest their own money, time and expertise into promising and risky start-ups – or by venture capital firms, which generally provide somewhat larger intermediated equity funding on behalf of other investors. Surveys suggest that these forms of external equity funding only provide a small share of funding for small businesses. (citations omitted)

This presents a problem for the broader Australian economy as small businesses represent about 95 percent of the over 2 million actively traded businesses in Australia, account for almost 70 percent of the workforce and over a third of production in the private, non-financial corporations sector.¹¹⁹ As part of the *Growing Jobs and Small Business* reform package announced in the 2015–2016 budget, the Australian government committed to examine the regulatory framework for small proprietary companies under the Australian *Corporations Act 2001* (ACA). The aim of this examination was to identify ways to reduce compliance costs and to make capital raising more flexible for these companies.¹²⁰ A similar goal has been set out in the government's *National Innovation and Science Agenda* which aims to remove bias against businesses that take risks and innovate.¹²¹ One aspect of this goal is to make it "easier and less expensive for small businesses, including start-ups, to raise equity from the general public, while ensuring adequate investor protection."¹²²

This goal seeks to overcome barriers that exist under the Australian framework. Under the ACA, proprietary companies are generally prohibited from making public offers of securities, and they

¹¹⁹ Reserve Bank of Australia, note 116 at 124. These figures relate to the 2012 financial year. Financial System Inquiry, Interim Report, Chapter 3 (funding), available at: <http://fsi.gov.au/publications/interim-report/03-funding/small-med-enterprises/>.

¹²⁰ The Hon Joe Hockey MP and the Hon Bruce Billson MP, Joint Media Release, "Supporting Start-ups and Entrepreneurship", 6 May 2015, available at: <http://bfb.ministers.treasury.gov.au/media-release/041-2015>; The Hon Tony Abbott MP, the Hon Joe Hockey MP, and the Hon Bruce Billson MP, Joint Media Release, "Growing Jobs and Small Business Package to Help Small Businesses Invest More, Grow More, and Employ More", 12 May 2015, available at <http://jbh.ministers.treasury.gov.au/media-release/044-2015>.

¹²¹ Australian Government, "National Innovation and Science Agenda: The Agenda", available at: <http://www.innovation.gov.au/page/agenda>.

¹²² Australian Government, "National Innovation and Science Agenda: Making it Easier to Access Crowd-Sourced Equity Funding", available at: <http://www.innovation.gov.au/page/access-crowd-sourced-equity-funding>. Several other government reviews suggested the need for an ECF regime. These include *The Industry Innovation and Competitiveness Agenda*, released in October 2014, *The Murray Inquiry into Australia's Financial System*, released by the government in December 2014 (and the government's response released in October 2015), The Productivity Commission's *Business Set-up, Transfer and Closure draft report*, released in May 2015, and the government's *FinTech Statement*, released in March 2016.

are only permitted to have a maximum of 50 non-employee shareholders,¹²³ making it difficult for them to access the “crowd”. Start-ups and other small businesses can issue shares to the public if they adopt the public company structure but this is complex and costly.¹²⁴ Under the current regulatory framework, companies can access funds through exemptions for small-scale offerings¹²⁵ and for offerings made to sophisticated and professional investors.¹²⁶ In a guidance note on crowdfunding, published by ASIC in 2012 before the ACA was amended to introduce an ECF regime, ASIC noted that some crowdfunding activities could involve offering or advertising financial products, providing financial services or fundraising through offers of securities that would require a disclosure document.¹²⁷

A number of reviews outlined difficulties with the Australian law regulating fund raising by companies and recommended the adoption of a specific regime for ECF. These include the Corporations and Markets Advisory Committee’s (CAMAC) *Crowd Sourced Equity Funding Report* (CAMAC Report),¹²⁸ the Financial System Inquiry *Final Report* (FSI Report)¹²⁹ and Treasury’s *Crowd-sourced Equity Funding Discussion Paper* (Treasury Report).¹³⁰ These reviews all acknowledged that the funding arrangements provided in the ACA restricted ECF. The CAMAC Report proposed a particularly unique regime for ECF including the following:

- The establishment of a new category of company for companies that wanted to use ECF. These companies would be excluded from certain public disclosure requirements for a certain period of time.
- The amount that could be raised by any company through ECF was to be capped at A\$2 million every 12 months.
- Intermediaries were to be licensed and had to conduct mandatory due diligence checks, and ensure certain conflict of interest provisions were complied with, including preclusion from providing investment advice, soliciting investors, and lending to investors.
- Investors were only permitted to invest A\$2,500 in any company raising funds through ECF and A\$10,000 overall in ECF during a 12-month period.

In response to recommendations put forward in the CAMAC Report and other reports, the government introduced the Corporations Amendment (Crowd-sourced Funding) Bill 2015 (CF Bill) into Parliament on 3 December 2015. The CF Bill was not passed into law before a new government was elected in 2016. This government introduced a new bill into Parliament for the creation of an

¹²³ *Corporations Act 2001*, section 113. Further obligations apply in relation to financial reporting depending on whether a proprietary company is classified as small or large: *Corporations Act 2001*, sections 113 and 45A.

¹²⁴ These prohibitions are set out in the CAMAC Report (see note 42).

¹²⁵ Those offerings that raise no more than \$2 million through offers to no more than 20 investors in any rolling 12-month period: *Corporations Act 2001* (Cth), sections 708(1)–(7).

¹²⁶ *Corporations Act 2001* (Cth), s 708(8).

¹²⁷ Australian Securities and Investments Commission, ‘ASIC Guidance on Crowdfunding’ (12-196MR, 13 August 2012) available at: <http://asic.gov.au/about-asic/media-centre/find-a-media-release/2012-releases/12-196mr-asic-guidance-on-crowd-funding/>.

¹²⁸ CAMAC Report, note 42.

¹²⁹ Financial System Inquiry, “Final Report”, 20 October 2014 at chapter 3, available at: <http://fsi.gov.au/publications/final-report/chapter-3/crowdfunding/>.

¹³⁰ Australian Government, “Facilitating Crowd-sourced Equity Funding and Reducing Compliance Costs for Small Businesses: Consultation Paper”, August 2015, available at: <http://www.treasury.gov.au/ConsultationsandReviews/Consultations/2015/Facilitating-crowd-sourced-equity-funding>.

ECF specific regulatory framework: Corporations Amendment (Crowd-sourced Funding) Bill 2016 (2016 Bill). The Bill was enacted by the Australian Parliament in March 2017: *Corporations Amendment (Crowd-sourced Funding) Act 2017* (2017 Act). This Act will commence on 29 September 2017.

The new ECF regime is generally contained in a new Part 6D.3A of the ACA, although other provisions may be relevant where expressly noted.¹³¹ The aim of Part 6D.3A is to set out:

- eligibility requirements for a company that wants to make an offer under the ECF regime;
- the process to make an ECF offer, including the role and obligations of the platform operator; and
- the prohibitions, liabilities, and investor protections applying to offers, including rules relating to defective disclosure documents and advertising restrictions.¹³²

ASIC is provided with authority to oversee the ECF regime through an amendment to Chapter 6D.4 of the *Corporations Act* (dealing with ASIC's powers relating to securities) so that it includes ECF.

*(ii) ECF Platform Operators*¹³³

Section 738C of the 2017 Act provides that an ECF platform operator (referred to in Australia as a CSF intermediary) is a financial services licensee (and in some cases an Australian Market Licence holder – although holding an Australian Market Licence will not do away with the need to hold a financial services licence when providing crowdfunding services) whose licence expressly authorizes the licensee to operate an ECF platform. Providing a crowdfunding service is therefore considered the provision of a financial service, which requires an Australian Financial Services Licence (AFSL). Therefore, in addition to complying with the relevant sections in Part 6D.3A, an ECF platform operator must also comply with the requirements relating to those holding an AFSL set out in Chapter 7 of the ACA. Further, as ECF platform operators will be offering financial services, they have to do so in accordance with general obligations provided under section 912A of the ACA. These obligations include that an AFSL holder must:

- (a) do all things necessary to ensure that the financial services covered by the AFSL are provided efficiently, honestly and fairly;
- (b) have in place adequate arrangement to manage conflicts of interest that may arise wholly or partially, in relation to activities undertaken by the licensee or one of its representatives;
- (c) comply with the conditions of the AFSL;

¹³¹ Current requirements in Chapter 6D.2 of the ACA regarding prospectuses and other disclosures are generally excluded from the ECF regime established in 6D.3A, as is Chapter 6D.3 which deals with prohibitions, liabilities, and remedies relating to offers of securities.

¹³² Corporations Amendment (Crowd-Sourced Funding) Bill 2016, Explanatory Memorandum at 9.

¹³³ The 2017 Act amends certain exemption powers in the ACA regarding the holding of an Australian Market Licence, ASIC supervision, clearing and settlement licensing obligations, and the compensation regime to allow the relevant minister to deal with the specific requirements of ECF platform operators.

- (d) comply with financial services laws and take reasonable steps to ensure that its representatives do too;
- (e) have available adequate resources (including financial, technological, and human resources) to provide the financial services and to carry out supervisory arrangements;
- (f) maintain the competence to provide the financial services;
- (g) ensure its representatives are adequately trained and are competent to provide the financial services;
- (h) if the financial services are provided to retail clients, have in place a dispute resolution system as follows:
 - (i) the dispute resolution system must include an internal dispute resolution procedure that complies with standards and requirements made or approved by ASIC and covers complaints against the licensee made by retail clients; and
 - (ii) the AFSL holder must be a member of one or more external dispute resolution schemes approved by ASIC and cover complaints made by a retail client;
- (i) have adequate risk management systems; and
- (j) comply with any other obligations that are prescribed by regulations.

ASIC has set out some of the considerations it takes into account when determining whether it will provide an AFSL. These considerations include whether the applicant:

- (a) is competent to carry out the relevant financial services business;
- (b) has sufficient financial resources; and
- (c) can meet the other obligations of an AFS licensee (such as training, compliance, insurance, and dispute resolution).¹³⁴

ECF platform operators have a number of other obligations, including:

- (a) Obligations which set out when an ECF platform operator must not publish an offer document presented by an issuer, or when an ECF platform operator must cease to publish an offer document on its platform (offer documents are discussed in the section below regarding regulation of issuers). Section 738Q(5) provides that an ECF platform operator must not publish an offer document, or must stop publishing the offer document when:¹³⁵
 - (i) it is not satisfied of the identity of the issuer or of any of the directors or other officers of the issuer; or

¹³⁴ Australian Securities and Investments Commission, "Applying for and Managing an AFS Licence", available at: <http://asic.gov.au/for-finance-professionals/afs-licensees/applying-for-and-managing-an-afs-licence/>.

¹³⁵ These will be expanded upon in the regulations which have not yet been published by the government.

(ii) it has reason to believe that any of the directors or other officers of the issuer are not of good fame or character; or

(iii) unless the offer has already been published, it has reason to believe that the issuer, or a director or other officer, has, in relation to the offer, knowingly engaged in conduct that is misleading or deceptive or likely to mislead or deceive; or

(iv) it has reason to believe that the offer to which the document relates is not eligible to be made.

(b) Provision of a risk warning on the ECF platform (sections 738ZA(1)–(2)) in accordance with the regulations.

(c) Offering a mechanism that allows investors to purchase shares but only after they have completed an acknowledgment (ss 738ZA(3)–(4)).

(d) Offering a communication facility so that people who access the offer document through the platform can make posts relating to the offer, see the posts of others, and ask questions of the issuer and the ECF platform operator.

(e) Ensuring that cooling-off rights (discussed in the section below dealing with investors), appear prominently on the platform, including the right of a person to withdraw the share purchases and the method of doing so.

(f) Ensuring that fees and direct or indirect interests of the ECF platform operator are displayed prominently on the platform.

(g) Ensuring that investors receive the benefit of any cooling-off periods, investor caps, and risk acknowledgments.

Section 738ZB sets out requirements regarding the handling of money. Division 2 of Part 7.8 of the ACA applies to an ECF platform operator as though it is the holder of a financial services licence. Under these provisions, an ECF platform operator must hold money provided for the purchase of shares in a qualifying account, and must comply with regulations regarding when money may be withdrawn from the account and how interest earned on the account is dealt with.

(iii) Issuers

The 2017 Act includes two broad areas of regulation for issuers: (1) eligibility requirements to determine who can issue shares through the ECF regime; and (2) once an issuer has been deemed eligible, a disclosure regime that applies specifically to those issuers raising funds through the ECF regime.

There are a number of “eligibility requirements” that issuers must meet in order to issue shares through ECF. In order for an offer to be made through an ECF platform, a prospective issuer must

meet all of these requirements and the offer must be expressed to be made under Part 6D.3A of the ACA.¹³⁶

Section 738G(1) provides that an offer is eligible to be made in accordance with Part 6D.3A where:

- (a) it is an offer by an issuer for the issue of securities of the issuer;
- (b) the issuer is eligible to make an offer as set out in section 738H at the time when the offer is made (discussed below);
- (c) the securities are of a class specified in the regulations (although the regulations have not yet been drafted, the government has clarified through the explanatory memorandum to the 2016 Bill that for the moment, only fully-paid ordinary shares will be offered through the ECF regime);
- (d) the offer complies with the issuer cap set out in section 738G(2) (discussed below);
- (e) the funds sought to be raised by the offer are not intended by the issuer to be used, to any extent, by the issuer or a related party to invest in securities or interests in other entities or schemes; and
- (f) any other requirements specified in the regulations are satisfied in relation to the securities or the offer.

Section 738G(2) provides that an offer of securities (a new offer) complies with the issuer cap mentioned in section 738G(1)(d) if the total of:

- (a) the maximum amount sought to be raised by the new offer; and
- (b) all amounts raised, in the period of 12 months before the time when the new offer is made, pursuant to ECF offers that were made in that period by the issuer or by related parties; and
- (c) all amounts raised, in the period of 12 months before the time when the new offer is made, pursuant to offers made by the issuer, or by related parties, that did not need disclosure because of sections 708(1) or 708(10);

do not exceed A\$5 million or an amount otherwise provided for in the regulations.

In effect, section 738G provides that the funds that are included in the Australian issuer cap (A\$5 million) include (1) the funds that are being raised in a current offer; (2) funds raised through ECF offers within 12 months of the current offer; and (3) funds raised within 12 months of the current ECF offer pursuant to sections 708(1) (small scale personal offers) and 708(10) (offers made via an Australian Financial Services licensee where the licensee is satisfied on reasonable grounds that the person to whom the offer is made has previous experience in investing that allows them to assess the merits and risks of the current offer). The reason for their inclusion is that investors from these

¹³⁶ 2017 Act, s 738B.

categories include retail investors who may also fall within the category of ECF investors. Funds raised from other offers that do not require disclosure, such as those made to sophisticated and professional investors, are not included within the issuer cap to allow issuers to continue obtaining funding from these investors.

Section 738H sets out the following eligibility requirements for an issuer:

- (a) the issuer must be a public company limited by shares;
- (b) the issuer must have a principal place of business in Australia;
- (c) a majority of the issuer's directors (not counting alternate directors) ordinarily reside in Australia;
- (d) the issuer must comply with the assets and turnover test provided in section 738H(2) which provides that an issuer must:
 - (i) have a value of consolidated gross assets that does not exceed A\$25 million or another amount specified in the regulations; and
 - (ii) have consolidated annual revenue less than A\$25 million or another amount specified in the regulations;
- (e) must not be listed; and
- (f) must not have as a substantial purpose investing in securities or interests in other entities or schemes.

The restriction of the ECF regime to public companies may provide a deterrent to some small businesses that do not want to adopt that form. To partly address this, the 2017 Act creates temporary concessions from certain public company corporate governance and reporting requirements for:

- (a) new public companies limited by shares; and
- (b) proprietary companies that convert to a public company that satisfy the eligibility criteria at the time of registration as a new public company and at the end of the relevant financial year,

and the company completes an ECF offer within the required timeframe.

The concessions apply for a maximum of 5 years and include an exemption from the need to hold an annual general meeting, the option to only provide financial reports to shareholders online, and an exclusion from the requirement that the company appoint an auditor or have audited financial reports until more than A\$1 million has been raised through the ECF process.

Once an issuer has been deemed eligible, it needs to comply with the ECF specific disclosure requirements to raise funds. This disclosure obligation is generally satisfied through the completion of what is referred to in section 738J as a "CSF offer document" (but for the purposes of

consistency will in this report be referred to as an “ECF offer document”) for each offer. The ECF offer document must contain information that will be included in the relevant regulations. Although the regulations have yet to be drafted, the explanatory memorandum to the 2016 Bill notes that the information that may be required of the ECF offer document includes information about the issuer and its business, the securities on offer, and how the proceeds raised will be used.

Division 3 of Part 6D.3A sets out provisions relating to the ECF offer document. In addition to complying with the requirements set out in the regulations, the document must be worded and presented in a clear, concise, and effective manner, and the ECF offer document must be published on a single ECF platform only. The ECF offer document must also require that any request to purchase shares and any money given in consideration for the shares be sent to the ECF platform operator. Division 3 also sets out (relevant to both ECF platform operators and to issuers) the people who must provide consent in order for the issuer to publish the ECF offer document. Further, the regime sets out when an offer will be made, open, closed, suspended, and complete as follows:

- (a) An offer must be made in accordance with the ECF regime and an ECF offer document must be prepared for each offer. An issuer is limited to making one offer through the ECF regime at a time. An offer will be made by publishing the ECF offer document on a single ECF platform. Detailed provisions are included regarding defective disclosure documents, including prohibitions, remedies, and liabilities.
- (b) An offer is open from the time the offer is made until the time that the ECF platform operator either suspends or closes the offer.
- (c) The offer is closed from the time that the ECF platform operator gives written notice on the platform that the offer is closed. An ECF platform operator must close an offer:
 - (i) three months after the offer has been made;
 - (ii) when the offer document states a date for close, on that date;
 - (iii) when the ECF platform operator considers the offer fully subscribed;
 - (iv) when an issuer withdraws an offer; and
 - (v) when the ECF platform operator is required to remove an offer document from its platform.
- (d) An offer is considered complete when three conditions are satisfied: (1) an offer has closed for one of the reasons in points (c)(i)–(c)(iii) above; (2) all withdrawal rights have expired; and (3) the value of the funds raised exceeds the minimum subscription offer set out in the offer document.
- (e) An ECF platform operator must suspend an offer when it becomes aware that an offer document is defective. The offer will continue to be suspended until either the issuer provides a replacement or supplementary offer document that the ECF platform operator publishes, in which case the offer will be “open”, or the ECF platform operator closes the offer.

(iv) Investors

As with all other jurisdictions, many of the regulations set out in relation to ECF platform operators and issuers are provided as a way to protect investors. Perhaps the most significant protection, however, is the imposition of caps on the amounts that certain investors can invest. Section 738ZC of the 2017 Act provides caps on investments by retail clients as follows:

(1) The [ECF platform operator] ... must reject an application made by a prospective investor if:

(a) the prospective investor is a retail client in relation to the offer; and

(b) having regard only to [ECF] offers for which the [ECF platform operator] is the responsible [ECF platform operator], the application would result in the total amount paid or payable by the person in respect of applications made by the person, in any period of 12 months, pursuant to [ECF] offers made by the same [issuer], exceeding:

(i) A\$10,000; or

(ii) if the regulations prescribe a different amount, the prescribed amount.

The above cap is contingent on the classification of a prospective investor as a "retail client". The ECF platform operator is required to determine whether a prospective investor is a retail client. The test to determine when a person is a retail client is set out in s 761G(7) of the ACA. A prospective investor is a retail investor unless they come within one of the following categories:

(a) the price of the financial product (the securities) or the value of the financial product to which a financial service relates, equals, or exceeds A\$500,000 (s 761G(7)(a)) (referred to as a product value test); or

(b) the securities or the financial service is provided for use in a business other than a small business (section 761G(7)(b)) (defined as a business employing less than 20 people, unless the business includes the manufacture of goods, where the business must employ less than 100 people (s 761G(12))); or

(c) where the securities or financial service is not provided for use in connection with a business, the person acquiring the securities or financial services gives the ECF platform operator a certificate prepared by a qualified accountant within the preceding six months that states that the person has net assets of at least A\$2.5 million, or gross income in the last two financial years of at least A\$250,000 (s 761G(7)(c)); or

(d) the person to whom the financial service is provided is a professional investor as defined in section 9 (section 761G(7)(d)) (this includes an AFSL holder, a listed entity, a bank, or a person who has or controls gross assets of at least A\$10 million).

If the prospective ECF investor is considered a retail investor then protections provided under the ACA relating to retail clients will also apply to that investor. This includes the requirement to (i) provide a retail client with a Financial Services Guide; (ii) have an internal dispute resolution scheme; and (iii) be a member of an ASIC approved external dispute resolution scheme and have arrangements for compensating retail clients for loss or damage suffered because the licensee (in this case, the ECF platform operator) breached its obligations.

ECF retail clients are also entitled to additional investor protections (in addition to the caps described above), such as cooling-off rights and risk acknowledgments and protections against receiving financial assistance to purchase shares. Section 738ZD provides that all retail clients can withdraw their purchase of shares within five business days after the purchase. ECF platform operators must display information regarding this cooling-off period prominently on their platform. If a retail client withdraws their purchase, then in accordance with section 738ZB, an ECF platform operator must return the retail client's money. Section 738ZE precludes ECF platform operators (and certain related parties) from offering financial assistance to a retail client or from arranging for such clients to receive financial assistance in relation to the ECF offer.

While these protections apply to retail clients, there are other protections that apply more broadly to all ECF investors. Perhaps most important are the restrictions detailed in section 738ZG regarding restrictions on advertising and publicity. The 2017 Act generally prohibits advertising except in certain permitted circumstances.¹³⁷ Issuers and ECF platform operators are not restricted in advertising publication of an offer, an ECF offer document, or any other information relating to an offer if it is on an ECF platform. Further, advertising restrictions do not apply to advertisements or publications that do not refer to a particular offer or intended offer, or where they identify an ECF platform operator, or where they provide general information about an ECF platform operator's services. A number of exemptions are also provided in the 2017 Act that allow ECF platform operators to advertise.

(v) Proposed extension of the Australian ECF regime

In May 2017, the Australian government released for public consultation draft legislation to extend the types of companies that can use ECF: Corporations Amendment (Crowd-sourced Funding for Proprietary Companies) Bill 2017 (2017 Bill). As noted above, the 2017 Act only allows public companies to raise funds using ECF. The draft legislation, if enacted, would allow proprietary companies to raise funds using ECF. The 2017 Bill has the following key elements:

- Proprietary companies are only required by the ACA to have one director. However, a proprietary company that wants to use the ECF regime will be required to have at least two directors. The explanatory memorandum to the 2017 Bill states that this will provide greater transparency, more robust decision-making and greater certainty around succession planning.

¹³⁷ Section 736 of the ACA also prohibits the offer of securities through unsolicited meetings or telephone calls.

- Proprietary companies are currently prohibited by the ACA from engaging in any activity that requires disclosure to investors under Chapter 6D of the ACA except to existing shareholders and the employees of a company. As ECF is a fundraising activity that requires disclosure to investors, the ACA will be amended so that proprietary companies are allowed to make ECF offers.
- To allow proprietary companies to effectively use the ECF regime, the existing shareholder cap in the ACA which provides that a proprietary company cannot have more than 50 non-employee shareholders will be amended so that ECF shareholders are not counted as part of the cap. Without this change, a proprietary company would only be permitted to have 50 non-employee shareholders, severely limiting its ability to use the ECF regime.
- A proprietary company that makes an ECF offer will be required to include additional information as part of its shareholder register. This information must be maintained on the company's register while the company has ECF shareholders. The additional information to be maintained on the register includes the:
 - date of each issue of shares as part of an ECF offer;
 - number of shares issued as part of each ECF offer;
 - shares issued to each member of the company as part of each ECF offer; and
 - date on which each person ceases to be an ECF shareholder of the company for a particular share in the company.
- Where a company makes changes to its register because it has issued shares as part of an ECF offer, the company will also be required to notify ASIC of the change to its register. The company will also have to inform ASIC if it starts to have ECF shareholders or stops having ECF shareholders.
- Under section 292 of the ACA, a small proprietary company would normally only have to prepare annual financial and directors' reports if it is directed to by its shareholders (under section 293) or ASIC (under section 294), or in some cases where it is controlled by a foreign company. To ensure that the individuals who invest their money into proprietary companies through an ECF offer have access to information about their investment in the company, section 292(2) will be amended to require proprietary companies to prepare annual financial and directors' reports while they have ECF shareholders.
- Proprietary companies that raise more than A\$1 million from ECF offers will be required to have their annual financial reports audited.
- To protect investors against fraud and bias arising as a result of transactions with related parties, proprietary companies that have ECF shareholders will be subject to the existing related party transaction rules and penalties under Chapter 2E of the ACA.

E: Developments in Other Jurisdictions

Jurisdictions other than the four analysed in the earlier sections of Chapter 4 have introduced regimes that deal specifically with ECF. While it is not possible to consider each of these

jurisdictions in the level of detail of the four key jurisdictions analysed, several jurisdictions have undertaken reforms that may prove useful in illustrating certain similarities and differences in the ECF regimes adopted across jurisdictions. With this aim in mind, this section provides a high level analysis of the ECF regimes adopted in the United States, New Zealand, and Canada. A briefer analysis is provided of the current regimes in China, Hong Kong, Singapore, and the European Union as these jurisdictions have not yet implemented specific regimes for ECF but they are currently in the process of considering ECF regulations. The high-level nature of the analysis in this section means that not every regulatory issue will be addressed. Where relevant, additional regulatory matters to those considered in the sections below are raised in Chapter 5 when dealing with specific regulatory issues.

(i) The United States

As with other jurisdictions, limited forms of ECF appeared in the United States before a dedicated ECF regime was created. ECF at the time was regulated (and restricted) by Rule 506 of Regulation D, which brought into effect the private offering exemption provided for in section 4(a)(2) of the *Securities Act 1933*.¹³⁸ Regulation D offerings allowed issuers to raise unlimited funds through Regulation D platforms, but only to accredited investors. Issuers could not advertise their offerings and could not solicit investors.

This regulatory framework was amended with the signing into law of the *Jumpstart Our Business Startups (JOBS) Act* 2012 on 5 April 2012 (JOBS Act). The most important aspects of the JOBS Act are Title II (effective from September 2013) and Title III (the Securities and Exchange Commission (SEC) adopted final rules regarding ECF under Title III in October 2015 and these became effective in May 2016).

Although Title II is set out briefly below, Chapter 5 will look predominantly at Title III as this is the more comprehensive ECF regime.

The introduction of Title II of the JOBS Act provided greater scope to offer ECF through the exemption provided in Rule 506 of Regulation D. Rules 506(b) and 506(c) now set out requirements for the exemption. Rule 506(b) provides, in general, that if an issuer does not use general solicitation or advertising to market the securities, then it can sell shares to an unlimited number of “accredited investors” and up to 35 other purchasers (although these purchasers must be classified as sophisticated investors meaning that they must have sufficient knowledge and experience in financial and business matters so that they can assess the merits and risks of investments). Where an issuer relies on Rule 506(b) it must make certain disclosures, be available to answer questions from prospective investors, and satisfy financial statement requirements. Rule 506(c) provides that issuers can solicit and advertise an offering but still fall within the s 4(a)(2) exemption if the offer of securities is made only to accredited investors and the issuer has taken steps to ensure that only accredited investors are responding to an offer.

¹³⁸ Prominent ECF platforms relied on Regulation D, including MicroVentures (which launched in 2011 and focuses on technology companies) and CircleUp (which launched in 2012 and focuses on consumer products and retail). Regulation D is located at 17 C.F.R. 230.501 – 230.508.

Although these reforms make it somewhat simpler for ECF to take place in the United States, it is only with the introduction of Title III that an ECF-specific regime was introduced into the United States by creating a Regulation Crowdfunding exemption in the securities regime.¹³⁹

To take advantage of the Regulation Crowdfunding exemption, ECF platform operators must be registered with the Securities and Exchange Commission (SEC) as either broker-dealers or as “funding portals”.¹⁴⁰ Funding portals are less rigorously regulated than broker-dealers, but they cannot offer investment advice or recommendations, solicit purchases, sales, or offers to buy securities offered in their ECF platforms, or compensate employees, agents, or others for such a solicitation, or hold, manage, possess, or otherwise handle investor funds or securities. If a prospective ECF platform operator wants to engage in any of these activities they need to register as a broker-dealer.

Once registered as either a broker-dealer or a funding portal, ECF platform operators must comply with a number of obligations. These obligations include the following:

- Provide investors with the most current and up-to-date education materials that explain, among other things, the process for investing through the platform and the securities offered. They must also provide all information that issuers are required to disclose and make available on their platform all information that an issuer is meant to declare.
- Have a reasonable basis for determining that the issuer complies with all relevant regulations.
- Provide communication channels on its ECF platform.
- Disclose the remuneration that the ECF platform operator receives.
- Obtain certain acknowledgments from prospective investors regarding their understanding of the risks involved with ECF investments, and have a reasonable basis for believing the investor complies with any investment caps.
- Deal with money in the manner prescribed, including, for those registered as a funding portal, transmitting money to a qualified third party.

Funding portals are also required to be members of the Financial Industry Regulatory Authority (FINRA). This is a self-regulatory organization existing under the *Securities Exchange Act 1934*, which issues further regulations. The rules focus on regulating the licensing of portals, their conduct, and ongoing monitoring and compliance. These rules are based on those applicable to broker-dealers, but are designed specifically to address the business operations of funding portals. Generally speaking, the aim of the rules is to ensure that funding portals behave in a way that

¹³⁹ Title III of the JOBS Act added s 4(a)(6) to the *Securities Act 1933*, which provides an exemption for registration with the SEC for certain crowdfunding transactions. The SEC adopted Regulation Crowdfunding in 2015 to implement Title III. Issuers were able to begin using Regulation Crowdfunding from 16 May 2016. Regulation Crowdfunding is available at: <https://www.sec.gov/rules/final/2015/33-9974.pdf>. When referring to ECF platform operators in the United States, many of the regulations discussed apply to funding portals as opposed to broker-dealers, who are separately regulated.

¹⁴⁰ The SEC provides a useful summary of Regulation Crowdfunding: U.S. Securities and Exchange Commission, “Regulation Crowdfunding: A Small Entity Compliance Guide for Issuers”, 13 May 2016, available at: <https://www.sec.gov/info/smallbus/secg/rccomplianceguide-051316.htm>. In this Report, we consider the regime applicable to funding portals as broker-dealers are subject to general securities regulations.

reflects high standards of commercial integrity and just and equitable principles of trade, and that they do not engage in activity that is manipulative, deceptive, or otherwise fraudulent. In accordance with the FINRA rules, funding portals have to establish internal monitoring systems to supervise activities of each associated person of the funding portal.¹⁴¹

The United States also regulates the activities of issuers. First, as with the majority of other jurisdictions, there are restrictions on the types of companies that can issue shares through ECF. Issuers must be private companies and they must be based in the United States. Issuers that qualify to use ECF may raise a maximum aggregate amount of US\$1 million in a 12-month period. This amount is adjusted for inflation at least once every 5 years, and on 31 March 2017 the SEC approved an increase to \$1,070,000 to become effective when published in the Federal Register.¹⁴²

When an issuer wants to raise US\$100,000 or less, they must provide certain financial data derived from tax returns and financial statements certified by the company's principal executive officer. When an issuer wants to raise between US\$100,000 and US\$500,000, they must provide financial statements reviewed by an independent accountant. Issuers seeking to raise more than US\$500,000 must have their financial statements audited by an accountant. However, where an issuer wants to raise between US\$500,000 and US\$1 million and they have not previously raised funds in reliance on the Regulation Crowdfunding exemption, they only need to have their financial statements reviewed by an independent public accountant. The above amounts are also adjusted for inflation and were increased by the SEC on 31 March 2017 with the increase to be effective when published in the Federal Register.

In addition to these financial limits, issuers must meet a number of other obligations. For instance, once issuers have raised funds through ECF, they must file offering information with the SEC and they may have to file annual reports with the SEC. Issuers must electronically file their offering statement on Form C through the SEC's Electronic Data Gathering, Analysis and Retrieval (EDGAR) system and with the relevant ECF platform operator. The filing must include the following:

- information about officers, directors, and owners of 20 percent or more of the issuer;
- a description of the issuer's business and the use of proceeds from the offering;
- the price of the securities or the method for determining the price;
- the target offering amount and the deadline to reach the target;
- whether the issuer will accept investments in excess of the target offering amount;
- certain related-party transactions; and
- a discussion of the issuer's financial condition and financial statements.

¹⁴¹ The FINRA rules for funding portals were proposed by FINRA in October 2013. The FINRA Funding Portal Rules are available at: http://finra.complinet.com/en/display/display_viewall.html?rbid=2403&element_id=12218&record_id=16794&filtered_tag=.

¹⁴² Securities and Exchange Commission, "SEC Adopts JOBS Act Amendments to Help Entrepreneurs and Investors", Media Release, 5 April 2017, available at: <https://www.sec.gov/news/press-release/2017-78>.

Issuers may advertise to direct prospective investors to the ECF platform where the shares are offered and may also advertise through the ECF platform; they also may participate in ECF offerings and Regulation D offerings at the same time.

As with other jurisdictions, the United States also imposes restrictions on the type of investor who can invest through ECF and the amount they can invest. Individual investors are limited in the amounts they can invest in all regulated crowdfunding over the course of 12 months as follows:

- If either of an investor's annual income or net worth is less than US\$100,000, then the investor's investment limit is the greater of:
 - US\$2,000 or
 - 5 percent of the lesser of the investor's annual income or net worth.
- If both annual income and net worth are equal to or more than US\$100,000, then the investor's limit is 10 percent of the lesser of their annual income or net worth.
- During the 12-month period, the aggregate amount of securities sold to an investor through all Regulation Crowdfunding offerings may not exceed US\$100,000, regardless of the investor's annual income or net worth.

The above amounts are adjusted for inflation at least once every 5 years, and on 31 March 2017 the SEC approved increases which become effective when published in the Federal Register.¹⁴³ When registering on an ECF platform, investors must demonstrate they understand the risks of private equity investments. Investors must also hold shares for at least 1 year after purchasing them, although there are some exceptions to this rule, including that they may sell shares back to the issuer or to an accredited investor within the one-year period.¹⁴⁴

As noted above, ECF under Title III of the JOBS Act was allowed from May 2016. As of 31 December 2016, 21 platform operators were registered with the SEC and FINRA, and they arranged 163 ECF offerings involving 156 different issuers.¹⁴⁵

(ii) New Zealand

The *Financial Markets Conduct Act 2013* (FMC Act), which came into effect on 1 April 2014, introduced a new regime for ECF through the licensing of ECF platform operators (called "crowdfunding service providers" in New Zealand). The rules regarding ECF are also set out in the

¹⁴³ Securities and Exchange Commission, "SEC Adopts JOBS Act Amendments to Help Entrepreneurs and Investors", Media Release, 5 April 2017, available at: <https://www.sec.gov/news/press-release/2017-78>.

¹⁴⁴ U.S. Securities and Exchange Commission, "Regulation Crowdfunding: A Small Entity Compliance Guide for Crowdfunding Intermediaries", 13 May 2016, available at: <https://www.sec.gov/divisions/marketreg/tmcompliance/cfintermediaryguide.htm>.

¹⁴⁵ SEC Commissioner Kara M. Stein, "Remarks on U.S. Securities-based Crowdfunding," Harvard Law School Forum on Corporate Governance and Financial Regulation, 3 March 2017, available at: <https://corpgov.law.harvard.edu/2017/03/03/commissioner-stein-remarks-on-u-s-securities-based-crowdfunding/>.

Financial Markets Conduct Regulations 2014 (FMC Regs 2014). New Zealand's Financial Market Authority (FMA), which oversees ECF in New Zealand, has also provided guidelines on the operation of the system: *A Guide to the Financial Markets Conduct Act 2013 Reforms* (November 2013). Prospective ECF platform operators must obtain a license to operate a market service from the FMA in accordance section 395 of the FMC Act. To obtain a license, a prospective ECF platform operator must comply with the requirements of section 396 of the FMC Act, including that they provide evidence to the FMA that they have the capability to operate as a market intermediary. This includes evidence that the prospective ECF platform operator has the necessary infrastructure, appropriate anti-fraud and promotion of fair dealing policies and procedures, and that its directors and senior managers have the capability and character to hold their respective positions.

Once licensed, ECF platform operators are responsible for the vetting of issuers and must disclose the selection criteria for issuers to potential investors at the time that the investors sign up with the ECF platform operator. ECF platform operator websites must also display the following:

- A warning statement about the risks of crowdfunding. The risks warnings must include the fact that there is a high failure rate for start-up companies, and that because they are investing in a non-listed company, they will receive fewer disclosures and less protection than is common for shareholder investors in listed companies. Prospective investors must acknowledge that they have read this information and acknowledge that they understand that the usual information requirements and legal protections for share offers do not apply.
- A disclosure statement that tells investors how the service works, the fees they will pay, and the checks the ECF platform operator has and has not conducted on the issuer.
- A client agreement that acts as a contract between the investor and the ECF platform operator, and a summary of the terms of the agreement.

The New Zealand framework focuses most regulatory attention on ECF platform operators. However, there are several regulations aimed at issuers. For instance, issuers raising funds through an ECF platform are exempt from mandatory disclosure requirements applying to standard offers of financial products contained in Part 3 of the FMC Act. Issuers must, however, comply with financial reporting requirements, and must also comply with fair dealing requirements set out in Part 2 of the FMC Act. These fair dealing requirements are a set of minimum standards of behaviour that issuers must meet and include:

- not making false or misleading representations, for example, issuers must be honest about who they are and what they are going to use the funds for;
- not making unsubstantiated representations, for example, issuers must ensure they have reasonable grounds for any financial projections provided to potential investors; and
- a prohibition on offering financial products (including shares through ECF) in the course of unsolicited meetings.

Issuers are also limited in the amount they can raise through ECF in any 12-month period to NZ\$2 million. There are no other limits imposed in the New Zealand ECF regime as is the case in other

jurisdictions. This means there is no limit on how much an individual investor can invest in ECF in any year or in total and there is no limit on the size of the issuer.

(iii) Canada

Those offering securities to the public in Canada must be registered unless there is an exemption available from registration and/or the preparation of a prospectus. The current approach to ECF in Canada is somewhat complicated by the adoption of rules at the provincial level rather than at the federal level, meaning that multiple proposals have been put forward by different provinces with each at different stages of implementation. However, two exemptions to the prospectus requirements under securities regulation appear to have gained prominence among a number of different provinces:¹⁴⁶ (i) the Start-up Crowdfunding and Prospectus Exemptions (Start-up Exemption),¹⁴⁷ and (ii) the Integrated Crowdfunding Prospectus Exemption and crowdfunding portal requirements proposed under Multilateral Instrument 45-108 (Integrated Crowdfunding Exemption).¹⁴⁸ Although this section considers both exemptions, Chapter 5 of this report will concentrate more on the Integrated Crowdfunding Exemption.

The aim of the Start-up Exemption is to provide substantially harmonized registration and prospectus exemptions that assist start-ups and early stage companies in participating jurisdictions to raise funds. The regime provides exemptions from the prospectus and registration requirements provided for in Canada's securities regulations.¹⁴⁹

¹⁴⁶ Entrepreneurs can also use ECF by relying on other exemptions from the prospectus and registration requirements of Canadian securities laws. The National Crowdfunding Association of Canada provides an outline of some of these exemptions: National Crowdfunding Association of Canada, "Equity Crowdfunding Regulation", February 2016, available at: <http://ncfacanada.org/equity-crowdfunding-regulations/>.

¹⁴⁷ See Canadian Securities Administrators, "Multilateral CSA Notice 45-316: Start-up Crowdfunding Registration and Prospectus Exemptions", 14 May 2015, available at: https://www.bcsc.bc.ca/Securities_Law/Policies/Policy4/PDF/45-316_Multilateral_CSA_Notice_May_14_2015/. The jurisdictions that have adopted this exemption are British Columbia, Saskatchewan, Manitoba, Québec, New Brunswick, and Nova Scotia. For an example of an order by one of these jurisdictions implementing the exemption, see Financial and Consumer Affairs Authority of Saskatchewan, "General Order 45-929: Start-up Crowdfunding Registration and Prospectus Exemptions", Saskatchewan General Order, available at: <http://www.fcaa.gov.sk.ca/adx/asp/adxGetMedia.aspx?DocID=8124,2149,1365,2259,2257,244,1,Documents&MediaID=35c8480a-6005-49d3-aba0-9ef9896be447&Filename=45-929-go-amended-june-30-2016.pdf>. The Start-up Exemption was intended to be one of two complementary exemptions for crowdfunding in these jurisdictions. The other was the Integrated Crowdfunding Exemption, although not all jurisdictions that have adopted the Start-up Exemption have adopted the Integrated Crowdfunding Exemption. See Autorité des marchés financiers, "Canadian Securities Regulators Propose New Crowdfunding Exemptions", 20 March 2014, available at: <https://lautorite.qc.ca/en/general-public/media-centre/news/fiche-dactualites/canadian-securities-regulators-propose-new-crowdfunding-exemptions/>.

¹⁴⁸ See Ontario Securities Commission, "Multilateral Instrument 45-108 Crowdfunding", 14 January 2016, available at: http://www.osc.gov.on.ca/en/SecuritiesLaw_45-108.htm. The participating jurisdictions are: Manitoba, Ontario, Québec, New Brunswick, and Nova Scotia. The exemption came into effect in these jurisdictions on 25 January 2016. On 31 October 2016, ministerial approval was received in Alberta, and the exemption came into effect in that jurisdiction immediately. (Alberta has another exemption available for crowdfunding: the start-up business exemption, ASC Rule 45-517.) The exemption is awaiting Ministerial approval in Saskatchewan.

¹⁴⁹ Canadian Securities Administrators, note 147. The amendments are made to National Instrument 45-106, Prospectus and Registration Exemptions.

The prospectus exemption allows prospective issuers to issue eligible securities¹⁵⁰ so long as a number of conditions are met, including the following:¹⁵¹

- (a) the head office of the issuer is located in a participating jurisdiction;
- (b) the issuer distributes eligible securities of its own through an ECF platform;
- (c) the issuer distributes eligible securities using an offering document in the form required that is made available through the ECF platform. The offering document includes basic information about the issuer, its management, and the distribution, including how the issuer intends to use the funds raised and the minimum offering amount;
- (d) the issuer group cannot raise aggregate funds of more than C\$250,000 per distribution, and is restricted to not more than two start-up crowdfunding distributions in a calendar year (meaning there is an aggregate yearly total cap of C\$500,000);
- (e) no investor invests more than C\$1,500 per distribution (although there is no limit in the number of offerings that an investor can participate in);
- (f) the distribution may remain open for a maximum of 90 days;
- (g) the distribution must be made through an ECF platform that is either relying on the start-up registration exemption or is operated by a registered dealer. Registered dealers that operate funding portals must meet their existing registration obligations under securities legislation, and confirm to issuers that they meet or will meet certain conditions provided in the start-up registration exemption;
- (h) the issuer provides each investor with a contractual right to withdraw their offer to purchase securities within 48 hours of the purchaser's subscription or notification to the investor that the offering document has been amended; and
- (i) none of the promoters, directors, officers, and control persons (collectively, the principals) of the issuer group are principals of the ECF platform operator.¹⁵²

The registration exemption permits ECF platform operators to offer services under the Start-up Exemption on the basis of a number of conditions:

- (a) the ECF platform operator must deliver an information form and individual information forms for each of its principals to the participating regulators at least 30 days prior to facilitating its first start-up crowdfunding distribution;
- (b) the head office of the ECF platform operator must be located in Canada;

¹⁵⁰ An eligible security means a common share, a non-convertible preference share, a security convertible into a common share or a non-convertible preference share, a non-convertible debt security linked to a fixed or floating interest rate, or a unit of a limited partnership. See e.g., Saskatchewan General Order, note 147.

¹⁵¹ The exemption also limits the ability to transfer shares.

¹⁵² Canadian Securities Administrators, note 147.

- (c) the majority of the ECF platform operator's directors must be Canadian residents;
- (d) the ECF platform operator does not provide advice to an investor or otherwise recommend or represent that an eligible security is suitable, or provide advice about the merits of the investment;
- (e) the ECF platform operator does not receive a commission, fee, or any other amount from a purchaser of eligible securities;
- (f) the ECF platform operator makes the offering document of the issuer and the risk warnings available online to investors, and does not allow a subscription until the investors have confirmed that they have read and understood these documents;
- (g) the ECF platform operator receives payment for an eligible security electronically through its website;
- (h) the ECF platform operator holds the investor's assets separate and apart from its own property, in trust for the investor, and, in the case of cash, at a Canadian financial institution;
- (i) the ECF platform operator maintains books and records at its head office to accurately record its financial affairs and client transactions, and to demonstrate the extent of its compliance with the Start-up Exemption orders for a period of 8 years from the date a record is created;
- (j) the ECF platform operator either:
 - (i) releases funds to the issuer after the minimum offering amount has been reached, and provided that the 48-hour right of withdrawal has elapsed, or
 - (ii) returns the funds to investors if the minimum offering amount is not reached or if the start-up crowdfunding distribution is withdrawn by the issuer; and
- (k) a participating regulator has not notified the ECF platform operator that it cannot rely on the exemptions because its principals or their past conduct demonstrate a lack of integrity, financial responsibility, or relevant knowledge or expertise.¹⁵³

The Integrated Crowdfunding Exemption provides another mechanism for start-ups to raise funds in participating jurisdictions.¹⁵⁴ The exemption is available to issuers that are incorporated or organized in Canada, have their head office located in Canada, have a majority of directors that are resident in Canada, and have a written business plan.

Issuers may raise up to C\$1.5 million under the Integrated Crowdfunding Exemption within a 12-month period. Offering periods are limited to 90 days, and the offering must include a minimum

¹⁵³ Ibid.

¹⁵⁴ Under the exemption, eligible securities are common shares, non-convertible preference shares, securities convertible into common shares or non-convertible preference shares, non-convertible debt securities linked to fixed or floating interest rates, units of a limited partnership, and flow-through shares.

offering size. There are also caps that apply on how much investors can invest, depending on the participating jurisdiction. In Ontario, non-accredited investors cannot invest more than C\$2,500 per offer and C\$10,000 for all offers made through the Integrated Crowdfunding Exemption in the same calendar year. Accredited investors that are not considered permitted clients must not invest more than C\$25,000 per offer and C\$50,000 for all offers made through the Integrated Crowdfunding Exemption in the same calendar year.¹⁵⁵ These limits do not apply to permitted clients.¹⁵⁶

Participating jurisdictions other than Ontario have different investor caps in place. For these jurisdictions, investors that are not accredited investors cannot invest more than C\$2,500 per offer. The annual C\$10,000 cap that applies in Ontario does not apply in other participating jurisdictions. Accredited investors must not invest more than C\$25,000 per offer.¹⁵⁷ Again, the C\$50,000 annual limit that applies in Ontario does not apply in other participating jurisdictions. In these other participating jurisdictions, there is no exemption from caps for permitted clients.

The Integrated Crowdfunding Exemption also imposes obligations on ECF platform operators and issuers (many of which differ depending on whether issuers have existing reporting obligations or whether they do not have existing reporting obligations).

Issuers must prepare an offering document that is made available only on the ECF platform. Issuers are not permitted to advertise an offering other than to refer prospective investors to the offering document on the ECF platform. The document will include information on the offering, the issuer, and the ECF platform. The document also includes rights of action for rescission or damages where there has been a misrepresentation in the material made available to investors. Issuers must also comply with strict financial reporting requirements. Financial statements must be approved by management of the issuer and be accompanied by:

- (a) a review report or auditor's report if the amount raised by the issuer under one or more prospectus exemptions from the date of the formation of the issuer until the end of its most recently completed financial year is C\$250,000 or more but is less than C\$750,000, or
- (b) an auditor's report if the amount raised by the issuer under one or more prospectus exemptions from the date of the formation of the issuer until the end of its most recently completed financial year is C\$750,000 or more.

Issuers must comply with a number of other obligations. These include the requirement that issuers obtain a signed risk acknowledgment form from every investor. Further, issuers have ongoing disclosure obligations including the requirement that when they raise funds in reliance on this

¹⁵⁵ Accredited investors for the purposes of Ontario are defined in section 73.3(1) of the Securities Act, R.S.O. 1990, c. S.5 and in National Instrument 45-106 Prospectus Exemptions.

¹⁵⁶ Permitted clients are those defined in National Instrument 31-103 Registration Requirements, Exemptions and Ongoing Registrant Obligations and include institutions such as financial institutions, the government of Canada, investment dealers, pension funds, and a person or company, other than an individual or an investment fund, that has net assets of at least C\$25 million as shown in its most recently prepared financial statements.

¹⁵⁷ For these participating jurisdictions, accredited investors are those defined in National Instrument 45-106 Prospectus Exemptions.

exemption they must report it and file an offering document within 10 days of the closing. Issuers must also provide all investors with ongoing information after closing (i.e., annual financial statements dependent on the amount raised and annual disclosure of information about the use of funds).

To rely on the exemption to provide ECF services, an ECF platform operator must be registered. Registration requirements include a number of obligations in relation to issuers that use the ECF platform (including the requirement to enter into an issuer access agreement), the requirement that they take reasonable steps to ensure that investors understand the risks associated with investing through an ECF platform including through provision of a risk acknowledgment form, an obligation to prominently disclose on their ECF platform information regarding remuneration, cost, and other expenses they may charge, obligations regarding the handling and release of funds; they must also ensure that relevant caps are complied with.

(iv) Jurisdictions that are Yet to Introduce a Specific ECF Regime

Several jurisdictions are actively considering introducing ECF specific regulation but have not yet to done so. In the meantime, limited types of ECF are taking place using various exceptions to existing securities regulations. While these jurisdictions may not yet have introduced an ECF specific regulatory framework, it is worth briefly considering some of the key developments in these jurisdictions.

The European Union (EU) has examined establishing a regional approach to crowdfunding for some years. This includes the European Commission's Communication on Crowdfunding and the Action Plan on Building a Capital Markets Union (CMU Action Plan). Both of these documents sought to explore the potential to strengthen the availability of alternative funding sources for SMEs through crowdfunding.¹⁵⁸ In discussing the importance of crowdfunding in the EU, the CMU Action Plan notes that:

Crowdfunding, for example, has been developing rapidly in some Member States. There are now more than 500 platforms providing a range of services in the EU. Given the predominantly local dimension of these activities, those Member States which are home to most crowdfunding activity are taking steps to clarify the conditions for this new business model. Securities-based crowdfunding platforms can be authorised under the Markets in Financial Instruments Directive (MiFID) and benefit from a passport to carry out regulated services and activities throughout the EU.¹⁵⁹ (citations omitted)

¹⁵⁸ European Commission, "Unleashing the potential of Crowdfunding in the European Union", Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, Brussels, COM(2014) 172 final, available at: http://ec.europa.eu/internal_market/finances/docs/crowdfunding/140327-communication_en.pdf; European Commission, "Action Plan on Building a Capital Markets Union", Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, Brussels, COM(2015) 468 final, 30 September 2015, available at: http://ec.europa.eu/info/publications/action-plan-building-capital-markets-union_en.

¹⁵⁹ Ibid at 7.

Part of the aim of the European Commission has been to analyse the development of national crowdfunding regimes and to report on the possible creation of a regional regime as well as obstacles in creating such a regime.¹⁶⁰ In its 2015 Green Paper, the European Commission identified a number of obstacles.¹⁶¹ The Green Paper identified a number of barriers to the development of cross-border capital markets in Europe, and noted that although the online nature of crowdfunding provided potential to contribute to financing of the economy across national borders, there was little evidence of cross-border activity in the area.¹⁶²

Despite the policy priority given to harmonizing ECF regulations at an EU level, no regime has yet been agreed. Instead, EU member states have increasingly implemented ECF regulatory frameworks at a national level that are not always consistent.¹⁶³

China has also been considering the implementation of an ECF specific regime. Several commentators have noted the potential significance for ECF in China. For instance, according to the 35th report of the China Internet Network Information Center, by December 2014, China's internet users reached 649 million, and the internet penetration rate was 47.9 percent of the population.¹⁶⁴ The World Bank estimates that in 2015, China's total national savings were approximately US\$5.58 trillion, which equalled 49 percent of its GDP.¹⁶⁵ Although these private savings are significant, China currently lacks the formal investment channels to efficiently allocate these savings.¹⁶⁶

Crowdfunding has the potential to play an important role in helping to make these funds available to SMEs looking for funding opportunities. The World Bank's 2013 Crowdfunding's Potential for the Developing World report estimated that China will generate US\$50 billion (over 50 percent of the global total) in crowdfunding by 2025.¹⁶⁷ This growth in crowdfunding has already started in China. By the end of 2015, 283 crowdfunding platforms hosted 49,242 projects in China. The majority of

¹⁶⁰ Ibid. The European Commission's support for this regional approach furthered that of the European Parliament which passed a resolution on 9 July 2015 calling for, among other things "financing models, including crowdfunding...", European Parliament, "Building a Capital Markets Union", European Parliament Resolution of 9 July 2015 on Building a Capital Markets Union (2015/2634(RSP), available at:

<http://www.europarl.europa.eu/sides/getDoc.do?type=MOTION&reference=B8-2015-0655&language=EN>.

¹⁶¹ European Commission, "Building a Capital Markets Union", Brussels, COM(2015) 63 final, 18 February 2015, available at: http://ec.europa.eu/finance/consultations/2015/capital-markets-union/docs/green-paper_en.pdf.

¹⁶² Ibid.

¹⁶³ See eg., Alessandro M. Lerro, "European Union Stops Harmonization Process for Crowdfunding Rules", Crowdfund Insider, 14 September 2016, available at: <http://www.crowdfundinsider.com/2016/09/90155-european-union-stops-harmonization-process-crowdfunding-rules/>; Therese Torris, "It's a Long Way to European Equity Crowdfunding Regulation", Crowdfund Insider, 30 October 2015, available at: <http://www.crowdfundinsider.com/2015/10/76509-its-a-long-way-to-european-equity-crowdfunding-regulation/>.

¹⁶⁴ China Internet Network Information Center, "Statistical Report on Internet Development in China", January 2015, available at: <https://cnnic.com.cn/IDR/ReportDownloads/201507/P020150720486421654597.pdf>.

¹⁶⁵ World Bank, Data: China, available at: <http://data.worldbank.org/country/china>.

¹⁶⁶ See e.g., Zhao Liang, "Crowdfunding in China: Potentials, Challenges, Risks and Solutions", October 6, 2015, available at: <http://www.crowdfundinsider.com/2015/10/75384-crowdfunding-in-china-potentials-challenges-risks-and-solutions/>; Menglu Zhang, "The Legislative Trends In Equity Crowdfunding In China", *Minnesota Journal of International Law*, 6 February 2016, available at: <http://minnijl.org/the-legislative-trends-in-equity-crowdfunding-in-china/>.

¹⁶⁷ See note 41.

these projects (69 percent) were reward-based crowdfunding, but the remaining projects were divided between charity crowdfunding and equity crowdfunding.¹⁶⁸

The Securities Association of China and the China Securities Regulatory Commission, in recognition of the need to facilitate new forms of investment, issued the *Measures for the Administration of Private Equity Crowd Funding (for Trial Implementation) (Consultation Draft)*.¹⁶⁹ This document contained draft rules that would allow “accredited investors” to invest through an ECF platform so long as these investors satisfy one of the following requirements:

- invest at least RMB1 million in a single project; or
- have net assets of RMB10 million; or
- have financial assets of RMB3 million and have an annual income of at least RMB500,000 for the past 3 years.¹⁷⁰

The restriction to “accredited investors” appears to severely limit the potential of ECF in China by reducing participation by potential investors to all but the very wealthy. This has led some commentators to note that the restriction to accredited investors contravenes the intended purpose of crowdfunding in providing SMEs an opportunity to raise funds from the “crowd”.¹⁷¹ The China Securities Regulation Commission, however, has stated that crowdfunding can be categorized as either private placements to qualified investors or public offerings to the general public, and the proposal put forward by the Securities Association of China fell within the first category.¹⁷²

The government of Hong Kong, in its 2015 budget, singled out the importance of SMEs and the need to support them to facilitate economic growth.¹⁷³ Assistance for SMEs is particularly important in Hong Kong, especially in the information and communications sector.¹⁷⁴ Alternative sources of funding are particularly important for this industry as it is made up of many SMEs.¹⁷⁵ Despite this, Hong Kong is yet to implement ECF-specific regulation, and in May 2014, the Hong Kong Securities and Futures Commission issued a notice warning persons engaging in activity like crowdfunding

¹⁶⁸ See Zolzaya Erdenebileg, “Better Together: The Potential of Crowdfunding in China”, *China Business Review*, 16 November 2016, available at: <http://www.chinabusinessreview.com/better-together-the-potential-of-crowdfunding-in-china/>.

¹⁶⁹ Zhao, note 166; The State Council (People’s Republic of China), “China to Regulate Online Equity Financing Platforms”, 8 August 2015, available at: http://english.gov.cn/state_council/ministries/2015/08/08/content_281475163531038.htm (discussing the issue of regulations by several authorities to prevent abuse of ECF)

¹⁷⁰ Zhao, note 166.

¹⁷¹ China Securities Regulatory Commission, Press Conference on December 26, 2014, available at: http://www.csrc.gov.cn/pub/csrc_en/newsfacts/PressConference/201501/t20150113_266540.html.

¹⁷² Ibid.

¹⁷³ See Financial Services Development Council, “Introducing a Regulatory Framework for Equity Crowdfunding in Hong Kong”, FSDC Paper No. 21, March 2016, available at: http://www.fsd.org.hk/sites/default/files/Final_Report.pdf.

¹⁷⁴ Ibid.

¹⁷⁵ Ibid. The Hon. Mr. Charles Mok, the Legislative Councillor for the Information Technology constituency, also suggested that the Hong Kong Government “consider formulating relevant financial policies and legislation to facilitate investments from angel investors, venture capitalist firms or crowdfunding in financing the start-ups at various stages, so as to build an effective and sustainable technology start-up ecosystem”. Legislative Council of Hong Kong (2014), p. 22, Financial Services Development Council, note 173 at 6–7.

that they may be contravening current investor protection and market supervision regulations if they provided services such as crowdfunding without obtaining appropriate licenses and complying with relevant regulations.¹⁷⁶

Singapore has also considered the possibility of issuing ECF specific regulations. On 16 February 2015, the Monetary Authority of Singapore (MAS) issued the consultation paper: *Facilitating Securities-Based Crowdfunding*, which, in its abstract, expressed the following purpose:

To facilitate the access by start-ups and small and medium enterprises (“SMEs”) to more sources of funding, the Monetary Authority of Singapore (“MAS”) is proposing measures to facilitate crowdfunding which involves the offer of securities (“securities-based crowdfunding” or “SCF”) to accredited and institutional investors. In particular, MAS proposes to relax certain financial requirements for capital markets intermediaries that deal in securities, which will benefit certain intermediaries that operate crowdfunding platforms. MAS will also clarify the application of certain exemptions from prospectus requirements under the Securities and Futures Act (Cap. 289) (“SFA”) for fundraising through SCF.¹⁷⁷

The consultation paper put forward a system to facilitate ECF from accredited and institutional investors through the relaxation of certain financial requirements for capital markets intermediaries that deal in securities and clarification of the application of certain exemptions from prospectus requirements. After receiving responses to the consultation paper, MAS published: *Response to Feedback Received – Facilitating Securities-Based Crowdfunding*.¹⁷⁸ The proposed system expands on the proposal put forward by the MAS in its consultation paper and includes a two-tiered process for (1) accredited and institutional investors, and (2) any investors (including retail investors).

In its statement accompanying the release of the response to feedback document, MAS noted the key features of the system as follows:

First, MAS will make it easier for [ECF platform operators] to rely on the existing regulatory framework for small offers, to raise funds through [ECF] including from retail investors. For such [ECF platform operators], MAS will simplify the pre-qualifications that currently allow issuers raising less than [SG\$5 million] within 12 months to do so without having to issue a prospectus. As a safeguard for investors, MAS will require these [ECF platform operators] to document and disclose the key risks of [ECF] investments and obtain investors’ acknowledgement that they have read and understood these risks.

¹⁷⁶ Securities and Futures Commission, ‘Notice on Potential Regulations Applicable to, and Risks of, Crowd-funding Activities’ 7 May 2014.

¹⁷⁷ Monetary Authority of Singapore, “Facilitating Securities-Based Crowdfunding”, Consultation Paper P005 – 15, February 2015, available at: <http://www.mas.gov.sg/News-and-Publications/Consultation-Paper/2015/Facilitating-Securities-Based-Crowdfunding.aspx>.

¹⁷⁸ Monetary Authority of Singapore, “Response to Feedback Received – Facilitating Securities-Based Crowdfunding”, Response to Feedback Received, June 2016, available at: <http://www.mas.gov.sg/News-and-Publications/Consultation-Paper/2015/Facilitating-Securities-Based-Crowdfunding.aspx>.

Second, MAS will reduce the financial requirements for [ECF platform operators] who want to raise funds through [ECF] only from accredited and institutional investors. MAS will ease the financial requirements for these platform operators to be licensed as dealing intermediaries, as long as they do not handle or hold customer monies, assets or positions, and do not act as principal against their customers. Both the base capital requirement and minimum operational risk requirement for such intermediaries will be reduced to [SG\$50,000]. The requirement for a [SG\$100,000] security deposit will also be removed. This will allow more qualifying [ECF platform operators] to operate in this restricted space and takes into account the limited systemic and business conduct risks posed by such intermediaries.¹⁷⁹ (citations omitted)

MAS also noted that it would be publishing guidelines on ECF-related advertising to clarify that existing advertising restrictions in Singapore do not prohibit ECF platform operators from publicizing their services and to provide guidance on the manner in which such advertisements can be made.¹⁸⁰

¹⁷⁹ Monetary Authority of Singapore, "MAS to Improve Access to Crowd-funding for Start-ups and SMEs", Media Release, 8 June 2016, available at: <http://www.mas.gov.sg/News-and-Publications/Media-Releases/2016/MAS-to-Improve-Access-to-Crowdfunding-for-Startups-and-SMEs.aspx>.

¹⁸⁰ On 3 November 2016, it was announced that Fundnel Limited, a Singapore-headquartered private investment platform, had received a provisional Capital Markets Services licence from MAS. Fundnel stated that it was the first such license issued by MAS to any private investing platform. The licence allows Fundnel to market its equity crowdfunding platform and deal in securities under Singapore's Securities and Futures Act. See, Alois, JD, "Fundnel Receives Capital Markets Services Licence for Monetary Authority of Singapore, Crowdfund Insider, 3 November 2016, available at: <https://www.crowdfundinsider.com/2016/11/92073-fundnel-receives-capital-markets-services-licence-monetary-authority-singapore/>

Chapter 5: Comparative Analysis and Key Recommendations

Chapter 5 provides a comparative analysis of key regulatory issues relevant to the jurisdictions explored in Chapter 4. The chapter also puts forward a number of recommendations for consideration by ASEAN member states when reforming their securities regimes to introduce ECF.

The Chapter proceeds as follows. Section A provides overarching observations regarding the establishment of a regulatory framework for ECF. Section B considers regulatory issues relevant to ECF platform operators. Section C considers regulatory issues relevant to issuers, and section D considers regulatory issues relevant to investors.

A: General Regulatory Observations

There are a number of considerations that should be taken into account when constructing a regulatory framework for ECF. The issues that are explored in this section are:

- (a) ECF Rules in Legislation or Regulator's Rules
- (b) Should there be a Separate ECF Regime?
- (c) Regional Considerations

(a) ECF Rules in Legislation or Regulator's Rules

All of the jurisdictions include a balance between regulation set out in legislation and regulation set out in the rules of regulators. It is common for jurisdictions to amend legislation only as much as necessary to ensure that regulators have the authority to create regulations for ECF.

This approach was adopted in both Malaysia and Thailand where legislation was used only to provide relevant regulators with the authority to construct rules regarding ECF. SC Malaysia and in Thailand, TSEC, used this legislative authority to draft the Guidelines and the ECF Notification respectively. Australia's 2017 Act sets out the rules of ECF in more detail, but also relies on the expansion of these rules through regulations. This is an approach adopted to some extent in New Zealand.

The United Kingdom has set out its rules in a policy document, but the changes to legislation have been made in a legislative instrument. Much of the U.K. regulations are set out in the FCA Handbook and are not separate from regulation of securities more broadly. The United States and Canada have relied on a mix of legislation and regulator's rules to provide their regulatory framework. In Canada, the Integrated Crowdfunding Exemption has permitted both reporting and non-reporting issuers to use the exemption, and many of the regulations relating to reporting issuers are found in general securities laws. This is true also of the United States, where broker-dealers operating as ECF platform operators have to comply with general securities laws.

Recommendation A1: ECF Rules in Legislation or Regulator's Rules

One of the primary aims of ECF is to provide a way to raise funds that is simple, clear, and, as it relies on innovation, flexible. For this reason, it may be preferable to reduce the level of detail of rules set out in legislation. Legislation may prove difficult to amend and may take too much time. Further, legislation is often relatively high level. It may be more appropriate to reduce the level of detail in legislation and rely more on rules drafted by regulators. The following matters should be set out in legislation:

- (a) authority of the appropriate regulator to create rules for ECF through subordinate regulation, policy documents, or guidelines; and
- (b) amendments of securities laws to allow for the operation of the ECF regime.

(b) Should there be a Separate ECF Regime?

There is some divergence in the jurisdictions explored in this report as to whether the rules for ECF should be integrated with general laws regarding securities or whether there should be a separate ECF regime.

The majority of jurisdictions provide provisions that relate specifically to ECF, with reference made in some cases to general securities laws where this applies irrespective of the securities offered. The United Kingdom has adopted an integrated system, with many of the rules regarding ECF being the same as the rules which apply more generally to the issue of shares to the public.

Recommendation A2: A Separate Regime

To the extent possible, there should be a separate ECF regime. This will help ensure that retail investors who have limited knowledge of investing will have access to clear and comprehensive regulation regarding their rights and the obligations of each of the actors in the ECF process.

Where ECF is subject to general securities regulations, consideration should be given to including these regulations in the guidelines regarding ECF and setting out how they apply specifically to the offer of shares through the ECF regime. This will avoid the complexity apparent in the U.K. regime, where it has been difficult for the relevant actors to determine their rights and obligations as well as the expectations of the FCA. It will also allow the relevant regulator to have a comprehensive guide regarding the ECF process.

(c) Regional Considerations

To encourage ECF at a regional level in ASEAN, regulations discussed in the remainder of Chapter 5 should be considered in light of regional considerations.

Recommendation A3: Regional Considerations

ASEAN has for some time encouraged economic integration among member states and sought to assist the development goals of developing states by improving economic performance. For this reason, the regulations considered in the remainder of Chapter 5 should take into account these regional goals. Regulators should consider establishing ECF regimes that take the following matters into account:

(a) Harmonizing the definitions of common matters dealt with in the ECF process to reduce barriers to operating across borders.

(b) Making concessions for licensing or registration of ECF platform operators. Where appropriate, the licencing or registration of an ECF platform operator in one ASEAN jurisdiction should be recognized by regulators in other jurisdictions. This may require that an ECF platform operator submit certain information to the regulator of a jurisdiction that it wants to operate in. Where this is not possible, the rules regarding licensing or registration should be as consistent as possible to encourage ECF platform operators to operate across the region.

(c) Providing consistency in the type of securities that can be purchased across borders and the mechanism over which ECF is offered. This will ensure that investors that want to invest across borders will have some certainty about the type of investment they are making and familiarity with the process through which the investment is taking place. It will also assist in harmonizing the rules and regimes that regulators must oversee.

(d) Consideration should be given to allowing ECF issuers from ASEAN jurisdictions to raise funds across the region.

(e) Other rules are to the extent possible harmonized, and regulators should consider establishing a regime of mutual recognition so that ECF actors that comply with the rules of one regime will be recognized as satisfying the requirements of other participating jurisdictions. This may require some form of certification and submission to the authority of the relevant regulator.

B: ECF Platform Operators

(i) Overview of Regulatory Issues

Each of the jurisdictions analysed in Chapter 4 divides regulation of ECF platform operators into two broad categories. First, the relevant jurisdictions set out a number of prerequisites that ECF platform operators must meet in order to be permitted to act as an intermediary in the ECF process. Second, once they have received approval, the jurisdictions require that ECF platform

operators comply with certain obligations that aim to protect investors as well as to ensure the efficiency of the ECF process. Each of the jurisdictions, however, differs on the extent of regulation that applies to ECF platform operators and the onus that is imposed on them to oversee the system. Despite these differences, each of the jurisdictions deal with a number of important regulatory issues regarding ECF platform operators. The issues explored in this section are:

- (a) Licensing and Incorporation Requirements
- (b) Service and Product Offering
- (c) Due Diligence
- (d) Investor Oversight
- (e) Disclosures
- (f) Education and Testing Requirements
- (g) Conflicts of Interest
- (h) Liability
- (i) Handling Investor Funds
- (j) Dispute Resolution

(ii) Comparative Analysis and Recommendations

(a) Licensing and Incorporation Requirements

The jurisdictions considered generally require that a prospective ECF platform operator either operate pursuant to a licence or through registration with a regulatory authority. Each jurisdiction, however, differs on what is required to receive a licence or to be registered as an intermediary. One common feature is a requirement that the prospective ECF platform operator be incorporated locally.

Malaysia requires that an ECF platform operator register with SC Malaysia as a recognized market operator (RMO). In order to be registered, the prospective ECF platform operator must be locally incorporated. SC Malaysia has broad discretion in determining whether or not to register an ECF platform operator as an RMO. However, the Guidelines set out the matters that SC Malaysia may consider when determining whether to register an applicant. These generally deal with the ability of the applicant to operate an orderly, fair, and transparent market; illustration of a commitment to maintain risk management processes; the capacity to protect investor interests; and the obligation to ensure the proper functioning of the market. Further, in order to be registered, SC Malaysia must be satisfied that a prospective ECF platform operator will ensure the proper regulation and oversight of users of its ECF platform.

Thailand operates a registration regime for its ECF platform operators. Similarly to Malaysia, TSEC requires that any prospective ECF platform operator be locally incorporated. The Thai regime sets out the requirements that TSEC must consider when it receives an application from a prospective ECF platform operator. For instance, an applicant must satisfy TSEC that its key personnel are fit and proper, it is not experiencing financial difficulties, it does not have any conflicts of interest, and it has in place the systems necessary to operate the ECF platform in accordance with regulatory requirements. Further, unlike many of the other regulatory regimes, the Thai regime requires that

applicants have paid up registered capital of not less than 5 million Baht (approximately US\$140,000).

The United Kingdom requires that a prospective ECF platform operator obtain authorization from the FCA in accordance with sections 19 and 21 of the FSMA. In order to obtain authorisation, an applicant must at a minimum illustrate to the satisfaction of the FCA that it meets the threshold requirements set out in Schedule 6 of the FSMA. Unlike the first two jurisdictions considered, the U.K. regime has not set out a prescriptive list of considerations that the FCA will consider in granting authorization. Instead, applicants must determine from the generic list of threshold requirements that are potentially applicable for the operation of any regulated financial service in the United Kingdom, which would be applicable for the provision of an intermediary service in the ECF process. After making this determination, they must illustrate to the FCA that they meet the relevant threshold requirements for the provision of that service.

This system provides flexibility in the provision of services, but also means there is less clarity for prospective ECF platform operators regarding the measures they must meet in order to be authorized to operate an ECF platform. The FCA, recognizing this lack of clarity, is proposing to provide further guidance on threshold requirements that may apply to the operation of an ECF platform. Presently, the FCA notes that it is likely that prospective ECF platform operators would need to illustrate, for instance, that they have adequate financial and non-financial resources to operate an ECF platform and that they have a website over which the service will be provided.

The Australian 2017 Act provides, as with the United Kingdom, that prospective Australian ECF platform operators need to comply with licensing requirements that apply generally to the provision of financial services. This means that ECF platform operators in Australia must obtain an Australian Financial Services Licence (AFSL) in accordance with the requirements set out in Chapter 7 of the ACA. The 2017 Act does not therefore set out a licensing regime as it applies specifically to the operation of an ECF platform. However, ASIC has provided some general guidance on when it will issue an AFSL. ASIC notes that the conditions it will consider include financial matters, non-financial matters such as human resources and dispute resolution processes and general competence matters.

The United States, Canada, and New Zealand also impose licensing requirements on prospective ECF platform operators. For instance, Part 6 of New Zealand's FMC Act and the associated regulations provide that New Zealand's FMA will provide a licence to operate an ECF platform if, among other things, an applicant illustrates it has fair, orderly, and transparent systems and procedures in place for providing the service, and if they satisfy certain capability standards. The FMA takes into account whether an applicant's directors and senior managers are fit and proper, whether they have appropriate internal governance procedures, financial resources and indemnity insurance, whether they have measures in place to prevent fraud, and whether they have in place appropriate information technology arrangements. Applicants must also have a plan to protect the interests of relevant issuers or investors if their services are terminated.

In the United States, ECF must be conducted through an "intermediary" that is registered with the SEC either as a broker-dealer or as a "funding portal", which is a category of operator specifically

created for the operation of an ECF service. A funding portal must have written policies and procedures reasonably designed to achieve compliance with its legislative obligations and SEC Rules, as well as complying with anti-money laundering requirements. The regime allows for non-resident funding portals to operate in the United States so long as they meet specific requirements.

The two main exemptions used in Canada to operate an ECF platform also contain registration requirements. The registration elements of the Start-up Exemption include a requirement that an ECF platform operator have its head office in Canada. Before relying on the Start-up exemption, an ECF platform operator must provide the relevant regulator with prescribed information. The Integrated Crowdfunding Exemption requires ECF platform operators to be registered in compliance with a number of broadly applicable registration requirements for the provision of financial services. Once registered, ECF platform operators must comply with ongoing requirements, including disclosure requirements, the obligation to receive a risk acknowledgment from investors, and handling of trust money.

The following table summarizes the state of licensing requirements in each of the jurisdictions:

Table 4: Licensing or Registration Requirements in Various Jurisdictions

Jurisdiction	Licensing or Registration Requirements	Local Incorporation
Malaysia	Requires registration as an RMO with SC Malaysia.	Applicants must be incorporated under Malaysian law.
Thailand	Requires registration with TSEC.	Applicants must be incorporated under Thai law.
United Kingdom	Authorization required pursuant to Part IV of FSMA from the FCA.	The regulations regarding authorisation to operate an ECF platform do not mention a local incorporation requirement.
Australia	Must hold an AFSL.	The 2017 Act does not specify whether an ECF platform operator must be locally incorporated. The general requirements applicable to AFSL holders apply.
New Zealand	Licence required from the FMA.	Must comply with general licensing requirements for offer of market services.
United States	Must be licenced to operate either as a broker-dealer or as a funding portal with the SEC.	Permits non-resident ECF platform operators.
Canada	Generally requires registration or authorisation from a relevant regulatory authority.	Contains some conditions of local operation depending on exemption used.

Recommendation B1: Licensing and Incorporation Requirements

Any licencing and incorporation requirements adopted by ASEAN member states should take, at a minimum, the following into consideration:

(a) Licensing or Registration: Any prospective ECF platform operator should be required to register with or receive a license to operate from their national securities regulator.

(b) ECF Specific Regime: Any licensing or registration requirement should cater specifically to the operation of an ECF platform. Where a licence or registration requirement is part of a broader licensing or registration regime, consideration should be given to clearly setting out in the regulations the requirements for ECF platform operators, or guidelines should be drafted that clearly outline the ECF process and how those generic licencing or registration requirements apply to the ECF platform operator.

(c) Minimum Requirements: The licencing or registration requirements should ensure compliance with the following minimum requirements:

(i) Agreement to operate the platform in a manner that is open, transparent, and fair, and in accordance with relevant laws;

(ii) The ECF platform operator has in place the measures required to ensure that it has the capacity to operate the ECF platform, including technical capacity and financial and other resources;

(iii) Agreement to have in place processes that require issuers to meet the obligations they have under ECF regulations; and

(iv) Agreement to comply with ongoing governance requirements as required under ECF regulations, including in relation to compliance with ongoing disclosure obligations, agreement to handle trust money in the manner provided in the regulations, and implementation of policies that ensure avoidance of conflicts of interest.

(b) Service and Product Offering

There are a number of limitations commonly imposed on the types of services and products that an ECF platform operator can offer and/or how they may be offered. Important limitations that ECF platform operators may need to either oversee or ensure compliance with, relate to:

(i) the medium over which ECF can be offered;

(ii) whether multiple offers can be made at the same time; and

(iii) whether there are restrictions on the type of securities that can be offered over an ECF platform.

Almost all jurisdictions either explicitly provide that ECF is provided over the internet or imply that this is the case. The United Kingdom is an exception, having adopted a media-neutral approach. This means that the ECF regulations apply equally to all intermediaries marketing offers for non-readily realizable securities whether they use the internet or other forms of media. The FCA provided the following reasons for its decision:

Our proposals reflect the rise of the popularity of internet-based crowdfunding. We consider this market to have arisen, in part, as a result of enhancements in digital technology. These have reduced marketing, distribution and transactional costs by providing standardised and automated processes.

However, in line with our high-level policy, the proposals we consulted on were media-neutral, and intended to apply to all firms marketing and selling non-readily realisable securities in the UK, whether over the internet or through other media. This was done with our competition objective in mind and in order to provide appropriate protection for all investors however they invest.¹⁸¹

This justification has not been adopted by other jurisdictions. For instance, in Australia, after reviewing the approach adopted by several other jurisdictions, CAMAC accepted arguments in favour of limiting ECF to online platforms as is the practice in the United States and Canada. The main justification for adopting this approach was the belief that restricting ECF to online platforms would "... ensure that all relevant information provided to the crowd concerning an issuer and its equity offer is available at one, readily accessible, internet location."¹⁸² According to CAMAC, this outweighed concerns raised in the United Kingdom regarding potential reduction in competition. The Australian government, in drafting the 2017 Act, accepted CAMAC's reasoning, and, as a result, Division 3 of Part 6D.3A has been drafted so that an ECF offer document, which is a prerequisite for issuing shares through the ECF process must be published on one online ECF platform.

Although the regulations in Thailand and Malaysia do not expressly provide that ECF can only be provided through online platforms, the regulations have been drafted in a way that effectively restricts the service to online platforms. For instance, in Malaysia, the Guidelines have been drafted on the basis of authority provided to SC Malaysia under the CMSA to register recognised market operators (RMOs). Paragraph 3.01 of the Guidelines further states that SC Malaysia may register an applicant which includes an ECF platform operator as a RMO if it is satisfied that the applicant will be able to operate an orderly, fair and transparent market in relation to securities that are offered through its electronic facilities.

The majority of jurisdictions provide, for similar reasons to the online-only requirement, that issuers may only issue shares through one platform operator at a time. As noted above, this restriction is used in the Australian regime. Both the Malaysian regime and the Thai regime similarly restrict

¹⁸¹ FCA Policy Statement, note 88 at 40.

¹⁸² CAMAC Report, note 42 at 90.

offers to one platform operator at a time (although the Thai regime offers potential for TSEC to waive this restriction). The justification for this restriction is that it ensures that information is readily accessible through one platform and as a result permits more informed decision-making.

Many of the jurisdictions considered limit the types of shares that can be offered through the ECF regime. Both Australia and New Zealand provide that only fully-paid, ordinary shares may be offered through the ECF regime. SC Malaysia proposed that this restriction on the form of shares be adopted in Malaysia as well, citing the Australian and New Zealand approach. SC Malaysia's decision was based on the following observations:

Given the fact that ECF was envisaged as a means to finance start-ups and other small enterprises, it has been proposed by New Zealand and Australia that only common shares, excluding options and convertible securities, are offered to investors through an ECF platform. Complex securities such as derivatives and securitised products are deemed inappropriate, given the fact that the vast majority of investors on an ECF platform are retail.

As such, the SC proposes to only allow common shares, excluding options and convertible securities to be offered to investors through an ECF platform. An issuer may only offer one class of shares in any one offering and that class of shares must be offered at the same price and carry the same rights.¹⁸³

Thailand's regime offers more scope in the form of shares that can be offered. Although securities are defined as shares, issuers using ECF must, in accordance with clause 8 of the ECF Notification, report to TSEC, among other things, the type, characteristics, and specific title of the securities (if any). Clause 37 also requires that an issuer notify an investor of the "features" of the securities purchased. Canada takes a more expansive approach, permitting issuers using one of the two main ECF exemptions to issue a wider range of shares, including common shares, non-convertible preference shares, securities convertible into common shares or non-convertible preference shares, and non-convertible debt securities linked to fixed or floating interest rates. However, as with other jurisdictions, Canadian regulations preclude the issue of complex derivatives and securitized products.

Some jurisdictions regulate debt and equity securities under the same regulatory regime. For instance, in the United Kingdom, the FCA regulatory structure relates to "investment-based crowdfunding" and covers both equity and debt securities for which there is no, or only a limited, secondary market. This regulatory framework is then distinguished from peer-to-peer crowdfunding (or lending crowdfunding). The combination of these two forms of securities under the U.K. regime is consistent with the more generic approach to ECF regulation in that jurisdiction. The other regimes considered have tended to restrict the regulatory framework to the issue of shares. The U.K. framework has the advantage of expanding the possible mechanisms for raising funds but at the same time provides a greater level of complexity that comes with generality in the rules developed.

¹⁸³ SC Malaysia, Consultation Paper No 2/2014, Proposed Regulatory Framework for Equity Crowdfunding, 21-22, available at: https://www.sc.com.my/wp-content/uploads/eng/html/consultation/140821_PublicConsultation_2.pdf.

Recommendation B2: Service and Product Offering

In determining the services and products offered by ECF platform operators and the mechanisms that they can adopt to offer those services or products, regulators should take the following into account:

(a) Internet-Only Restriction: To ensure simplicity in the process and to increase the prospects of investors having complete and readily-accessible information required to make investment decisions, regulators should restrict ECF to internet platforms. Although this may be considered a restraint on technological innovation, the fact that the rules of most jurisdictions are set out in detail in the rules of regulators should provide regulators with the flexibility required to undertake appropriate reforms where technological advances warrant reform.

(b) Sole Offer Restriction: Issuers should be restricted in the number of offers for shares that they can have open at one time. The restriction should require that only one share offer can be open at a time with one ECF platform operator. ECF platform operators should be required to obtain the agreement of issuers to comply with this requirement before they open an offer. This again ensures that investors have access to accurate information about the securities they are purchasing. It also ensures that ECF platform operators are able to oversee compliance with regulations by issuers.

(c) Eligible Shares: As ECF is a relatively recent innovation, particularly in developing states, consideration should be given to restricting the shares that can be issued to retail investors to fully paid, ordinary shares all at the same price and with the same rights. This measure seeks to protect vulnerable retail investors who have limited knowledge and experience with financial investment. Issuers who want to raise funds through issues of more complex derivative and securitisation products should use other fundraising options.

(c) Due Diligence

It is a common feature of most regulatory frameworks to include due diligence requirements for ECF platform operators. The obligation to undertake checks includes those that are required before an issuer can use an ECF platform and those that take place on an ongoing basis.

The Malaysian regime provides that ECF platform operators must comply with due diligence requirements listed in the Guidelines. Paragraph 12.06 of the Guidelines provides that ECF platform operators conduct background checks on issuers to ensure that they, their board of directors, senior management, and controlling owners are fit and proper, as well as verify the business plan of issuers. Further, ECF platform operators in Malaysia must ensure on an ongoing basis that

issuers conform to issuer caps. Malaysia also requires that ECF platform operators have in place processes to monitor anti-money laundering requirements. SC Malaysia's approach to due diligence is to adopt a self-declaratory approach for issuers, with ECF platform operators expected to ensure through their due diligence checks that the information provided is true and accurate. The requirements set out therefore act as minimum parameters with which ECF platform operators must comply.

Thailand requires that ECF platform operators must, in accordance with clause 18(1) of the ECF Notification, undertake due diligence requirements in a manner expected of professionals in similar circumstances. Clause 36 of the ECF Notification expands on these due diligence requirements. ECF platform operators are required to comply with the following requirements that may qualify as due diligence requirements:

- (a) verifying the identify of an issuer and ensuring that in the 2 years leading up to an offer of shares, the issuer has not made materially false or incomplete disclosures;
- (b) ensuring that an issuer provides the required information to the ECF platform operator after an offer for the sale of shares has closed;
- (c) ensuring that an offer of shares is conducted in accordance with regulations; and
- (d) entering into an agreement with an issuer which requires the issuer, among other things, to agree to make certain disclosures on an ongoing basis and to notify of material changes to information disclosed.

In the United Kingdom, apart from conducting some basic preliminary checks on issuers, there is no prescriptive list of checks provided in the ECF regime. Instead, ECF platform operators must disclose information to the FCA that provides sufficient detail to give a balanced indication of the benefits and risks involved in the service provided, including whether due diligence has been carried out on an issuer, the extent of that due diligence, and the outcome of the analysis. The FCA has justified this approach on the basis of the flexibility that it offers in conducting due diligence checks. However, the FCA has left open the possibility of a more prescriptive approach if needed in the future.

Australia and New Zealand also limit the due diligence obligations of ECF platform operators but provide more guidance on how these obligations are to be satisfied. Australia's 2017 Act outlines certain "gatekeeper" provisions that act as due diligence requirements. The explanatory memorandum to the 2016 Bill explains the limited effect of the due diligence requirement as follows:

The purpose of the gatekeeper obligations is not to require the intermediary to conduct exhaustive due diligence on the company, its directors or other officers, or the company's business. Such an obligation would impose a relatively high burden on an intermediary, with potential flow-on costs for issuers seeking to access the intermediary's platform.

Rather, the gatekeeper obligations are intended to ensure that an ECF platform operator does not publish, or continue to publish, the offer document in four specific circumstances. The basis for not

publishing or continuing to publish the offer document is dependent on the actual knowledge of the intermediary (that is, whether they were satisfied as to certain matters or had reason to believe certain things) and what the intermediary should have become aware of from conducting the prescribed checks to a reasonable standard.¹⁸⁴

New Zealand's due diligence requirements are limited to ECF platform operators having anti-fraud and fair dealing policies that enable them to assess issuers and their management, and, if needed, exclude an issuer from using their ECF platform. While due diligence is limited to these two issues, the New Zealand regime sets out, in a prescriptive manner, what ECF platform operators must do to comply with these two requirements.

When it comes to anti-fraud measures, ECF platform operators must conduct checks and exclude on the basis of these checks, offers by issuers where there is evidence that the issuer or related parties of the issuer are not of good character and reputation. The New Zealand regime establishes a minimum basis for these checks, which includes checking publicly available and readily accessible information (for instance, public registers and the internet to check for bankruptcy, convictions for fraud, and the like), and excluding issuers and related parties from using their ECF platform when they are not satisfied as to the identity of the issuer and their related parties. When it comes to fair dealing, ECF platform operators operating under the New Zealand regime must have an adequate policy for excluding issuers if checks illustrate that the issuer has engaged in certain misleading or deceptive conduct.

In the United States ECF platform operators are required to have a reasonable basis for believing that an issuer complies with regulations regarding ECF, including background and regulatory checks on directors, officers, and significant shareholders of issuers. ECF platform operators may reasonably rely on an issuer's representations about compliance unless they have reason to question the reliability of those representations. Where an ECF platform operator considers that an issuer does not comply with certain ECF regulations, they must not permit the issuer to use their ECF platform. The SEC has adopted this approach because it considers that a reasonable basis standard is appropriate, particularly because issuers have their own obligations to comply with ECF regulations. According to the SEC, a more onerous regime which would require due diligence on issuers or monitoring of issuer communication during the course of an offering would likely increase operating costs.

The Integrated Crowdfunding Exemption in Canada contains a list of due diligence requirements that ECF platform operators must comply with. At a minimum, an ECF platform operator must conduct the following checks:

- (a) for issuers:
 - (i) the existence of the issuer and its business registration, including a review of the issuer's constitutional documents;
 - (ii) criminal record and securities enforcement history checks;

¹⁸⁴ Explanatory Memorandum to the 2016 Bill, paras 3.37 and 3.38.

- (iii) bankruptcy/liquidation checks; and
 - (iv) court record checks, where available;
- (b) for directors, executive officers, control persons and promoters of the issuer:
 - (i) criminal record and securities enforcement history checks;
 - (ii) bankruptcy checks; and
 - (iii) court record checks, where available.

The Canadian regime also requires that ECF platform operators review offering documents, materials provided as part of their due diligence obligations, and any personal information forms collected.¹⁸⁵ Where The ECF platform operator identifies an error or misleading or incorrect information, it must require that the issuer correct, complete, or clarify the information before the issuer can use the ECF platform. An ECF platform operator must not permit an issuer to use their ECF platform if these background checks, or the information provided by an issuer in its application, indicate to the ECF platform operator that the issuer may not act with integrity and in the best interests of security holders.

Recommendation B3: Due Diligence

Due diligence is an important aspect of an ECF regulatory framework as it protects against fraudulent behaviour or other abuses of the system. Investors, particularly retail investors, who will rely predominantly on the information provided through the ECF platform to make decisions on their investments, may find it difficult to detect such behaviour. It is therefore important that ECF platform operators engage in due diligence checks. The following considerations should be taken into account when establishing a regime for due diligence checks:

(a) Mandatory Due Diligence Checks on Issuers: ECF platform operators should be required to conduct checks on issuers that seek to use their ECF platform.

(b) Establishing Minimum Requirements: Although it is important that costs be kept low, there should be some guidance on the checks that ECF platform operators must undertake in relation to those who seek to issue shares through their ECF platform. This will avoid ECF platform operators reducing the stringency of their due diligence checks in the hope of attracting issuers to their ECF platform. The following may be appropriate minimum requirements:

(i) Initial Checks on Issuers:

¹⁸⁵ The form is available at: http://www.osc.gov.on.ca/documents/en/Securities-Category4/mi_20160114_45-108_personal-information.pdf.

(1) Basic checks to identify whether an issuer is incorporated in accordance with the requirements of the ECF regime and satisfies the requirements of an issuer to issue shares through an ECF platform (basic checks).

(2) Whether the issuer and related parties are fit and proper. This would include searches regarding criminal activity and bankruptcy (fraud checks).

(3) Whether the issuer has provided misleading or deceptive information (fair dealing checks).

(ii) Ongoing Checks: As a condition to continued use of an ECF platform, issuers should be required to agree that they will update an ECF platform operator if there is a material change to any of the information that they provided as part of the original due diligence checks.

(c) Reliance: Any liability of an ECF platform operator for the actions of an issuer, should be limited if they have undertaken appropriate due diligence checks in compliance with the relevant regulations.

(d) Not Permitting Issuers to Use ECF platform: An ECF platform operator should not permit issuers to issue offers over their ECF platform where checks indicate that the issuer is not fit and proper or where an issuer has not acted in accordance with requirements of fair dealing or does not conform to the basic requirements of an issuer using ECF. Where an ECF platform operator is not able to make a determination on these matters due to lack of information, it should not permit an issuer to issue shares over their ECF platform until suitable information is provided to allow such a determination. Further, ECF platform operators should include in their agreements with prospective issuers a duty to disclose material changes in information by issuers.

(d) Investor Oversight

It is common for jurisdictions to include an obligation on ECF platform operators to ensure that (1) an investor satisfies any requirements to invest through the ECF platform; and (2) an investor is, on an ongoing basis, investing in accordance with the regulations, including in compliance with investor caps. The major aim of these provisions is to ensure that investors, particularly vulnerable retail investors, do not expose themselves to risks that they are not aware of or that they do not understand. Investor screening therefore often includes a risk acknowledgment component although this is considered under the heading "Disclosures" below.

Malaysia includes a broad, overarching requirement that ECF platform operators monitor compliance with its rules and conduct investor education programs. An ECF platform operator

must inform investors on an ongoing basis of any material adverse changes to an offer made over its platform and ensure that investors comply with the limits imposed on their investment. This means that an ECF platform operator must ensure that the different categories of investor comply with restrictions regarding how much they can invest. Investors are also required to provide ECF platform operators with self-declared risk acknowledgment forms before they can invest over an ECF platform and ECF platform operators must retain these forms.

Thailand imposes an overarching obligation on ECF platform operators to maintain systems that allow them to identify investors, verify their qualifications to invest through the platform, and test the knowledge of a prospective investor. Having created these systems, ECF platform operators must then enter into agreements with prospective investors that at a minimum ensure they understand the services being offered.

ECF platform operators are then required to obtain information that allows them to identify investors, ensure that those investors are placed in the appropriate category of ECF investor, and make determinations regarding the ability of an investor to comply with their obligations. This means that ECF platform operators in Thailand have an ongoing obligation to ensure that investors meet any caps on investment. Clause 37 of the ECF Notification sets out the ongoing obligations of ECF platform operators in making certain disclosures to investors regarding such matters as the risks involved in investing through ECF and basic information about the service offered through the ECF platform. ECF platform operators are also required to test the knowledge of retail investors on matters generally relating to the risks involved with investing through ECF (testing and education requirements are considered in Section F, below).

Similarly to other jurisdictions, ECF platform operators in the United Kingdom must ensure that retail clients meet eligibility criteria before communicating direct offer promotions to them. For those investors considered vulnerable, ECF platform operators must, in certain instances, comply with the following requirements regarding appropriateness to invest:

- (1) When providing a service (including an ECF platform), an ECF platform operator must ask a prospective investor to provide information regarding their knowledge and experience in investing in the field so as to enable the ECF platform operator to assess whether it is appropriate for the prospective investor to invest through ECF.
- (2) When assessing if it is appropriate for the prospective investor to invest through ECF, an ECF platform operator must determine whether the prospective investor has the necessary experience and knowledge required to understand the risks involved in relation to investing through an ECF platform.¹⁸⁶

Where an ECF platform operator is of the view that a prospective investor does not possess the relevant knowledge and experience, then they must provide them with a warning. However, if a prospective investor requests that they be able to invest after receiving a warning, an ECF platform operator, may at its discretion, allow the prospective investor to invest through the ECF platform.

¹⁸⁶ COBS 10.2.1(2)(b) provides that a relevant firm may assume that a professional client has the requisite experience and knowledge. See also COBS 10.6.1G.

Further, where retail investors have received appropriate advice, there are some exemptions to the above appropriateness tests. Finally, where a retail investor certifies that they will not invest more than 10 percent of their net investible assets in non-readily realisable securities, intermediaries can communicate such offers to that individual for 12 months after the date of the statement without a new certification from that individual.

Australia's 2017 Act provides that an ECF platform operator can only permit investors to purchase shares after they have completed an acknowledgment. ECF platform operators are required to reject applications made by a person pursuant to an offer if they are a retail client and responding to the offer would make them exceed applicable investor caps. The determination as to whether a prospective investor is a retail client is also left to the ECF platform operator in accordance with the test set out in the 2017 Act.

Canada's Integrated Crowdfunding Exemption requires funding portals that wish to rely on the exemption to establish the identity of, and conduct due diligence on, their clients as required by general "know your client" obligations set out in Canadian law. ECF platform operators must also obtain risk acknowledgment forms from prospective investors where the investor confirms they have read and understood risk warnings and information in the crowdfunding offering document ,and (in jurisdictions except for Ontario) must confirm and validate that the purchaser is an accredited investor if the acquisition cost is greater than C\$2,500. In Ontario, ECF platform operators must obtain from a prospective investor, and must validate, a confirmation of investment limits form.

In the United States, ECF platform operators must make efforts to ensure that no investor in a 12-month period exceeds investor caps. In New Zealand, there are no limits on the amount that investors can invest.

Recommendation B4: Investor Oversight

An ECF regulatory framework should include both screening obligations and ongoing oversight obligations on ECF platform operators regarding investors. The following considerations should be taken into account:

(a) Initial Screening Obligations: ECF platform operators should ensure, as a precondition to use of their ECF platform, that investors provide sufficient information that allows them to:

(i) identify an investor;

(ii) determine the category in which an investor falls (i.e. retail investor or other type of investor);

(iii) ensure the investor complies with any investment caps imposed on individual issues of shares as well as any overall caps imposed on certain investors during a defined period;

(iv) ensure the investor has received and stated that they understand information regarding investments made through the ECF platform, including the risks associated with the investment (considered below under the heading "Disclosures").

(b) Ongoing Oversight: ECF platform operators should require, in their agreement with investors before they use the ECF platform, that the investor commits to continued compliance with investor caps. Investors should agree to disclose to the ECF platform operator the ECF investments they have made should the ECF platform operator require this for the purpose of determining the eligibility of the investor to invest via the platform.

(c) Self Declarations: Many of the jurisdictions explored rely on self-declarations by investors both in the initial screening process and for ongoing oversight. This is an appropriate approach. ECF platform operators should maintain the right to prevent an investor from investing using the ECF platform if they become aware the investor has provided incorrect information.

(e) Disclosures

Jurisdictions require that ECF platform operators disclose certain information to prospective investors through their ECF platforms. These disclosures generally relate to the risks associated with investing through ECF as well as disclosures regarding the operation of ECF.

Malaysia has a disclosure regime requiring that ECF platform operators display "prominently" on their ECF platform information regarding ECF. This includes information relating to issuers, investor education materials and risk disclosures, information on how the platform operates, general risk warnings regarding investment through ECF, information on the rights of investors, information on the complaints handling process or dispute resolution procedure, fees, charges, and other expenses associated with using the ECF platform, and information on what happens if the ECF platform operator cannot carry out its operations or if it ceases its business.

Thailand has disclosure requirements for ECF platform operators. First, ECF platform operators must have in place a system that permits the disclosure of required information through the ECF platform. Information that must be displayed includes warnings regarding the risks associated with investments. This warning must be displayed in a manner that is "noticeable".

Second, ECF platform operators are also required to enter into an agreement with prospective investors that includes, among other things, certain disclosure obligations. ECF platform operators must, for instance, provide prospective investors with information regarding the ECF platform, the services offered, how those services are provided, and what communication channels are open to investors, the rights, duties, liabilities, and conditions associated with investing over the ECF platform, any conflicts of interest, and laws and practices relevant to ECF.

Thailand also has rules regarding educational information that ECF platform operators must provide to investors (explored below in Section F). This includes information on how to subscribe for shares, the risks associated with shares offered through the ECF platform, and the risks associated with different types of securities offered through the process, disclosures regarding shares, detail on withdrawal of a purchase and cooling-off periods, limitations applicable to investments, and warnings regarding the illiquidity of shares purchased through the ECF process.

The United Kingdom requires that ECF platform operators provide fair, clear, and prominent risk warnings, but provides discretion to ECF platform operators on the content and form of the warning. In rejecting boiler-plate standard warnings, the FCA notes the following:

As the risks involved when investing in different non-readily realisable securities vary greatly, depending on the nature of the investment offered, it may not always be meaningful or helpful to present consumers with a single, uniform FCA-approved risk warning. Different warnings will be needed in differing circumstances, for different investments and audiences.

COBS 4.2 requires however that any communication made to a client is fair, clear, and not misleading. COBS 4.5 sets out rules regarding communication with clients when providing information in relation to a designated investment business. Communications that need to be made in compliance with COBS 4.5 must comply with the following:

- (a) they must include the name of the firm;
- (b) they must be accurate, and, in particular, must not emphasize any potential benefits of a relevant business or a relevant investment without also giving a fair and prominent indication of any relevant risks;
- (c) they must be sufficient for, and presented in a way that is likely to be understood by, the average member of the group to whom it is directed (in this case an investor), or by whom it is likely to be received; and
- (d) they must not disguise, diminish or obscure important items, statements or warnings.

Although there is no prescribed format made available to crowdfunding operators, they are required to provide this information in a standardized format.

COBS 4.7 is also relevant as it requires ECF platform operators to make disclosures regarding their business and the services they offer, the costs associated with the services, handling of money held by the ECF platform operator, a description of the nature of the risks, and the availability of a prospectus document when an issuer is required to provide one.

The Australian regime includes a number of disclosure obligations for ECF platform operators. For instance, ECF platform operators must prominently display on their ECF platform a risk warning, information on cooling-off rights, and the fees charged to and interests in an issuer.

Canada's Integrated Crowdfunding Exemption includes information on risk warnings. Before an investor may invest, they must acknowledge that a distribution on the ECF platform:

(a) has not been reviewed or approved by a securities regulator; and

(b) is risky, may lead to the loss of all money invested, and may not offer a mechanism to sell any shares purchased.

ECF platform operators must also obtain risk acknowledgement forms from investors. The investor must positively confirm through this form that they have read and understood risk warnings and the information in the offering document. An investor must positively answer all the questions on this form before they are entitled to invest through an ECF platform.

In New Zealand, ECF platform operators must display the following mandatory notices:

(a) A warning statement about the risks of crowdfunding. Investors must acknowledge that they have read and understood this information. The risk warning must be displayed on the homepage and on the page before an investment is made and must be displayed prominently in all application forms. New Zealand provides a prescribed format for the risk warning:

Equity crowdfunding is risky.

Issuers using this facility include new or rapidly growing ventures. Investment in these types of businesses is very speculative and carries high risks. [Omit these sentences if the facility is confined to issuers for whom the sentences would be inapplicable]

You may lose your entire investment, and must be in a position to bear this risk without undue hardship.

New Zealand law normally requires people who offer financial products to give information to investors before they invest. This requires those offering financial products to have disclosed information that is important for investors to make an informed decision.

The usual rules do not apply to offers by issuers using this facility. As a result, you may not be given all the information usually required. You will also have fewer other legal protections for this investment.

Ask questions, read all information given carefully, and seek independent financial advice before committing yourself.

(b) A statement that informs investors about how the service works, the fees they will pay, and the checks that the ECF platform operator has and has not conducted on the issuer.

ECF platform operators in New Zealand are also expected to enter into a client agreement with investors that acts as a contract between the two parties and outlines the terms of the agreement between them.¹⁸⁷

¹⁸⁷ The FMA provides an explanation of these disclosure obligations on its crowdfunding site available at: https://fma.govt.nz/consumers/ways-to-invest/crowdfunding/#Risk_involved_in_crowdfunding. For an example of the

The United States also requires that ECF platform operators provide a number of disclosures. An ECF platform operator cannot permit an investor to use its ECF platform until the investor has opened an account with the ECF platform operator and the ECF platform operator has obtained consent to electronic delivery of materials. ECF platform operators must provide information including educational materials, notices, and confirmations through electronic means, through an electronic message that includes a specific link to the information as posted on the ECF platform or through an electronic message that provides notice of what the information is and that is located on the ECF platform or the issuer's website.

Recommendation B5: Disclosures

ECF platform operators should be required to make a number of disclosures to investors. These should relate both to the risks associated with investing through an ECF platform as well as the nature of the services offered by the ECF platform operator. The following considerations should be taken into account at a minimum:

(a) Risk Disclosures: Investors should be provided with a risk warning. Risk disclosures should be displayed prominently on the ECF platform as well as in any application or offer documentation.

(b) Disclosure Regarding Services Offered: ECF platform operators should be required to prominently display on their website, and to include in any application and offer documentation, information regarding the services offered. This disclosure should at a minimum include information on the following:

- (i) how the ECF platform operates and general information regarding investment through the ECF process;
- (ii) the rights and obligations of investors;
- (iii) the complaints handling process or dispute resolution procedure;
- (iv) fees, charges and other expenses associated with using the ECF platform;
- (v) the process put in place to handle conflicts of interest;
- (vi) the availability of educational materials;
- (vii) cooling-off and withdrawal information; and

disclosures required of ECF platforms, see Equitise, "Equitise Disclosure Statement", available at: <https://equitise.com/disclosure-statement>; AlphaCrowd, "Disclosure Statement", available at: <https://www.alphacrowd.co.nz/legal/disclosure-statement>.

(viii) how trust money will be handled.

(c) Acknowledgment: Investors should be required to sign an acknowledgment form and provide it to ECF platform operators indicating they have read and understood all information disclosed to them and they understand the risks involved in investing through ECF. They should also be required to signify they understand the nature of the service being offered and that the ECF platform operator is not providing advice on investments made or the potential success of any investment.

(f) Education and Testing Requirements

In some jurisdictions ECF platform operators are required to provide educational material or services to investors. For instance, Malaysian ECF platform operators are required to carry out education programs for investors. Thailand offers a regime for education and testing. Clause 37 of the ECF Notification requires that ECF platform operators provide educational information to prospective investors that includes as a minimum:

- (a) the processes and methods for subscribing for shares through ECF;
- (b) the risks associated with an investment, including risks as they relate to different types of securities offered;
- (c) information regarding the issue of shares through ECF;
- (d) the caps imposed on investors;
- (e) rights to cancel subscriptions;
- (f) warnings regarding illiquidity because of the lack of a secondary market.

The Thai regime also requires that retail investors who have not been tested within three months of a proposed offer and qualified investors who do not express an intention to forgo testing undertake a test to assess their level of investment knowledge. ECF platform operators must ensure that the test covers at least the following issues:

- (a) the high risk of failure of companies issuing shares through the ECF process;
- (b) the risk that an investor may not obtain a return on their investment if the company is liquidated;
- (c) knowledge that there is no secondary market for shares purchased through the ECF process and that restrictions may apply on the transfer of the shares (meaning that the shares are illiquid);
- (d) the payment of dividends or any other benefit is contingent on the issuer's articles of incorporation or the terms and conditions set out by the issuer;

- (e) any profit sharing arrangement and voting rights of existing shareholders may be affected if the issuing company issues new shares to increase capital (dilution);
- (f) acknowledgment that information regarding the offer of shares provided by the ECF platform operator is based on the information disclosed to the operator by the issuer (self-declaration); and
- (g) acknowledgment that investors under the ECF regime are not entitled to claim compensation under the SEA in cases where an issuing company discloses materially false or incomplete information.

The U.K. appropriateness requirement for investors is set out in Section D, above and the requirement in the United States to provide educational material has been set out in Section E, above.

Recommendation B6: Education and Testing Requirements

Some jurisdictions require that ECF platform operators offer educational services to investors, while others impose “testing” requirements for certain investors. The following factors should be taken into account when considering these elements of a regulatory framework:

- (a) Educational Requirements: These requirements may be satisfied through the requirement that certain disclosures be made to investors before they sign up to use an ECF platform and before they invest. Further educational obligations (for example, the platform operator conducting education programs) should also be considered, noting that this may help investors to make more informed investment decisions.
- (b) Testing Requirements: Thailand includes testing elements in its regulatory framework. The testing regime appears to cover, through the tests, elements that are covered in the acknowledgment processes discussed in Section E above. Most jurisdictions do not impose on ECF platform operators a requirement to test investors, and it may be thought that this is too onerous an obligation and may be challenging to implement. If a jurisdiction decides to impose a testing element in the regime for certain investors, it should provide latitude to the ECF platform operator to determine whether an investor possesses the requisite knowledge of risks and processes involved.

(g) Conflicts of Interest

It is common for jurisdictions to have regulations dealing with conflicts of interest.

In Malaysia, the Guidelines require ECF platform operators to establish a framework which sets out policies and procedures to effectively and efficiently manage conflicts of interest. The conflicts must be managed in a timely manner. ECF platform operators may hold shares in issuers that use their ECF platform. However, if they do so, they must disclose the fact that they hold shares in an issuer.

ECF platform operators may only hold up to 30 percent of the shares in an issuer hosted on their ECF platform. They must also disclose where they pay an “introducer” or receive payment of any form in connection with an issuer hosted on their ECF platform. ECF platform operators are also not allowed to provide any financial assistance to investors to invest in shares of an issuer using the ECF platform.

In Thailand, ECF platform operators must adopt written policies on the prevention and management of conflicts of interest. The policies must be approved by the board of directors or a committee as assigned by the board of directors. The policies must be distributed within the organization. Further, ECF platform operators must undertake necessary steps to supervise directors, managers, and other relevant parties so as to ensure they comply with the conflicts policies. The Thai regime defines conflicts as follows:

- (a) conflicts between the interests of an investor and the ECF platform operator or its related parties;
- (2) conflicts between different investors or between investors and clients of an ECF platform operator in cases where the ECF platform operator provides many types of services whereby conflicts of interest may arise.

In Australia, ECF platform operators, as AFSL holders, must comply with s 912A(1)(aa) of the ACA. This requires they have in place adequate arrangements regarding management of conflicts of interest that may arise wholly, or partially, in relation to activities undertaken by the licensee or a representative of the licensee in the provision of financial services as part of the financial services business of the licensee or the representative.

In the United Kingdom, ECF platform operators are expected to manage any conflicts of interest fairly, whether they arise between the ECF platform operator and an issuer or an investor, or whether they arise between an issuer and an investor. The U.K. rules require that ECF platform operators identify possible conflicts of interest that may result in material risk of damage to interests of a client, keep a record of these possible conflicts, and take all reasonable steps to avoid the conflicts. Where that risk cannot be managed, it should be disclosed to clients.

In New Zealand, an ECF platform operator must have in place adequate systems and procedures for handling conflicts between its commercial interests (and those of parties related to the ECF platform operator) and the need for the ECF platform operator to have fair, orderly, and transparent systems and procedures in place to provide the service. Where an ECF platform operator has a direct or indirect conflict, they must disclose it and they must disclose the nature of the interest as well as any fees that an issuer pays an ECF platform operator above the standard disclosed amount.

In the United States, certain related parties of an ECF platform operator may not have a financial interest in an issuer that is offering shares over the ECF platform in reliance on the Regulation

Crowdfunding exemption.¹⁸⁸ These related parties of the ECF platform operator are also not permitted to receive a financial interest in an issuer as remuneration for the services provided to, or for the benefit of, the issuer in connection with the offer or sale of such securities. An ECF platform operator is also prohibited from having a financial interest in an issuer offering shares over its ECF platform in reliance on the Regulation Crowdfunding exemption unless:

- (a) they receive the financial interest from the issuer as remuneration for the services provided to, or for the benefit of, the issuer in connection with the offer or sale of the shares; and
- (b) the financial interest consists of securities of the same class and having the same terms, conditions and rights as the securities being offered or sold through the ECF platform.

Where the ECF platform operator has a financial interest in an issuer, this is required to be disclosed. The disclosure must include the amount to be paid to the ECF platform operator and any other direct or indirect interest that the ECF platform operator has in the issuer or any arrangement for the ECF platform operator to acquire such an interest.

In Canada, the Integrated Crowdfunding Exemption provides that an ECF platform operator must include on its website prominent disclosure of all remuneration, including fees, costs, and other expenses that it may charge to, or impose on, an issuer or an investor and any such other disclosure that may be required under securities legislation.

ECF platform operators are also not permitted to act as intermediaries in connection with a distribution of or trade in securities of an issuer that is a related issuer. This restriction does not apply if the interest does not amount to ownership or control of more than 10 percent of the issuer.

Recommendation B7: Conflicts of Interest

Regulations regarding conflicts of interest should take into account the following matters:

- (a) Requirement to Have in Place Policies and Procedures: All ECF platform operators should be required to have in place policies and procedures regarding conflicts of interest. These policies and procedures should allow early identification of conflicts and a clear process for handling them. The policy should be made available on the ECF platform.
- (b) Holding of Shares in the Issuer: Jurisdictions need to decide if ECF platform operators can hold shares in issuers that use their platforms. The argument in support of allowing this is that it can align the interests of the ECF platform operator and the issuer. However, in some circumstances there can be risks. Some jurisdictions allow ECF platform operators to hold shares in an issuer where the shares are

¹⁸⁸ A financial interest in an issuer means a direct or indirect ownership of, or economic interest in, any class of the issuer's securities.

remuneration for the services offered by the ECF platform operator. Malaysia has a broader provision and does not restrict the holding of shares by ECF platform operators in issuers to situations where the shares are remuneration for the services offered by the ECF platform operator. Where a jurisdiction permits ECF platform operators to hold shares in an issuer, this holding should be limited (as is the case in jurisdictions such as Malaysia and Canada) and should be disclosed.

(c) Prohibition on Providing Financial Assistance: ECF platform operators should not be permitted to provide any financial assistance to investors to invest in shares of an issuer using the ECF platform.

(h) Liability

Many of the jurisdictions explored do not deal expressly with issues of legal liability in their ECF regimes. These issues may relate to the extent of liability that an ECF platform operator may incur for the actions of issuers using the ECF platform as well as for actions undertaken by the ECF platform operator itself.

Thailand does deal with the issue of liability in the ECF Notification. It provides in clause 19 that ECF platform operators must not seek to exclude or limit their liability for damages suffered by an investor as a result of a failure by the ECF platform operator to provide services in accordance with the rules set out in the ECF Notification. This liability extends to directors, managers, or others with management responsibilities related to the ECF platform operator.

The Australian ECF regime provides for the liability of ECF platform operators in certain circumstances. For instance, an ECF platform operator that fails to conduct checks, or fails to conduct checks to a reasonable standard, will commit an offence punishable by a financial penalty. The 2017 Act adopts this approach because ECF platform operators have a central role in the ECF regime and the requirement to undertake prescribed checks is in place to ensure the integrity of the ECF regime. It is also within the power of the ECF platform operator to undertake such checks and liability is therefore considered appropriate. Strict liability obligations are also imposed on ECF platform operators where they have not complied with other obligations, including handling trust money, failure to obtain necessary consents before publishing an offer document, and failure to remove an offer document or suspend an offering in accordance with the regulations.

The Australian regime also includes liability for ECF platform operators in some circumstances where an issuer has contravened its obligations. For instance, where an offer document is defective and the ECF platform operator knows this, and a statement, omission, or new circumstance which led to the document being defective is materially adverse from the point of view of an investor, an ECF platform operator may be criminally liable (in addition to the issuer). The explanatory memorandum to the 2016 Bill explains the liability of the ECF platform operator in such instances as follows:

... an [ECF platform operator that] publishes an offer document that it knows to be defective commits an offence if the statement, omission or new circumstance that caused the document to be

defective is materially adverse from the point of view of an investor ... This means an [ECF platform operator] will not commit an offence where the defect in the offer document is materially defective if the [ECF platform operator] did not know the offer document was defective. For the purpose of determining what an [ECF platform operator] knows, an [ECF platform operator] is taken to know all matters that they would have known had they conducted the prescribed checks to a reasonable standard.

Recommendation B8: Liability

Jurisdictions considering implementing an ECF regime should take into account the following matters regarding the liability of ECF platform operators:

(a) Excluding Liability: ECF platform operators should not be permitted to exclude liability for loss to investors as a result of their conduct.

(b) Liability for Matters within Control of ECF platform Operators: Consideration should be given to imposing penalties on ECF platform operators where they breach their obligations under ECF regulations and where this is consistent with the approach to liability under the jurisdiction's securities laws. These liabilities should however be restricted to matters within the control of ECF platform operators.

(i) Handling Investor Funds

All of the jurisdictions explored include obligations on ECF platform operators relating to the handling of funds received from investors. These obligations include how the funds are to be collected and held, and when they to be released to the issuer.

Paragraph 12.09 of Malaysia's Guidelines provides that an ECF platform operator must establish and maintain in a licenced institution one or more trust accounts designated for the funds raised by an issuer. The money held in trust must only be released to an issuer once a target for the amount of funds raised has been reached, when there is no material adverse change made to an offer during the relevant period that an offer remains open, and when the six-day cooling-off period given to investors has expired.

Thailand requires, in accordance with clause 39 of the ECF Notification, that an ECF platform operator comply with certain obligations regarding subscription money so as to protect the interests of investors. Money invested must be held in escrow or by a custodian. The money can only be released to an issuer when the funding target has been reached and when any cancellation periods available to the investor have expired.

In Australia, section 738ZB of the 2017 Act sets out the procedures for handling trust money. Division 2 of Part 7.8 of the ACA applies to ECF platform operators as they are considered AFSL holders. These regulations require that an ECF platform operator hold money provided for the

purchase of shares in a qualifying account. ECF platform operators must also comply with regulations regarding when funds can be withdrawn from the qualifying account and how interest is to be earned on money held in the account.

Further, an ECF platform operator must release funds to an issuer as soon as practicable after an offer is complete. This occurs when the minimum funding target has been reached, all withdrawal rights have expired, and the issuer has issued the shares to the investors. In certain circumstances, ECF platform operators are obligated to return investment funds to investors (for instance, when an offer is withdrawn by an issuer or when an investor exercises a withdrawal right).

In the United States, ECF platform operators must prevent an issuer from accessing funds until the target for funds raised has been reached. Investors may cancel their commitments to invest as determined by the rules of the SEC. ECF platform operators are also prohibited from holding or managing investor funds or securities. Instead, investors are directed to transmit funds directly to an account with a qualified third party such as a bank, which has agreed in writing to hold the funds in escrow and to transmit them to the issuer or the investors, depending on whether the offer has been completed or cancelled. An ECF platform operator must direct the return of funds to an investor when an investment commitment has been cancelled, and must return funds to investors when an issuer does not complete the offering.

The Canadian Integrated Crowdfunding Exemption requires ECF platform operators to arrange for a reputable third party to handle investor funds in trust or escrow until the funding target has been reached.

In New Zealand, if ECF platform operators hold, pay, or transfer funds from investors, they must comply with broker obligations. This means that investment funds must be held in trust.

Recommendation B9: Handling Investor Funds

Regulation should at a minimum take into account the following:

- (a) Funds Held in Trust: Investor funds should be held by an appropriate third party, such as a bank. Funds should be held in an account that is designated for investor funds.
- (b) Restricted Access to Funds: ECF platform operators should be restricted in their access to the funds and how they are permitted to handle the funds. This should be reflected in agreements with investors, issuers, and the designated third party.
- (c) Release of Funds to Issuers: ECF platform operators should be directed to release funds to issuers only when certain conditions are met. Investor funds should only be released to an issuer when the funding target has been reached and all rights of withdrawal or cancellation for an investor have expired.
- (d) Return of Funds to Investors: The ECF platform operator should be required to

return funds to investors when the funding target has not been met, when an offer is withdrawn by an issuer, and when an investor exercises a withdrawal right.

(j) Dispute Resolution

The majority of jurisdictions include in their regulatory framework provision for complaints handling and dispute resolution. This means that the regulations require an ECF platform operator to provide a complaints handling and dispute resolution system as part of the service that they offer to issuers and investors. Much less commonly addressed in the ECF regulations are external dispute resolution processes.

In Malaysia, ECF platform operators are required to have in place an internal dispute resolution process. This requirement satisfies the provision in section 379 of the CMSA regarding the ability of the regulator to make provision for the settlement of disputes. In the SC Malaysia Consultation Paper and the SC Malaysia Public Response Paper, SC Malaysia was of the view that ECF platform operators must provide an internal dispute resolution mechanism. In setting out the reasoning for this approach, the SC Malaysia Public Response Paper states:

Given that the ECF [Platform] operator acts as the conduit between issuers and investors, they would be in the best position to deal with any conflicts that may arise. [SC Malaysia] is of the view that the proposals in relation to complaints and dispute resolution mechanisms should be maintained, as supported by the feedback received. [SC Malaysia] was made to understand that the mechanism to facilitate such dispute resolution could be technology-based and some operators leverage on the chat space where peer review and investors' expectations often lend weight to the resolution of a dispute.

In Thailand, ECF platform operators are required to put in place an effective system of dispute settlement for investor complaints.

In the United Kingdom, the FCA Policy Statement does not address complaints handling as it relates to ECF. However, the FCA Handbook and the FSMA that apply broadly to all those subject to the FCA's regulatory authority require that a dispute resolution process be made available to clients (in the U.K. context, this includes both issuers and investors), as set out in the FSMA. This regime contains both an internal and an external dispute resolution system.

In Australia, the 2017 Act provides that where financial services are provided to retail clients, the service provider (in this case, the ECF platform operator) must have in place the following dispute resolution system:

- (a) an internal dispute resolution procedure that complies with the standards and requirements made or approved by ASIC and which covers complaints against the licensee made by retail clients; and
- (b) the AFSL holder must be a member of one or more external dispute resolution schemes approved by ASIC and which cover complaints made by a retail client.

In New Zealand, ECF platform operators are expected to have in place a complaints process. This includes belonging to an external dispute resolution scheme in accordance with the *Financial Service Providers (Registration and Dispute Resolution) Act 2008*.

Recommendation B10: Dispute Resolution

ECF platform operators should be required to have the following processes in place:

- (a) Internal Processes: ECF platform operators should have in place an internal complaints and dispute resolution process. These should be made available to both investors and issuers that have a complaint about the service being offered.
- (b) Disclosure of Dispute Process: ECF platform operators should prominently display details regarding the complaints and dispute resolution process on their website and in any documentation regarding an offer.
- (c) External Processes: In those jurisdictions in which there are existing external dispute resolution process for financial services (e.g., a financial services ombudsman) the regulator should consider requiring ECF platform operators to join the external dispute resolution process to provide an avenue for investors and issuers to lodge a complaint when an ECF platform operator has not adequately provided a service and dealt with the complaint. The investor or issuer must first use the internal complaints and dispute resolution process of the ECF platform operator before using the external dispute resolution process. This allows the ECF platform operator the opportunity to resolve the complaint.

C: Issuers

(i) Overview of Regulatory Issues

Each of the jurisdictions shares some commonalities in the way they regulate ECF issuers. The key regulatory issues regarding issuers explored in this section are:

- (a) Permitted Issuers
- (b) Issuer Cap
- (c) Disclosure
- (d) Advertising and Marketing Restrictions
- (e) Oversubscriptions
- (f) Material Adverse Change while the Offer is Underway
- (g) Completing the Offer

(h) Liability

(ii) Comparative Analysis and Recommendations

(a) Permitted Issuers

It is common for jurisdictions to restrict the types of companies that can raise funds through the ECF process. However, these restrictions vary widely.

Malaysia restricts permitted users to locally incorporated, private limited companies, although some private companies are excluded. Private limited companies are generally required to restrict the transfer of their shares, can only have up to 50 non-employee shareholders (although this restriction is overcome by using a nominee structure for shareholders in the case of ECF), and cannot invite the public to subscribe for shares in the company unless it is an ECF offering. The Guidelines expressly preclude from raising funds through ECF commercially or financially complex structures, public listed companies that are subsidiaries, companies with no specific business plan (or with a business plan that involves a merger or an acquisition of an unidentified entity), companies (other than microfunds) that propose to use funds raised through ECF to provide loans or invest in other entities, companies (other than microfunds) with paid up share capital exceeding RM5 million (approximately US\$1.16 million),¹⁸⁹ and any other entity that SC Malaysia specifies.

The exclusion of public companies is justified by SC Malaysia on the basis that these companies are able to seek funding through private placements or through an initial public offering. The requirement that companies seeking funding through ECF must have in place a business plan reflects SC Malaysia's view that start-ups wishing to raise funds should have a business plan before they raise ECF funds.

Thailand's company law makes a general distinction between two types of companies: public limited companies and limited companies. Public limited companies may offer shares for sale to the public or to any person, so long as the offer is made in accordance with relevant laws regarding securities and the stock exchange. A limited company is a privately held company and is precluded from making an invitation to subscribe for shares to the public. The ECF regime allows both types of companies to issue shares through ECF if clause 5 of the ECF Notification is satisfied. The requirements of clause 5 are that the company must be incorporated under Thai law, have a business plan and intend to operate its business with the funds raised through the ECF platform, must have never issued shares via a private placement or public offering, and must not have its shares listed on the Stock Exchange of Thailand.

In the United Kingdom, ECF is effectively restricted to public companies as the crowdfunding regime does not provide an exemption to the prohibition against the public offer of private company shares. Public companies can make public offers of shares, and they are therefore able to make public offers through an ECF platform. To qualify as a public company, a company must have a nominal value of allotted share capital that is not below GBP50,000 (approximately US\$61,500).

¹⁸⁹ All currency conversions in this document are approximate. The conversions have been made using the following website: www.xe.com between 29 and 31 December 2016.

Section 738H of Australia's 2017 Act sets out the following eligibility requirements for an issuer:

- (a) the issuer must be a public company limited by shares;
- (b) the issuer must have a principal place of business in Australia;
- (c) a majority of the issuer's directors (not counting alternate directors) must ordinarily reside in Australia;
- (d) the issuer must comply with the assets and turnover test provided in section 738H(2) which provides that an issuer must:
 - (i) have a value of consolidated gross assets that does not exceed A\$25 million (approximately US\$18 million) or another amount specified in the regulations; and
 - (ii) have consolidated annual revenue less than A\$25 million or another amount specified in the regulations;
- (e) must not be listed; and
- (f) must not have as a substantial purpose investing in securities or interests in other entities or schemes.

Australian law-makers acknowledged that the restriction of the ECF regime to public companies may provide a deterrent to some small businesses that do not want to adopt the public form. To partly address this, the 2017 Act creates temporary concessions from certain public company corporate governance and reporting requirements for (a) new public companies limited by shares; and (b) proprietary companies that convert to a public company. However, to obtain the temporary concessions, the public company must complete an ECF offer within the required timeframe."

These concessions apply for a maximum of 5 years and include an exemption from the need to hold an annual general meeting, the option to only provide financial reports to shareholders online, and an exclusion from the requirement that the company appoint an auditor or have audited financial reports until more than A\$1 million (approximately US\$723,000) has been raised through the ECF process. As noted in Chapter 5 of this report, in May 2017 the Australian government released for public consultation draft legislation that, if enacted, would allow proprietary companies to raise funds using ECF.

In the United States, the Regulation Crowdfunding exemption cannot be used by issuers that are:

- (a) not organized under, and subject to, the laws of a State or territory of the United States or the District of Columbia;
- (b) companies that already are reporting companies in accordance with existing regulation;
- (c) certain investment companies;
- (d) companies that are disqualified under Regulation Crowdfunding's disqualification rules;

(e) companies that have failed to comply with the annual reporting requirements under Regulation Crowdfunding during the 2 years immediately preceding the filing of the offering statement; and

(f) companies that have no specific business plan or have indicated their business plan is to engage in a merger or acquisition with an unidentified company or companies.

Both exemptions in Canada restrict those that may rely on the exemption to raise funds. This includes requirements such as the need to be incorporated or organized in Canada, have a head office in Canada, and have the majority of directors or other officers resident in Canada. The Canadian regime is available to companies that have reporting requirements and those that do not have reporting requirements. However, the Canadian regime does impose some additional restrictions on those who may raise funds through ECF. The exemption may not be relied on by an issuer if any of the following apply:

(a) the proceeds of the distribution are used by the issuer to invest in, merge with or acquire an unspecified business;

(b) the issuer is not a reporting issuer, and has previously distributed securities in reliance on the exemption but is not in compliance with a number of reporting and disclosure obligations;

(c) the issuer is a reporting issuer and has not complied with reporting obligations under securities laws; and

(d) the issuer has an open offer that relies on the exemption.

Recommendation C1: Permitted Issuers

The regulation of permitted ECF issuers is heavily reliant on the general legal regime for companies and securities in each jurisdiction. This means that each jurisdiction will need to reform existing regulations so as to encourage the use of ECF while ensuring that ECF fits within the broader regulatory framework. Some considerations that may be taken into account when considering which companies should be permitted to raise funds through ECF include:

(a) Emphasis on Start-ups and Innovative Companies: Regulations should be aimed at encouraging SMEs to seek funding using ECF. Companies that may already raise funds through the public issue of shares and large, complex companies in general have greater access to alternative funding mechanisms. This restriction can be enforced in a number of ways depending on the legal entities permitted to raise funds:

(i) First Alternative – Australia: Australia offers an example of ECF being

restricted to public companies. To ensure that the regime caters to the needs of smaller companies, the Australian regime limits the public companies that can use ECF by reference to the assets and the revenue of the company. Further, to encourage smaller companies that traditionally adopt the private form to use ECF, the Australian regime offers an exemption for 5 years from some of the regulatory rules associated with public companies. However, as noted above, the Australian government has released for public consultation draft legislation that, if enacted, would allow proprietary companies to raise funds using ECF.

(ii) Second alternative – Malaysia: Malaysia restricts ECF to private companies. This has the advantage of catering to the legal form commonly adopted by smaller businesses.

(iii) Third alternative – Thailand: Thailand allows both public and private companies to issue shares using ECF, subject to the requirements outlined above.

(b) Large, Complex Companies: Jurisdictions often restrict the use of ECF to SMEs. Commercially or financially complex institutions (such as financial institutions) should not be permitted to use ECF. Further, companies that are listed should be precluded from using ECF as these companies can already issue shares and trade them through a listed exchange.

(c) Local Incorporation: The aim of ECF regimes is generally to assist SMEs operating in a domestic context. For this reason, it may be appropriate to require some form of local connection to a jurisdiction, including local incorporation, maintaining a head office in the jurisdiction, and requiring a majority of directors to be local residents.

(d) Business Plan: Issuers should be required to provide a business plan. Investors should have this information available to them before making an investment decision.

(e) Restrictions on Business Purpose: Several jurisdictions prevent the use of ECF where the business purpose is to engage in a merger with, or acquisition of, an unidentified company or companies.

(b) Issuer Cap

The jurisdictions considered generally provide three types of issuer cap. First, some jurisdictions impose a cap on the amount that an issuer can raise through a single offer or from a single investor. Second, some jurisdictions impose a cap on the amount that can be raised within a defined period, usually 12 months. Finally, some jurisdictions impose a total cap on the amount

that can be raised by an issuer through ECF. The caps are set out in the following table.¹⁹⁰ Also included in this table is information about investor caps, although investor caps are discussed in more detail later in this chapter. It is useful to see both the issuer and the investor caps in the one table.

Table 5: Issuer and Investor Caps in Various Jurisdictions

Jurisdiction	Investor cap	Issuer cap in a defined period (US\$)	Issuer total cap (US\$)	Notes
Malaysia	Retail investors: RM5,000 per issuer with a total of RM50,000 from each investor each 12 months	RM3 million (\$669,000) every 12 months	RM5 million (\$1.16 million)	
Thailand	Retail investors: 50,000 Baht per issuer with a total of 500,000 Baht from each investor each 12 months	20 million Baht (\$558,788) every 12 months	40 million Baht (\$1.18 million)	The caps in Thailand relate to retail investors only. There are no caps on how much an issuer can raise through ECF from non-retail investors.
United Kingdom	There are no caps imposed on how much an issuer can raise through ECF. However, certain retail clients may only invest up to 10 percent of their net investable assets			
Australia	Retail investors: A\$10,000 per issuer each 12 months	A\$5 million (\$3.614 million) every 12 months	N/A	The Australian regime expressly provides that the regulations may provide for different caps. Small-scale offerings and offerings to certain experienced investors that do not require disclosure fall within the issuer cap of A\$5 million.
United States	Over 12 months: 1. if annual income or net worth is less than \$100,000: the greater of \$2,000 or 5% of the lesser of annual income or net worth; 2. if both annual income and net worth are equal to or exceed \$100,000: 10% of the lesser of annual income or net worth; 3. the aggregate	\$1 million every 12 months	N/A	The figures in the columns are to be periodically adjusted according to the consumer price index. As noted in Chapter 4 of this report, on 31 March 2017, the SEC approved increases in the amounts to become effective when published in the Federal Register.

¹⁹⁰ The figures provided in the table are in local currency and also US\$. They are an approximate conversion of the figures provided for each jurisdiction.

	amount of securities sold to an investor through all Regulation Crowdfunding offerings may not exceed \$100,000, regardless of the investor's annual income or net worth			
New Zealand	N/A	NZ\$2 million (\$1.39 million) every 12 months	N/A	Funds raised from small-scale personal offerings are included within the cap. However, funds raised from wholesale investors are not counted in the cap.
Canada (Start-up Exemption)	C\$1,500 per issue	C\$250,000 (\$185,439) per issue with a limit per issuer of two issues every 12 months – meaning a cap of C\$500,000 (\$370,828) every 12 months	N/A	
Canada (Integrated Crowdfunding Exemption)	Non-accredited investors: 1. C\$2,500 per issue 2. C\$10,000 for all issues every 12 months (Ontario only)	C\$1.5 million (\$1.13 million) every 12 months	N/A	The cap relates to an issuer group. Funds raised through other exemptions are not included in the cap.

Recommendation C2: Issuer Cap

Regulation of issuer caps varies widely across jurisdictions and depends on factors such as the perceived funding needs of SMEs balanced against the need to protect investors. Issues that should be taken into account include:

(a) SME Focus: The main aim of the ECF regime is to provide an alternative source of funding for SMEs that find it difficult to raise funds. A cap is usually imposed on the amount that can be raised within every 12-month period to reflect the funding needs of SMEs in a specific jurisdiction.

(b) Setting a Cap: While each jurisdiction should establish a cap that is suitable for SMEs, there are some common considerations that may help in establishing an appropriate cap. For instance, the cap should allow the majority of start-ups to prove

their concept on a small scale and allow for product development.

(c) Flexibility: In order to provide flexibility as ECF develops, it may be appropriate to provide that caps may be altered through the rules of regulators instead of legislation.

(d) Sophisticated Investor Exemptions: Funds raised from non-retail investors should not be included within the cap. SMEs should be encouraged to continue to seek funds from other available sources including non-retail investors.

(e) Other Retail Investor Fund Exemptions: Where a jurisdiction offers issuers the opportunity through other exemptions to raise funds from retail investors, regulators need to consider if these funds should be included within the ECF issuer cap.

(c) Issuer Disclosure

Each jurisdiction imposes certain disclosure obligations on issuers. This disclosure is required at the initial stage before an issuer is permitted to issue shares. There may also be ongoing disclosure obligations.

The Malaysian regime requires that issuers disclose certain information in order to be permitted to use an ECF platform. This information must, at a minimum, include the following:

- (a) information that explains the key characteristics of the company;
- (b) information that explains the purpose for raising the funds and the amount that the issuer seeks to raise;
- (c) information relating to the company's business plan; and
- (d) financial information relating to the company:
 - (i) for offerings below RM500,000:
 - (A) audited financial statements where applicable (e.g. where the issuer has been established for at least 12 months); and
 - (B) where audited financial statements are unavailable (e.g. the issuer is newly established), certified financial statements or information by the issuer's management; and
 - (ii) for offerings above RM500,000: audited financial statements of the company.

The Malaysian regime does not set out in its Guidelines any ongoing disclosure obligations for issuers. However, it is common for ECF issuers to provide ongoing disclosure to investors via the platform operators.

The Thai regime requires that ECF platform operators enter into an agreement with an issuer on a number of matters including disclosure at both the initial stage and on an ongoing basis. These disclosures may be made in an electronic format, but they must be clear, easy to understand, and made in a manner that is not misleading. Although the ECF Notification does not prescribe the disclosures that must be made, it may be assumed that at a minimum, the agreement should require disclosures that allow the ECF platform operator to comply with its obligations. This includes determinations regarding the local incorporation of an issuer seeking to use an ECF platform, its business plan, and initial and ongoing compliance with various caps.

Thailand also requires that a limited company that raises funds through an ECF platform report the sale of securities to TSEC within 15 days after the closing date of the offer. This disclosure must include the following information:

- (a) date of offer for sale of the securities;
- (b) type, characteristics, and specific title of the securities (if any);
- (c) total number of the securities offered for sale and total number of the securities sold;
- (d) price of the securities offered for sale;
- (e) name, contacting address, telephone number, and website of the ECF platform operator;
- (f) names and addresses of the purchasers of the securities;
- (g) number of the securities obtained by such purchasers; and
- (h) name, contact address, and telephone number of the person filing the report.

In the United Kingdom the FCA Policy Statement discusses issuer disclosure as follows:

In addition to complying with the disclosure and financial promotion requirements and restrictions in the FCA Handbook, it is for the firms operating crowdfunding platforms, and the companies seeking finance through them, to satisfy themselves that they are meeting any requirement to publish a prospectus (or satisfy themselves that an exemption is available). (citations omitted)

This means that issuers must publish a prospectus or other disclosure documents in accordance with the requirements set out in Part VI of the FSMA and the FCA Handbook.¹⁹¹ This approach takes into account the fact that in the United Kingdom, the crowdfunding regulatory framework deals with the direct sale of any form of security of any issuer, of whatever size, where the security does not have a secondary market.

U.K. corporate law does contain some disclosure exemptions for small securities issues, and issuers must ensure that if they want to take advantage of these exemptions they meet the necessary requirements set out in the FSMA and the FCA Handbook. Further, the FCA Handbook has some generally applicable disclosure requirements including information that must be disclosed before offering a service or information that must be disclosed in direct offer financial promotions.

¹⁹¹ These implement the Prospectus Directive [2003/71/EC], as supplemented by the Prospectus Regulation (EC No. 809/2004).

In Australia, the 2017 Act requires that once an issuer has been deemed eligible, they must comply with disclosure requirements to raise funds through the ECF regime. The disclosure obligation is generally satisfied through the completion of an offer document for each offer. The explanatory memorandum to the 2016 Bill notes that the information that may be required in the offer document includes information about the issuer and its business, the securities on offer, and how the proceeds raised will be used.

Title III of the U.S. JOBS Act includes a list of matters that an issuer must disclose to the SEC (in some circumstances on an annual basis), the ECF platform operator and to investors. This includes:

- (a) the name, legal status, physical address and website of the issuer;
- (b) the names of the directors and officers (and any persons occupying a similar status or performing a similar function) of the issuer, all positions and offices with the issuer held by such persons, the period of time in which such persons served in the position or office and their business experience during the past three years, and the current number of employees of the issuer;
- (c) information about officers, directors, and owners of 20 percent or more of the issuer;
- (d) a description of the business of the issuer, the anticipated business plan of the issuer, and how proceeds of the offering will be used;
- (f) a discussion of the material factors that make an investment in the issuer speculative or risky;
- (g) the target offering amount and the deadline to reach the target offering amount, as well as a statement that if these are not met funds will be returned;
- (h) whether oversubscriptions will be accepted and how they will be allocated;
- (i) certain related party transactions;
- (j) a description of the process to complete the transaction or cancel an investment commitment;
- (k) a statement on the issuer's financial condition and financial statements as follows:
 - (i) where an issuer wants to raise US\$100,000 or less, they must provide certain financial data derived from tax returns and financial statements certified by the company's principal executive officer;
 - (ii) where an issuer wants to raise between US\$100,000 and US\$500,000, they must provide financial statements reviewed by an independent accountant;
 - (iii) where an issuer wants to raise more than US\$500,000, they must provide financial statements audited by a public accountant who is independent of the issuer;

(iv) requirement (iii) above does not apply, however, where an issuer has not previously sold securities in reliance on the exception provided for ECF and the issuer has a target of more than US\$500,000 but not more than US\$1 million, in which case, financial statements of the issuer must be reviewed by a public accountant who is independent of the issuer.

Canada's Integrated Crowdfunding Exemption imposes ongoing disclosure obligations on non-reporting issuers (with reporting issuers required to continue to comply with disclosure requirements generally imposed in accordance with Canada's securities regulations). These include annual financial statements, notices disclosing the use of proceeds, and in some participating Canadian jurisdictions, notices regarding the following specified events: (1) discontinuation of the issuer's business, (2) a change in the issuer's industry, and (3) a change in control of the issuer.

Annual financial statements must be approved by management of the issuer and must be accompanied, where the amount raised during a financial year is between C\$250,000 and C\$750,000, by a review report or auditor's report, or, when the amount raised exceeds C\$750,000, by an auditor's report.

In New Zealand, regulation 186(1)(d) of the FMC Regulations requires that an ECF platform operator have adequate disclosure arrangements to give investors, or to enable investors to readily obtain, timely and understandable information to assist investors to decide whether to acquire the shares. In considering whether these disclosure arrangements are adequate, the FMA must, in accordance with regulation 186(2), consider the limits (if any) on the amount that retail investors may invest under the service and the amount that issuers may raise under the service.

In its guidelines, the FMA has indicated that adequate disclosure would usually include at a minimum:

- (a) a dedicated webpage on the ECF platform for each offer, which is simple to access and navigate and available to all investors;
- (b) a description of the business and the purpose of the fund raising;
- (c) the terms of the offer, including price, minimum funding sought, the duration of the offer, amounts raised (and updated regularly), investor caps, and the rights attaching to the shares;
- (d) information about how shares can be sold, including about any available secondary markets;
- (e) the names and positions of the issuer's directors and senior managers; and
- (f) arrangements with issuers to supply required information.

The FMA also provides a number of matters that may, at the discretion of ECF platform operators and issuers be disclosed, including a Q&A (question and answer) function on the ECF platform or information from the Companies Office about the issuer (or a link to the company summary page of the website). Further, where no investor caps are imposed, where these caps are high or where an issuer is seeking to raise a large amount of funds, the FMA would usually expect disclosure obligations to include extra disclosure regarding the business plan, details of how funds will be used, key risks, and key financial information (such as financial statements).

Recommendation C3: Issuer Disclosure

Issuers should be required to make certain disclosures before they are permitted to use an ECF platform. The following matters should be considered:

(a) Type of Obligation: Disclosure obligations are imposed through the offer document made available to potential investors. Some jurisdictions have provided a template of obligations. A template approach has advantages as it provides clear guidance on matters that must be disclosed and assists investors to compare offers. These template obligations for disclosure may be provided through an offer disclosure document.

(b) Minimum Requirements for Disclosure: At a minimum, disclosure regulations should include the following:

(i) information regarding the issuer (for instance, name, legal status, physical address, website address, names of directors and senior officers, and certain financial information);

(ii) the issuer's business plan (including the reasons for the offer of shares and how the issuer intends to use the funds raised);

(ii) the number and price of the shares to be issued, as well as the minimum amount to be raised by the issue and whether there is a maximum amount to be raised by the issue (including matters relating to oversubscription);

(iii) how long the offer is open;

(iv) the rights attached to the shares;

(vi) a general risk disclosure (i.e., risks generally associated with ECF) and specific risk disclosure (i.e., risks associated with the specific ECF issue).

(c) Ongoing Disclosure: There should be some ongoing disclosure to investors relating to matters such as progress implementing the business plan and the use of investor funds. It is a matter for each jurisdiction to decide how often the ongoing

disclosure should be made. Two options are every six months or every three months.

(d) Advertising Restrictions

Jurisdictions usually impose restrictions on issuers advertising an offer of shares through an ECF platform. The Malaysian ECF regime does not set out restrictions on issuers regarding advertising by issuers. However, SC Malaysia indicated in both the SC Malaysia Consultation Paper and the SC Malaysia Public Response Paper that advertising the offer of shares is restricted other than a reference to the disclosure document. The SC Malaysia Public Response Paper notes that an "... issuer will be prohibited from promoting its offering to the public except through the ECF platform. Any notice used by the issuer as a form of advertising its offerings should always be redirected to the standardised disclosure document that has been lodged with the ECF operator and is made available on the [ECF] platform".¹⁹² SC Malaysia noted further that "... while advertising is allowed, the issuer must ensure that such advertisement or notice does not contain any element of advice as this may trigger the relevant licensing requirement under s.58 of the CMSA."¹⁹³

In Thailand obligations and restrictions regarding advertisements are imposed on ECF platform operators rather than on issuers. In the United Kingdom, issuers are not precluded from making promotions (for instance, undertaking general marketing activities), but they are not permitted to undertake such activities in relation to specified investment opportunities.

In Australia, the 2017 Act includes restriction on advertising and publicity. Advertisements are generally prohibited except in certain permitted circumstances. Issuers and ECF platform operators may advertise the publication of an offer, an ECF offer document, or any other information relating to an offer if it is on an ECF platform. Further, advertising restrictions do not apply to advertisements or publications that do not refer to a particular offer or intended offer, or where they identify a person as an ECF platform operator, or where they provide general information about an ECF platform operator's services.

In the United States, an issuer may not, either directly or indirectly, advertise the terms of an offering (meaning the amount of securities offered, the nature of the securities, the price of the securities, and the closing date of the offering period) except if a notice directs investors to the ECF platform and includes no more than the following information:

- (a) a statement that the issuer is conducting an offer pursuant to the Regulation Crowdfunding Exemption;
- (b) the name of the ECF platform through which the offer is being conducted and a link to the ECF platform;
- (c) the terms of the offering; and

¹⁹² SC Malaysia, *Public Response Paper No. 2/2014: Proposed Regulatory Framework for Equity Crowdfunding*, 2014, para 3.6.5.

¹⁹³ *Ibid* at para 3.6.7.

(d) factual information about the legal identity and business location of the issuer, limited to the name of the issuer of the shares, the address, phone number, and website of the issuer, the email address of a representative of the issuer, and a brief description of the business of the issuer.

Issuers are, however, permitted to communicate with investors and potential investors about the terms of an offer through the communication channels provided by an ECF platform operator on the ECF platform, provided that the issuer identifies itself as the issuer in all communications (or if a person is communicating on behalf of an issuer, the person identifies their affiliation with the issuer).

In Canada, an issuer must not, directly or indirectly, advertise an offer or solicit investors under the Integrated Crowdfunding Exemption. However, issuers are permitted to inform investors that the issuer proposes to distribute securities under the exemption and may refer investors to the ECF platform where the offer is being made. It is envisaged that issuers may use communication channels or discussion boards to encourage investors to discuss the crowdfunding distribution if the ECF platform operator offers this on its ECF platform. Any statement made through these channels must, however, be consistent with the offer document.

Recommendation C4: Advertising Restrictions

The ECF regulatory regime should restrict the advertising that can be undertaken by issuers. Promotion of ECF offers should be undertaken by the ECF platform operator although issuers should be permitted to direct potential investors to the website of the ECF platform

(e) Oversubscriptions

Some jurisdictions have regulations regarding oversubscriptions. Malaysia's Guidelines do not preclude oversubscriptions, and both the SC Malaysia Consultation Paper and the SC Malaysia Public Response Paper envisage that issuers can accept funds in excess of original funding targets. Thailand's ECF Notification has rules regarding oversubscriptions. Offers may only be oversubscribed where the total amount offered during the 12 months from the time of the first offer does not exceed 20 million Baht, providing that an issuer must not offer the portion for oversubscription in an amount larger than 25 percent of the offering amount and the total offering amount from the time of the first offer does not exceed 40 million Baht.

The United States permits issuers to accept investments in excess of the target offer, and if so, must disclose the maximum amount that the issuer will accept and how the oversubscriptions will be allocated (for instance, on a pro-rata, first-come-first-serve, or other basis). The issuer must also describe the purpose and intended use of the excess funds.

Recommendation C5: Oversubscriptions

Issuers should be permitted to raise more than the initial target. This can assist SMEs. Issuers

which seek to raise more funds through an offer than indicated in their initial target should be required to:

- (a) specify whether there is a cap for any oversubscriptions;
- (b) ensure that the additional funds raised through an offer come within any relevant cap for the oversubscriptions;
- (c) indicate the intended use of the additional funds raised; and
- (d) describe how the additional funds will be allocated – for example, on a pro-rata, first-come-first-serve, or other basis.

(f) Material Adverse Change while the Offer is Underway

Jurisdictions often have regulations regarding notification when a material adverse change occurs while an ECF offer is underway. In Malaysia, the obligation to notify of a material adverse change is imposed on ECF platform operators rather than on issuers. Material adverse changes are defined as follows. A material adverse change relates to the discovery of a false or misleading statement in the disclosure document, the discovery of a material omission of information required to be included in the disclosure document, or the occurrence of a material change or development in the circumstances relating to the offer or the issuer. In such cases, an ECF platform operator is obligated to inform investors of the material adverse change relating to the issuer's proposal.

In Thailand, an ECF platform operator must enter into an agreement with an issuer that contains a number of commitments by the issuer. These include an obligation that the issuer notify the ECF platform operator, without delay, of any significant change regarding information disclosed. This allows the ECF platform operator to disseminate the information. If a change occurs and the offer remains open for less than 48 hours, the issuer making the offer must give investors the right to cancel the subscription of securities within five days of notification.

Australia's 2017 Act specifies that an issuer provide an ECF platform operator with a supplementary offer document or a replacement offer document if, among other reasons, the issuer becomes aware that the existing offer document is defective.

In the United States, if there is a material change to the terms of an offer or to information provided by the issuer, the ECF platform operator must give notice of the change to investors. The notice must inform investors that their investment commitment will be cancelled unless the investor reconfirms their investment within five business days of receipt of the notice. This is in contrast to other regimes which assume that an investor will continue with an investment unless they notify that they are cancelling their investment. If the investor does not reconfirm their investment, then the ECF platform operator must, within five business days, give the investor notice disclosing the cancellation, the reason for the cancellation, and the refund amount of the investment.

Recommendation C6: Material Adverse Change while the Offer is Underway

Where an issuer becomes aware of a material adverse change relating to the issuer or the offer while the offer is underway, then the issuer must promptly notify the ECF platform operator and update the offer document. Once notified by the issuer, the ECF platform operator must promptly notify investors of the material adverse change.

If the ECF platform operator becomes aware of a material adverse change relating to the issuer or the offer while the offer is underway, even where this is not notified to it by the issuer, the ECF platform operator must promptly notify investors of the material adverse change.

Investors should be provided with a reasonable period of time from notification of a material adverse change to withdraw their purchase of shares. Investors should be made aware of this right to withdraw in any initial, supplementary, or replacement offer document and at the time they are notified of the material adverse change.

(g) Completing the Offer

Jurisdictions have rules regarding when an offer is considered complete and what must take place once an offer is complete.

The Malaysian Guidelines require that an ECF platform operator must not release trust money until the offer period is complete. The SC Malaysia Public Response Paper notes that it is for the ECF platform operator to determine for how long an offer will remain open and issuers may decide how long their offer remains open within this period.

Thailand's ECF Notification refers to an "offering period" but does not define the term so this is a matter left to ECF platform operators and issuers to decide. An issuer may close an offer early where the target for funds raised has been met and the issuer complies with certain notification requirements.

In Australia, an offer is closed from the time that the ECF platform operator gives written notice on the ECF platform that the offer is closed. An ECF platform operator must close an offer when the first of the following occurs:

- (a) three months after the offer has been made;
- (b) where the offer document states a date for close, on that date;
- (c) when the ECF platform operator considers the offer fully subscribed;
- (d) when the issuer withdraws the offer;
- (e) when the ECF platform operator's functions require it to remove the offer document from its ECF platform.

An offer is considered complete when three conditions are satisfied: (1) an offer has closed for one of the reasons in points (a)–(c) above, (2) all withdrawal rights have expired, and (3) the value of the funds raised exceeds the minimum subscription amount set out in the offer document.

The Canadian Integrated Crowdfunding Exemption provides for a distribution period, which means the period referred to in an offering document during which an issuer offers its securities to investors. However, the distribution period must end no later than 90 days after the date the issuer first offers its securities to investors. An offer cannot close until:

- (a) any right of withdrawal has expired;
- (b) the aggregate minimum funds have been raised;
- (c) the issuer has received the purchase agreement between the issuer and the investor;
- (d) risk acknowledgement forms (where the investor confirms having read and understood the risk warnings and the information in the offering document) have been completed; and
- (e) confirmation is provided that caps have been complied with.

The U.S. Regulation Crowdfunding exemption provides that if an issuer reaches the target offer amount prior to the deadline identified in its offering materials (see 227.201(g)), it may close the offer on a date earlier than that deadline provided certain criteria are met.

Recommendation C7: Completing the Offer

Regulations should specify when an offer closes. This should include when the minimum funds specified have been received and all withdrawal rights for investors have expired.

An issue to consider is whether there should be a maximum time for an ECF offer to remain open. Jurisdictions differ on whether they specify a maximum time for an ECF offer to remain open. Some jurisdictions specify 90 days and other jurisdictions have no time limit.

(h) Issuer Liability

Jurisdictions typically require information provided to ECF investors to not be false or misleading and not have any material omission. However, there are very significant differences between jurisdictions according to whether liability is imposed on an issuer for false or misleading disclosure or material omissions. Whether liability is imposed depends, at least in part, on the extent to which a jurisdiction already has a widely developed legal regime for imposing liability on issuers for false or misleading disclosures or material omissions in securities offerings. Another relevant consideration is that onerous liability provisions can deter issuers from making ECF offers.

In Malaysia, an issuer is required to ensure that all information submitted or disclosed to an ECF platform operator is true and accurate and does not contain any information or statement which is

false or misleading or from which there is a material omission. ECF platform operators must be able to direct a person in breach of ECF rules to take appropriate remedial action. The Guidelines do not however specify that liability is imposed for a breach of this and other obligations. Where however an ECF platform operator discovers a material adverse change (which includes discovery of false or misleading statements made by the issuer or material omissions), then an ECF platform operator is precluded from releasing funds to an issuer.

In Thailand, an ECF platform operator oversees the offer, and when it has reasonable grounds to believe that the offer is being conducted in a manner that does not comply with relevant laws and regulations, must suspend the offer and must notify TSEC. As with the Malaysian regime however, the Thai regime does not specify that liability is imposed for breaching one of the obligations. The ECF Notification does require that investors acknowledge they are not entitled to claim compensation under securities legislation in cases where an issuer discloses materially false or incomplete information.

Australia's 2017 Act contains a liability regime. The explanatory memorandum to the 2016 Bill states that the general securities regime which contains prohibitions, liabilities, and remedies that usually apply to the offer of securities requiring disclosure, do not apply to the ECF regime unless expressly provided for. This is considered appropriate as the ECF specific regulations were considered the best place to deal with prohibitions, liabilities, and remedies applying to ECF offers. The 2017 Act expressly notes that the ECF regime does not otherwise affect any liability that a person has under any other law.

The Australian ECF regime imposes liability on those who have primary responsibility for an obligation. For instance, issuers are strictly liable for obtaining and retaining written statements of consent from a person who has made a statement in the offer document. The regime provides a monetary penalty for breach of the provision. Liability is also imposed where a restriction on advertising is contravened. The most serious liabilities are imposed in relation to the provision of defective offer documents. An issuer must not offer securities under an ECF offer document if the document is defective. An issuer is potentially criminally liable if the person contravenes this obligation and the statement, omission, or new circumstance which leads to the contravention is materially adverse from the point of view of an investor. There are defences. This approach to liability is consistent with the law in relation to prospectuses.

Further, a person who suffers loss or damage because of the defective offer document may recover the amount of the loss or damage from an issuer and certain other persons whose conduct resulted in the offer document being defective. These liabilities will not apply, however, if an issuer can show that it did not know of the defect or where a person acted in reasonable reliance on information provided to them.

The U.S. Regulation Crowdfunding Exemption provides that the SEC may ban a person from using ECF where they have not complied with a regulatory requirement or where they have engaged in fraudulent, manipulative or deceptive conduct. Issuers will not be subject to such bans where a deviation from the regulations is insignificant, so long as the failure to comply is insignificant in relation to the offer as a whole, the issuer made a good faith and reasonable attempt to comply

with the regulations, and the issuer did not know of the failure to comply if that failure was carried out by the ECF platform operator.

The Canadian Integrated Crowdfunding Exemption provides for a certification process. A crowdfunding offer document must contain a certificate executed by the issuer that states:

(a) where the issuer is a reporting issuer, "This crowdfunding offering document does not contain a misrepresentation. Purchasers of securities have a right of action in the case of a misrepresentation"; and

(b) where the issuer is not a reporting issuer, "This crowdfunding offering document does not contain an untrue statement of a material fact. Purchasers of securities have a right of action in the case of an untrue statement of a material fact."¹⁹⁴

The certificate must be true at the date that it is signed, the date that the offer document is made available to investors, and the time the offer is closed. If the certificate ceases to be true, then the issuer must amend the offer document and sign a new certificate, and must provide the amended offer document to the ECF platform operator to then be made available to investors.

Issuers are also required to enter into agreements that set out these rights as they relate to misrepresentations and untrue statements. In relation to misrepresentations, if a participating Canadian jurisdiction does not provide a comparable right, the offer document of an issuer must provide a contractual right of action to an investor for rescission and damages. This must be available to the investor if the offer document or other materials contain a misrepresentation (without regard being given to whether the investor relied on the misrepresentation). The right is enforceable by the investor delivering a notice to the issuer:

(a) in the case of rescission, within 180 days after the date of purchase of the shares; or

(b) in the case of an action for damages, before the earlier of 180 days of the investor first having knowledge of the facts giving rise to the cause of action or 3 years from the date of the purchase.

The right is subject to the defence that the purchaser had knowledge of the misrepresentation. There are limitations on the amount that can be recovered. For an action in damages, the amount recoverable must not exceed the price at which the security was distributed and does not include all or any part of the damages that the issuer proves do not represent the depreciation in value of the security resulting from the misrepresentation. The right under this provision is in addition to, and does not detract from, any other right of the investor.

An equivalent right is provided in the case of untrue statements made by non-reporting issuers. The same provisions apply as they do for misrepresentations made by reporting issuers, however they relate to untrue statements of a material fact rather than to misrepresentations.

Recommendation C8: Issuer Liability

¹⁹⁴ Multilateral Instrument 45-108, "Crowdfunding", January 2016, s 7.

Jurisdictions need to decide whether they will impose liability on issuers when information provided by issuers to ECF investors is false or misleading or has a material omission. There are very significant differences between jurisdictions according to whether liability is imposed on an issuer for false or misleading disclosure or a material omission.

When a jurisdiction does decide to impose liability, there is an issue whether this should be criminal (for example in the case of intentional misrepresentations) or civil liability. Where liability is imposed, there should be appropriate defences.

D: Investors

(i) Overview of Regulatory Issues

The final group of actors that are regulated in jurisdictions with ECF specific regulation are investors. Many of the regulations considered in the sections above are aimed at protecting investors. However, there are a number of express regulatory provisions which place restrictions on the activities of investors. Many of these regulations are contingent on the classification of investors as either retail investors or non-retail investors. This section considers the following regulatory issues:

- (a) Distinction between Different Investors and Caps
- (b) Cooling-off Period

(ii) Comparative Analysis and Recommendations

(a) Distinction between Different Investors and Caps

Jurisdictions have as a central regulatory aim the protection of investors. A key mechanism for protecting investors is placing caps on how much an investor can invest through the ECF process. These caps may be imposed on a per offer basis, during a defined period (usually of 12 months) or through overall caps (i.e., a cap on how much an investor can invest in total in ECF offers). As the main aim is to protect investors who are considered vulnerable, these caps generally do not apply to investors who have experience in investing. Regulations set out how investors are classified to determine whether caps should apply. Chapter 4 considered these caps in detail. The analysis below sets out the caps in local currencies and (approximate) U.S. dollars (as at January 2017) to make it easier to compare the different jurisdictions.

The Malaysian regime imposes the following caps on investors:

- (a) sophisticated investors: No restrictions on investment amount;
- (b) angel investors: A maximum of RM500,000 (US\$111,300) within a 12-month period; and

(c) retail investors: A maximum of RM5,000 (US\$1,113) per issuer with a total amount of not more than RM50,000 (US\$11,113) within a 12-month period.

Sophisticated investors include the following individuals who are considered to have a high net worth:

(a) individuals whose total net personal assets, or total net joint assets with his or her spouse, exceed RM3 million (US\$667,779), excluding the value of the individual's primary residence;

(b) individuals who have a gross annual income exceeding RM300,000 (US\$66,778) per annum in the preceding 12 months; or

(c) individuals who, together with their spouse, have a gross annual income exceeding RM400,000 (US\$89,031) per annum in the preceding 12 months.

In Thailand, caps are set out as limitations on how much issuers can raise from different investors. These caps have been set out in the section above when discussing issuer caps. In addition, ECF platform operators must keep track of the value of investments made by each investor and in relation to retail investors must also ensure that they do not invest more than 500,000 Baht (US\$13,946) during any 12-month period. The effect of this requirement is to provide an additional cap on the amount that individual retail investors may invest through the process during every 12-month period. Non-retail investors do not have to comply with these caps.

The United Kingdom makes a distinction between those investors that it classifies as sophisticated and those that it classifies as retail investors. Retail investors may not fully understand the risks involved in the ECF process and therefore require further protection. Issuers are only allowed to promote illiquid securities to certain experienced or sophisticated investors, or to retail investors who confirm that they will not invest more than 10 percent of their net investable assets in investments sold through investment-based crowdfunding platforms. This means that, as in most other jurisdictions, sophisticated investors can invest as much as they want through the ECF process. Retail investors are permitted to invest so long as they do so within the prescribed cap that is tied to the value of their net investable assets.

Certain retail investors are excluded from the cap requirement. This includes retail investors who confirm they will receive specialist advice and investors who are certified as sophisticated investors or who are certified as high net worth investors. These investors are individuals who have signed, within a 12-month period ending on the day that a communication for an offer is made, a statement acknowledging the risk of losing all their investments and their right to seek advice from an authorised person. Further, the statement must confirm:

(a) for high net worth investors, that they had a GBP100,000 (US\$122,915) annual income and net assets above GBP250,000 (US\$307,287) (excluding primary residence and various other assets);

(b) for certified sophisticated investors, that they have, within the last 36 months, received a certificate from a crowdfunding platform operator that they are an investor who understands the risks associated with an investment; or

(c) that an investor is a self-certified sophisticated investor, who is either a member of a network or syndicate of business angels for at least the past six months, or who has made more than one investment in an unlisted company in the 2 years prior to the date of the communication, or who works or has worked in the 2 years prior to the date of communication in a professional capacity in the private equity sector or in provision of finance to SMEs. or is currently or has in the past 2 years been a director of a company with an annual turnover of at least GBP1 million (US\$1,229,000).

Australia's 2017 Act provides a cap on investments by retail clients as follows. There is a cap on the amount that retail investors can invest in a 12-month period of A\$10,000 (US\$7,211) (or a different amount prescribed in the regulations).

A retail client is defined as a person who does not come within one of the following categories:

(a) the price of the financial product or the value of the financial product to which the financial service relates, equals, or exceeds A\$500,000 (US\$360,870); or

(b) the securities or the financial services is provided for use in a business other than a small business; or

(c) where the securities or financial service is not provided for use in connection with a business, the person acquiring the securities or financial services gives the ECF platform operator a certificate prepared by a qualified accountant within the preceding six months that states that the person has net assets of at least A\$2.5 million (US\$1.805 million), or gross income in the last 2 financial years of at least A\$250,000 (US\$180,497); or

(d) the person to whom the financial service is provided is a professional investor.

The U.S. Regulation Crowdfunding Exemption provides that issuers may raise a maximum aggregate amount of US\$1 million in a 12-month period. However, there are limits on the amounts that investors may invest depending on their classification. The following limits apply over a 12-month period:

(a) if either of an investor's annual income or net worth is less than US\$100,000, then the investor's limit is the greater of US\$2,000 or 5 percent of the lesser of the investor's annual income or net worth;

(b) if both annual income and net worth are equal to or exceed US\$100,000, then the investor's limit is 10 percent of the lesser of their annual income or net worth; and

(b) during the 12-month period, the aggregate amount of securities sold to an investor through all Regulation Crowdfunding offerings must not exceed US\$100,000, regardless of the investor's annual income or net worth.

Canada's Integrated Crowdfunding Exemption provides caps for accredited, non-accredited investors, and permitted clients. Non-accredited investors are limited to investing C\$2,500 (US\$1,862) for each offer (and in Ontario, a further cap of C\$10,000 (US\$7,448) is imposed during a 12-month period). For accredited investors in Ontario that are not considered permitted clients, a cap of C\$25,000 (US\$18,619) is imposed on each offer and C\$50,000 (US\$37,238) cap during a calendar year. Permitted clients do not have to meet any of these caps. In other Canadian jurisdictions, the limit imposed on accredited investors is C\$25,000 (US\$18,619) per offer with no 12-month restriction and no provision is included for cap-free permitted clients.

In New Zealand, there are no caps imposed on the amount that an investor can invest through the ECF process.

The following table sets out the caps for each jurisdiction (in local currency and in US\$ as at January 2017):

Table 6: Investment Caps for Various Jurisdictions in local currency and US\$ (January 2017)

Jurisdiction	Cap per offer	Cap over 12 months	Notes
Malaysia	Retail Investors: RM5,000 (US\$1,113) per investor per issuer	1. Angel investors: RM500,000 (US\$111,300) 2. Retail Investors: RM50,000 (US\$11,113)	Sophisticated investors, including high net worth investors are excluded from caps.
Thailand	Retail investors: 50,000 Baht (US\$1,396) per investor per issuer	Retail investors: 500,000 Baht (US\$13,946)	These caps must be considered together with those regarding issuers.
UK	Certain retail clients may only invest up to 10% of their net investable assets.		
Australia	N/A	Retail investors: A\$10,000 (US\$7,211) per issuer	The cap applies only to retail clients.
USA	N/A	1. if annual income or net worth is less than US\$100,000: the greater of US\$2,000 or 5% of the lesser of annual income or net worth; 2. if both annual income and net worth are equal to or exceed US\$100,000: 10% of the lesser of annual income or net worth; 3. the aggregate amount of securities sold to an investor through all Regulation Crowdfunding offerings must not exceed US\$100,000, regardless of the investor's annual income or net worth.	The figures in the column are to be periodically adjusted according to the consumer price index. As noted in Chapter 4 of this Report, on 31 March 2017, the SEC approved increases in the amounts to become effective when published in the Federal Register.

Canada	1. Non-Accredited Investors: C\$2,500 (US\$1,862) per issue 2. Accredited Investors: C\$25,000 (US\$18,619) per issue (exc permitted clients in Ontario)	In Ontario: 1. Non-Accredited Investors: C\$10,000 (US\$7,448) 2. Accredited Investors: C\$50,000 (US\$37,238)	Permitted clients in Ontario are not subject to caps.
New Zealand	There are no caps placed on the amount that investors can invest through ECF.		

Recommendation D1: Distinction between Different Investors and Caps

As with issuer caps, any cap placed on the amount that investors can invest through ECF is contingent on each jurisdiction's economic circumstances. There are however some general principles that may provide guidance:

(a) Imposing a Cap: Most jurisdictions impose investor caps to protect retail investors. New Zealand is the only jurisdiction discussed in this report without any caps. This approach may be appropriate for non-retail investors. However, it exposes retail investors to risks associated with losing large sums on an investment process that is still in its infancy, and that promotes investment in small businesses with a high failure rate. For that reason, caps should be imposed.

(b) Type of Cap: In determining what the cap should be, two approaches have been adopted. The first is a monetary cap (Malaysia, Thailand, Australia, and Canada). The second pegs the cap to the income or asset worth of a prospective investor. As the ECF process is intended to be a clear and straightforward process that is available to a wide range of people, this may mean that a monetary cap should be adopted.

(c) Amount of the Cap: The amount of the cap needs to be determined in accordance with the economic circumstances of each jurisdiction. As a guide, caps for retail investors tended to range between US\$7,000 and US\$14,000 during a 12-month period. There needs to be flexibility to change the cap as economic circumstances change.

(d) Caps per Offer and Caps During a Defined Period: Jurisdictions often impose two caps: one on the amount that an investor can invest in a particular ECF issuer; and a second cap on how much an investor can invest in ECF issuers generally over a specified period of time (in most jurisdictions it is 12 months). These caps are aimed at limiting investors' exposure to risk. Jurisdictions should therefore consider whether they want to impose one or both of these types of caps.

(e) Oversight of Caps and Sanctions on Investors: The primary responsibility should

be imposed on investors to ensure they remain within any investor cap. ECF platform operators should receive a self-certification from investors and should be entitled to rely on this so long as there is no indication that the self-certification is inaccurate. Where an ECF platform operator becomes aware that an investor has provided incorrect information, the ECF platform operator should be able to prevent that investor using the platform.

(f) Exclusion of Non-retail Investors: Jurisdictions should distinguish between retail investors and non-retail investors. Jurisdictions tend to include within the definition of non-retail investors those with considerable experience in investing and those with a high net worth. Their investments should not be included within caps imposed on issuers that limit how much issuers can raise from retail investors. Jurisdictions need to consider if any restrictions should be imposed on investment by non-retail investors in ECF. Jurisdictions have different approaches regarding this.

(b) Cooling-off Period

Many jurisdictions provide investors with a cooling-off period during which they can cancel their investment.

In Malaysia, a cooling-off period of six business days is given to investors to cancel the purchase of shares. Trust money cannot be released to an issuer until this period has lapsed.

In Thailand, an investor may cancel the purchase of shares as follows:

- (a) at any time up until 48 hours before the offer closes; and
- (b) where there is a significant change regarding disclosures made by an issuer and there is less than 48 hours remaining before the offer closes, issuers must give investors the right to cancel the purchase of shares within five days from the date on which the ECF platform operator notifies such change to investors.

In Australia, all retail clients can withdraw their purchase of shares within five business days after the purchase. ECF platform operators must display information regarding this cooling-off period prominently on their ECF platform. If a retail client cancels their purchase, then an ECF platform operator must return the funds invested.

In the United States, an investor may cancel an investment commitment for any reason until 48 hours prior to the deadline identified in the issuer's offering materials. During the 48 hours prior to such deadline, an investment commitment may not be cancelled except if there is a material change to the offer, in which case an investor has five business days of being notified of the material change to reconfirm their investment.

In Canada, if the securities legislation of a relevant jurisdiction does not provide a comparable right, the offer document must provide an investor with a contractual right to cancel the purchase of shares by notice to the ECF platform operator within 48 hours after the date of the purchase and any subsequent amendment to the offer document.

Recommendation D2: Cooling-off Period

Investors should be provided with a cooling-off period during which they can cancel the purchase of shares for any reason. The jurisdictions explored in this report provide for two alternative approaches:

- (a) a cooling-off period of a certain number of days after the purchase of shares (in Canada two days, Australia five days, and Malaysia six days);
- (b) a cooling-off period that is available any time up until 48 hours before the end of an offer (Thailand and the United States).

There should be a requirement imposed both on ECF platform operators and issuers to disclose cooling-off periods.

Chapter 6: Concluding Remarks

ECF is quickly emerging as an important mechanism for SMEs to raise funds to engage in business endeavours. ECF is particularly important as SMEs find it even more difficult in the aftermath of the global financial crisis to raise funds through traditional financial channels. ECF therefore provides an opportunity for these companies to leverage technological advances that provide access to funds from a wider range of potential investors, including those retail investors who may previously not have participated in investing.

ECF is gathering pace across the world, including in Asia. This provides an opportunity for ASEAN and its member states to develop ECF regimes that enhance economic growth.

The development of regulatory frameworks for ECF must take into account the need to encourage innovation and economic growth and to provide appropriate protection for retail investors. In particular, intermediaries that seek to act as ECF platform operators must comply with a number of licencing or registration requirements that ensure they are suitable to provide the service and must also comply with a number of ongoing obligations that ensure the platform operates in a suitable manner. Issuers must comply with important regulations on matters such as disclosure.

Retail investors require particular protection. The primary way this is done is through limiting the amount that can be invested and ensuring that investors have the requisite information.

ECF is still evolving as the analysis in this report demonstrates. The recommendations in this report seek to ensure the flexibility required in the regulatory process to adapt as ECF develops and as more is learned about how ECF operates in practice. With this in mind, the recommendations in this report aim to promote ECF, promote clarity and simplicity in the ECF process, ensure that the relevant actors act in a manner that ensures there is confidence in the operation of ECF, and protect vulnerable retail investors.