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An Easy Start for Start-ups: Crowdfunding Regulation in Singapore

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An Easy Start for Start-ups: Crowdfunding Regulation in Singapore

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Crowdfunding is a rapidly-growing type of financial intermediation requiring regulatory attention. Some countries, such as the United States, have enacted legislation in response to intrinsic challenges in crowdfunding relating to investor protection. Other countries rely on existing regimes governing financial intermediation and adjust them in response to issues arising from the relationship between crowdfunding platforms, investors, and recipients of financing. Singapore, one of the biggest financial markets in Asia, has seen an immense increase in crowdfunding. The country has chosen to adapt its regulatory framework rather than instituting new laws. This article analyses the rules governing debt- and equity-based crowdfunding in Singapore, compares the findings with crowdfunding regulation in the United Kingdom—Europe's largest crowdfunding market—and concludes with policy proposals concerning Singapore's regulatory framework.

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INTRODUCTION

In recent years, crowdfunding has emerged as an alternative type of financial intermediation that makes use of the internet to connect those seeking funding for their business projects with those looking for investment opportunities.[1] An online marketplace, oftentimes referred to as a platform, provides the technical means to aggregate small investments from multiple sources to finance the projects of entrepreneurs, usually start-ups and other small business entities.[2]

The growth of money invested through crowdfunding platforms is considerable.[3] Estimates vary, but all reports agree that volumes have exploded from 2012 to 2016.[4] This remarkable development has occurred throughout the world and includes the US, EU, and Singapore markets.[5] In Europe, the UK is the clear

1. For different definitions that amount in substance to the description presented here, see Paul Belleflamme, Thomas Lambert, & Armin Schwienbacher, *Individual crowdfunding practices*, 15:4 VENTURE CAPITAL: AN INT'L J. OF ENTREPRENEURIAL FIN. 313 (2013); Financial Conduct Authority, Policy Statement PS14/4 on *The FCA's regulatory approach to crowdfunding over the internet, and the promotion of non-readily realisable securities by other media* 1, 6 (2014) [hereinafter *FCA Policy Statement PS14/4*], https://www.fca.org.uk/publication/policy/ps14-04.pdf; David Ridley, *Will New Regulation on Crowdfunding in the United Kingdom and United States Have a Positive Impact and Lead to Crowdfunding Becoming an Established Financing Technique?*, 37 STATUTE L. REV. 57, 58-59 (2016); Monetary Authority Singapore, *Consultation Paper on Facilitating Securities-Based Crowdfunding* 1, 3 (2015) [hereinafter *MAS Consultation Paper Facilitating Securities-Based Crowdfunding*], http://www.mas.gov.sg/~/media/MAS/News%20and%20Publications/Consultation%20Papers/Facilitating%20Securities%20Based%20Crowdfunding.pdf (defining crowdfunding as the concept of raising capital from a large number of individuals through an Internet-based platform).

2. *See* U.K. House of Lords and House of Commons, Parliamentary Commission on Banking Standards, *Changing Banking for Good*, HL Paper 27-II HC 175-II 75, 216 (2013).

3. On numbers reflecting increases in volumes, see Teresa Rodríguez de las Heras Ballell, *A Comparative Analysis of Crowdfunding Rules in the EU and U.S.*, figs. 5-11 (Stanford-Vienna TTLF Working Paper No. 28); Steven Bradford, *Crowdfunding and the Federal Securities Laws*, COLUMBIA BUS. L. REV. 1, 100-04 (2012).

4. For global numbers for 2015, see Massolution Crowdfunding Industry 2015 Report, http://crowdexpert.com/crowdfunding-industry-statistics/ (last visited Jan. 16, 2018, 9:00AM).

5. For numbers on the United States, see Tania Ziegler et al., The Americas Alternative Finance Benchmarking Report 2017: Hitting Stride 1, 26 fig. 2 (2017); Robert Wardrop et al., Breaking New Ground: The Americas Alternative Finance Benchmarking Report 1, 33 (2016). For the European Union, see European Commission, Crowdfunding in the EU Capital Markets Union, SWD (2016) 154 final, https://ec.europa.eu/info/system/files/crowdfunding-report-03052016_en.pdf; Cambridge Center for Alternative Finance, Sustaining Momentum: The 2nd European Alternative Finance Industry Report (2016), https://www.jbs.cam.ac.uk/fileadmin/user_upload/research/centres/alternative-finance/downloads/2016-european-alternative-finance-report-sustaining-momentum.pdf. For Singapore, see Bryan Zhang et al., Harnessing Potential: The Asia-Pacific Alternative Finance Benchmarking Report 1, 84-85 (2016),

leader, accounting for just under 75% of all transaction volumes.[6] Academics and authorities emphasize the importance of and need for crowdfunding, explaining that conventional ways of funding are often unavailable for the important start-up and SME sectors.[7]

This rise of a new type of financial intermediation comes with challenges for regulators. Support for new channels of funding for small companies must not come at the cost of investors and financial systems. The discussion in this article analyses how regulation in Singapore seeks to strike a balance between these potentially conflicting objectives. As shown in Part II, Singapore's approach caters to the interests of the crowdfunding industry and provides some protection to investors, but as the analysis of EU and UK regulation shows in Part III, its principles of investor protection are low in comparison. Such conclusions must, in particular, be drawn for non-securities based lending that platforms are permitted to provide without a license and without being subject to stringent conduct of business rules if certain prerequisites are observed.

Ultimately in Part IV, the article suggests a new type of crowdfunding license that encompasses securitized and non-securitized investments and uniform conduct of business requirements for all crowdfunding platforms. It also warns against instances of regulatory arbitrage and systemic risk.

PART I: THE PHENOMENON, ITS RISKS AND REGULATORY CHALLENGES

The Business Model and Types of Crowdfunding

The success of crowdfunding is largely a consequence of the impact the recent global financial crisis and the subsequent reforms of global standards of bank regulation[8] have had on banks' lending policies and on general investor behavior, both of which resulted in financing gaps for companies with higher

https://assets.kpmg.com/content/dam/kpmg/pdf/2016/03/harnessing-potential-asia-pacific-alternative-finance-benchmarking-report-march-2016.pdf.

6. Robert Wardrop & Tania Ziegler, *A Case of Regulatory Evolution – A Review of the UK Financial Conduct Authority's Approach to Crowdfunding*, https://www.cesifo-group.de/DocDL/dice-report-2016-2-wardrop-ziegler-june.pdf. *See also* Bryan Zhang et al., *Pushing Boundaries: The 2015 UK Alternative Finance Industry Report*, https://www.nesta.org.uk/sites/default/files/pushing_boundaries_0.pdf (showing that the online alternative finance market was estimated to have grown by 84% from 2014 (GBP 1.74 billion) to 2015 (GBP 3.22 billion).

7. European Commission, *supra* note 5, at 3 (citing Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, Action Plan on Building a Capital Markets Union, COM(2015) 468/2, 30.09.2015); U.K. House of Lords and House of Commons, *supra* note 2; John Armour & Luca Enriques, *The Promise and Perils of Crowdfunding: Between Corporate Finance and Consumer Contracts* 6-8 (Working Paper N° 366/2017, 2017); Ridley, *supra* note 1, at 57-76; Lin Lin, *Managing the Risiks of Equity Crowdfunding: Lessons from China*, 17 Journal of Corporate Law Studies 327, 329-330 (2017).

8. Basel Committee on Banking Supervision, *Basel III: A Global Regulatory Framework for more Resilient Banks and Banking Systems* (Dec. 2010, rev. June 2011) [hereinafter *BCBS*], http://www.bis.org/publ/bcbs189.pdf, (explaining that the Basel III principles seek to establish a worldwide standard for risk-weighted equity requirements and crisis resistance reserves for banks).

credit risks.[9] In addition, banks and other established lenders generally tend to avoid small start-ups because they regularly lack sufficient collateral.[10] While funding sources outside the banking sector have long been established, their main drivers, venture capitalists and angel investors, pick the most promising companies and favor local projects and industries with which they are most familiar. Venture capitalists and angel investors commonly avoid early-stage investments because of their high risks. They instead support companies that have shown high growth in the past.[11]

In these respects, crowdfunding has served as a gap-filler for voids left by traditional types of corporate finance. However, crowdfunding has not created new ways in which companies receive funding since it follows all classic models of investment. The new invention here is the type of intermediation that brings companies and investors together, which is often referred to as a process of 'disintermediation'. Disintermediation is a problematic term in the crowdfunding context because crowdfunding cannot function without an intermediary. The platform replaces more traditional financial intermediaries involved in the process of debt- or equity-based investments, but the parties to the transaction—the company and the investor—cannot dispose of financial intermediation altogether.[12] Instead, crowdfunding has created, at least for internet-savvy investors, a cheaper and simpler process of intermediation. Since internet platforms are cheaper to create and maintain than branches of large financial institutions, the platforms can operate profitably even when claiming lower shares in transactions, a fact from which the main parties to the transactions can expect to benefit. If banks lend to newly-established companies whose business models seem promising, but are run by mostly inexperienced executives, the banks charge a high premium for the credit risk to which they commit. This is the case because the principles of bank regulation make such lending expensive for banks.[13]

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9. Eleanor Kirby & Shane Worner, *Crowd-funding: An Infant Industry Growing Fast*, 12 (Staff Working Paper of the IOSCO Research Department SWP3/2014, 2014); Flavior Pichler & Ilaria Tezza, Crowdfunding as a New Phenomenon: Origins, Features and Literature Review, in Crowdfunding for SMEs: A European Perspective 5, 7 (Roberto Bottiglia & Flavio Pichler, eds, 2016); Hu Ying, *Regulation of Equity Crowdfunding in Singapore*, SING. J. LEGAL STUD. 46, 48-56 (2015); Armour & Enriques, *supra* note 7, at 2.

10. *See* Deloitte Consulting, *Digital Banking for Small and Medium-sized Enterprises – Improving Access to Finance for the Underserved* (2015), https://www2.deloitte.com/content/dam/Deloitte/sg/Documents/financial-services/sea-fsi-digital-banking-small-medium-enterprises-noexp.pdf (finding that financial institutions in Singapore do not support SMEs due to their failure to meet collateral requirements).

11. Alma Pekmezovic & Gordon Walker, The Global Significance of Crowdfunding: Solving the SME Funding Problem and Democratizing Access to Capital, 7 WM. & MARY BUS. L. REV. 347, 378-80 (2016); Darian Ibrahim, Equity Crowdfunding: A Market for Lemons?, 100 MINN. L. REV. 561, 575 (2015); Ying, supra note 9, at 49-50; Abraham J.B. Cable, Fending for Themselves: Why Securities Regulations Should Encourage Angel Groups, 13 U. PENN. J. BUS. L. 107, 111-14, 120-22 (2010); Armour & Enriques, *supra* note 7, at 6-7.

12. *See* Iris H-Y Chiu, *Fintech and Disruptive Business Models in Financial Products, Intermediation and Markets – Policy Implications for Financial Regulators*, 28 J. TECH. LAW & POLICY, 168, 189 (2016) (explaining some of the resulting advantages).

13. For the reasons of such increased costs, see BCBS, *supra* note 8.

Crowdfunding comes in different forms.[14] Some models rely on the altruistic support of funders who want to see a project succeed. These types are known as donation- and rewards-based crowdfunding and do not provide any financial return.[15] Donation-based crowdfunding relies on donors financing projects without expectation of any kind of compensation, while rewards-based crowdfunding bundles funds from investors who accept non-financial compensation in return for their support. The compensation may include the company's product or service once it becomes available, thereby allowing it to raise capital while concurrently testing demand for a product,[16] or an item of mostly sentimental value, such as promotional items bearing the company's logo.

Another type of crowdfunding is more strongly aligned with traditional forms of project financing. In this model, companies engage funders seeking adequate returns on their investments. These returns could be one of several, or the predominant, motivation for their financial engagement. These funders are investors in the traditional sense and require legal and regulatory attention.[17]

This regulation-sensitive type of crowdfunding consists of two subgroups: debt- and equity-contribution arrangements. In debt-contribution arrangements, investors lend money to companies, resulting in a repayment obligation reflected as debt in the balance sheet of the borrowing company. Funders lend money to individuals or businesses in exchange for a financial return in the form of interest payments or a share in the profits of the business. In contrast to donation- and rewards-based crowdfunding, these lenders expect repayment of the principal in a lump sum or in tranches.[18] Such lending can be executed by way of a traditional loan or through the purchase of securitized debt instruments.

In equity-contribution arrangements, investors contribute to the subscribed capital of a company by way of acquiring shares or stock in a company and consecutively participating in its profits.[19] This type of investment is always securitized. Securities-based crowdfunding can therefore be debt- or equity-based. For our regulation-focused discussion, the distinction between securitized and non-securitized investments is essential because Singapore applies different rules

14. *See* Financial Conduct Authority, Consultation Paper CP13/13 on *The FCA's Regulatory Approach to Crowdfunding (and Similar Activities)* 1, 10 (2013) [hereinafter *FCA Consultation Paper CP13/13*], https://www.fca.org.uk/publication/consultation/cp13-13.pdf; MAS Consultation Paper Facilitating Securities-Based Crowdfunding, *supra* note 1 (stating the 4 forms of crowdfunding).

15. Kirby & Worner, *supra* note 9, at 9.

16. For more detail on the reward model, see Armour & Enriques, *supra* note 7, at 17-21.

17. The term investor is used here for all profit-seeking contributors to the financing of companies, not just—as often done elsewhere in the crowdfunding literature—for acquirers of equity-based securities. Hence, the term comprises equity-holders in companies (investors in a more narrow sense) and contributors to debt-based financing, be it securitized or based on a loan agreement (often called "lenders" elsewhere).

18. Roberto Bottiglia, *Competitive Frontiers in P2P Lending Crowdfunding*, *in* CROWDFUNDING FOR SMES: A EUROPEAN PERSPECTIVE 61, 63 (Roberto Bottiglia & Flavio Pichler eds, 2016).

19. Garry A. Gabison, *Equity Crowdfunding: All Regulated but Not Equal*, 13 DEPAUL BUS. & COMM. L.J. 362; MAS Consultation Paper Facilitating Securities-Based Crowdfunding, *supra* note 1.

to securities offerings and non-securitized lending (as explained below at Part II).

Equity- and debt-based investments can be combined into hybrid instruments. To prevent repayment obligations that might endanger the company's continued existence, debt converts into equity if the company misses its financial goals.[20] In other instances, the conversion takes place for the benefit of the investors. Debt becomes equity when the company reaches predetermined milestones, such as when the company expands its equity base substantially by way of an IPO or venture capital financing.[21]

The Role of Crowdfunding Platforms and the Execution of Funding Transactions

The parties to the crowdfunding business model are investors, companies and internet-based platforms.[22] The platforms are the heart and mind of the crowdfunding system. Their primary role is to match companies with investors. Linking companies and investors provides aspiring entrepreneurs with access to money and allows individuals to profit from returns when the companies succeed.[23] For these services, crowdfunding platforms charge companies—i.e. the issuers of securities or borrowers in loan contracts—success fees, usually in the form of a stipulated percentage of the funding target.

However, this business model has substantially expanded from its humble beginnings at the start of the crowdfunding phenomenon. Platforms commonly engage in secondary services that facilitate the funding transactions. They may assist investors with their knowledge and expertise,[24] such as conducting due diligence checks on the companies[25] and providing mentoring services[26] to help hedge against risks. As explained below (in Part II), Singapore grants platforms the regulatory leeway to design their business models freely. Such freedom is also common in other jurisdictions (see Part III for the UK). However, when platforms offer services that go beyond the simplest form of crowdfunding inter-

20. *See* Jack Wroldsen, *Crowdfunding Investment Contracts*, 11 VA. L. & BUS. REV. 34 (2017) (providing information on Simple Agreements for Future Equity).

21. On these Keep It Simple Security (KISS) agreements, see *id.*

22. Gabison, *supra* note 19.

23. MAS Consultation Paper Facilitating Securities-Based Crowdfunding, *supra* note 1, at 4; The International Organization of Securities Commissions, *Crowdfunding 2015 Survey Responses Report* 1 (2015) [hereinafter *IOSCO 2015 Report*], https://www.iosco.org/library/pubdocs/pdf/IOSCOPD520.pdf.

24. Florian Danmayr, ARCHETYPES OF CROWDFUNDING PLATFORMS: A MULTIDIMENSIONAL COMPARISON 26 (2014).

25. Joan Heminway, *The New Intermediary on the Block: Funding Portals under the* CROWDFUND *Act*, 13 U.C. DAVIS BUS. L.J. 177, 181-83 (2013).

26. OurCrowd, a crowdfunding platform in Singapore, provides support and guidance to companies on their platform by having mentors join the company's board. *See* OurCrowd, *How it Works*, https://www.ourcrowd.com/How_it_works?Source=Footer (last visited Jan. 17, 2018, 9:00AM).

mediation (i.e., do more than solely connecting investors and recipients of funding), especially when they provide investment advice, regulators commonly subject them to serious obligations in the interest of investors (e.g., require them to execute due diligence checks on companies and disclose their findings to investors, see below for Singapore at Part II and the UK at Part III).[27]

The funding process is typically double-layered. Investors decide to finance a project and offer their contributions. Whether these amounts raised are actually distributed to the recipients depends on the funding targets. Under the 'flexible funding' model, the company receives the raised funds even when targets are not reached. The 'all-or-nothing' approach, in contrast, only permits funding to be provided to companies when the aggregate amount raised meets the predetermined targets.[28] This latter model is more common because it protects the interests of investors—it seeks to prevent that the company is drastically undercapitalized and thereby exposes the investors to a particularly high risk of default.[29]

The platform is typically involved in the execution of payments between the parties to the investment contract. The involvement of the platform is unavoidable in the 'all-or-nothing' approach but can also be useful in situations when payments are due by ensuring that they are processed correctly—e.g., that investors of the same class are treated equally. Regulations commonly require that monies are handled in ways that protect the parties to the payment transaction from third-party insolvency risks.[30] When the platform manages funds and executes payments between the parties, the accounts that store the money should or must be, depending on regulations in a particular jurisdiction, insolvency-proof—i.e., the platform's creditors cannot have access to those funds.[31]

Investors providing equity to a company receive shares or stocks in return.[32] Alternatively, funds may be bundled in a nominee account. A third party, often the platform, holds the legal titles to the company's equity rights as a fiduciary on behalf of the investors who are the beneficial owners.[33] The third party also

27. This is the case in all EU countries for securities-based investments, see below at Part III (MiFID-regime).

28. Jordana Viotto da Cruz, *Competition and Regulation of Crowdfunding Platforms: A Two-sided Market Approach*, 99 COMM. & STRATEGIES 1, 5 (2015).

29. Douglas J. Cumming et al., *Crowdfunding Models: Keep-it-all vs. All-or-nothing* 1, 16-25 (2015), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2447567https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2447567 (last visited Jan. 17, 2018, 9:00AM).

30. *But see* European Banking Authority, *Opinion of the European Banking Authority on Lending-based Crowdfunding*, EPA/Op/2015/03 1, 13 (2015). For a discussion of Singapore, see below at Part II.

31. For details on how to design such accounts under U.S. law, see Uriel S. Carni, *Protecting the Crowd Through Escrow: Three Ways that the SEC Can Protect Crowdfunding Investors*, 19 FORDHAM J. CORP. & FIN. L. 682, 701 (2014). For Singapore see Part II.

32. European Commission, *supra* note 5, at 32.

33. *Similar* Ying, *supra* note 9, at 70. For an example of such a nominee structure, see Seedrs, *Community FAQs: What is Seedrs's Nominee Structure?*, https://www.seedrs.com/learn/help/what-is-seedrss-nominee-structure (last visited Jan. 17, 2018, 9:00AM).

exercises all rights and receives all payments from the investment as the investors' trustee.[34]

In some jurisdictions, the nominee model is the result of legal restrictions. Singapore limits the maximum number of shareholders in private companies to 50 members.[35] When private companies seek to avoid the costs involved in becoming a public company—e.g., more burdensome disclosure and reporting standards—a nominee structure becomes the only option. The nominee structure also comes with the advantage of relying on trustees whose expertise enables them to efficiently exercise the membership rights.[36] This model mimics the decision-making patterns well known in other types of financial intermediation, such as mutual funds. The entity managing the funds exercises all rights stemming from the investments on behalf of the fund and its investors. As an alternative, investors can become members of a separate legal entity which invests the accumulated funds in the crowdfunding project and holds legal title to all equity rights stemming from the investments.[37]

The Risks of Crowdfunding

While crowdfunding may be advantageous from an overall cost perspective, the consequences for the parties in the model can only be discerned through a risk-focused analysis. The often-cited advantages of crowdfunding are simultaneously telling of the risks that come with this type of financial intermediation. Crowdfunding is seen as an opportunity for companies to "test the market for a specific business or product"[38] in a stage of development in which these companies prefer not to provide much information about their business and/or would not be able to convince traditional investors to support their business plans.[39] What represents a benefit for companies comes at a price for investors, who bear the risks during this "test phase". Investors are faced with information asymmetry, uncertainty about the company's future and the behavior of its agents.[40]

34. *But see* Ronald Kleverlaan, *Equity Crowdfunding Considering Potential Risks and Liabilities as the Industry Grows and Matures*, CrowdfundingHub Research Report 1, 11 (2016).

35. Companies Act, c. 50, §18(1)(b) (amended 2006) (Sing.).

36. For these reasons, one author considers it the most efficient model. *See* Ying, *supra* note 9, at 70.

37. At least one platform in Singapore pursues this model. For the concept and the resulting doubts whether regulatory benefits attributed to platforms are justified, see below at Part II pp. 249-251.

38. Ridley, *supra* note 1, at 59; *see also* European Commission, *supra* note 5, at 3 (stating that crowdfunding can offer other benefits to firms: it can give a proof of concept and idea validation to the project seeker; it can help attract other sources of funding, such as venture capital and business angels; it can give access to a large number of people, providing the entrepreneur with insight and information; and it can be a marketing tool if a campaign is successful).

39. The lacuna of relevant information about the companies is generally perceived as a particularly problematic aspect of crowdfunding. *See* Eric Chaffee & Geoffrey Rapp, *Regulating Online Peer-To-Peer Lending in the Aftermath of Dodd Frank: In Search of an Evolving Regulatory Regime for an Evolving Industry*, 69 WASH. & LEE L. REV. 485, 496, 505 (2012); European Securities and Markets Authority, *Opinion on Investment-based Crowdfunding*, ESMA/2014/1378 1, 11 (2014).

40. On these three classic problems of entrepreneurial finance, see Andrew A. Schwartz, *The Digital Shareholder*, 100 MIN. L. REV. 609, 629-35 (2015); Armour & Enriques, *supra* note 7, at 6.

Unlike traditional investors such as banks and venture capitalists, crowdfunding investors are unable to bargain for collateral or a strong position in the company allowing them to monitor or even direct the decision-making process.[41]

The risk of total or substantial losses is very real as nascent companies are subject to high failure rates. Data from the Singaporean Department of Statistics reveals that only about 50% of start-ups survive to their 5th year.[42] The failure rate in other markets without minimum capital requirements for private companies is similarly high: 41.4% in the UK[43] and about 50% in the US.[44]

Taken to extremes, gullible retail investors in such companies may serve as "guinea-pigs", testing the waters for recipients of funding and professional investors alike. This is the case because a company that survives the critical, initial phase of its existence can then rely on more traditional funding options from angel investors, venture capitalists, and banks. In addition, professional investors demand much lower risk premiums at this advanced stage than at the initial stage of existence. Early investments by retail investors therefore also reduce costs for start-ups.

Under a standard investment model—i.e., where the platform does not offer early redemption —investors enter into a highly illiquid investment model. Secondary markets for crowdfunding investments do not exist, especially organized markets such as formalized exchanges.[45] This liquidity risk comes in addition to the high credit risk, leading to the adequate description of crowdfunding investments as "illiquid long-term bets".[46]

The position of equity-investors is aggravated by the low likelihood of substantial returns during the first few years because start-ups must build up their capital and therefore retain potential earnings. Earnings in later years are possible if things go well, but the probability of a substantial dilution of early investors' holdings is high. Start-ups are set to grow and will make use of any chance to expand their capital base by welcoming angel investors and venture capitalists or initiating IPOs at the earliest time possible.[47] If the investment agreement lacks anti-dilution provisions, early investors may find their holdings marginalized before the company enters into a more successful stage.[48]

41. Armour & Enriques, *supra* note 7, at 44.

42. MAS Consultation Paper Facilitating Securities-Based Crowdfunding, *supra* note 1, at 4.

43. UK Office for National Statistics, *Business Demography 2015* 1, 6 (2016), https://www.ons.gov.uk/businessindustryandtrade/business/activitysizeandlocation/bulletins/businessdemography/2015 (Last visited Jan. 17, 2018, 9:00AM).

44. U.S. Bureau of Labor Statistics, *Entrepreneurship and the U.S. Economy*, chart 3 (2016), https://www.bls.gov/bdm/entrepreneurship/entrepreneurship.htm (Last visited Jan. 17, 2018, 9:00AM).

45. This is obvious for both lending-based crowdfunding and equity-based crowdfunding, see European Commission, *Communication from the Commission on Unleashing the Potential of Crowdfunding in the European Union* 1, 3 (2014).

46. Wroldsen, *supra* note 20, at 10. On the aspect of illiquidity, see Armour & Enriques, *supra* note 7, at 13.

47. *See* also Ying, *supra* note 9, at 60-62.

48. European Securities and Markets Authority, *supra* note 39.

In absence of any regulatory compulsion to that aim, investors cannot necessarily rely on platforms because they are parties with their own set of incentives. The platforms' business model relies on the success fees they charge companies.[49] The platforms have short-term incentives to see as many funding bids succeed as possible, and only long-term interests argue in favor of mechanisms that help investors. Since many platforms are currently start-ups themselves, it is unclear for investors which business model they will ultimately pursue.

Taking these concerns into consideration, one arrives at various conclusions. The conventional, early-stage crowdfunding model may hold benefits for companies that are barred from or have no reasonably priced access to traditional ways of financing. The model may also pay off for the platforms as long as it generates at least modest returns. However, it is questionable whether non-professional investors should take on disproportionately high risks in exchange for the prospect of rather modest returns.

Yet, the impressive growth numbers of crowdfunding around the world indicate that investors think differently. Having said that, many platforms only engage with institutional and accredited investors[50] who can be assumed to have ways of receiving and using adequate information from companies and platforms to reduce risk exposure. This focus on the wealthy and savvy explains why platforms are developing from agents simply connecting the two parties to the funding transaction into more complicated types of intermediaries.

The UK Financial Conduct Authority (FCA) has signaled the need for heightened regulatory vigilance in light of crowdfunding platforms' increased assumption of intermediation risks. For example, platforms have introduced early redemption options for investors.[51] This practice allows investors to redeem their funds prior to them falling due and hence prior to any payment from the recipients of such funding. But, for platforms, such services come with serious risks as they engage in maturity transformation. The resulting liquidity risks resemble those well-known from the businesses of banks and mutual funds with early redemption rights.[52] For now, the risks from maturity, liquidity, and credit intermediation are systemically irrelevant. But if numbers continue to grow exorbitantly and platforms expand their services to accumulate more risks, crowdfunding could potentially grow into a new shadow banking sector. Regulators should be vigilant and avoid regulatory arbitrage.[53]

49. Pichler & Tezza, *supra* note 9, at 13.

50. As is often the case in Singapore, see below at Part II p. 245.

51. Financial Conduct Authority, Feedback Statement FS16/13 on *Interim feedback to the call for input to the post-implementation review of the FCA's crowdfunding rules* 1, 10 (2014) [hereinafter *FCA Feedback Statement FS16/13*].

52. The FCA has recognized the implied maturity transformation and potential regulatory arbitrage resulting from such practice. *See id.* at 11, 17.

53. On the phenomenon of regulatory arbitrage in shadow banking and regulators' responds to it, see e.g., IMF, *Shadow Banking Around the Globe: How Large, and How Risky?*, Global Financial Stability Report (Oct. 2014); Gary Gorton, *Slapped in the Face by the Invisible Hand: Banking and the Panic of*

General Considerations on Regulating Crowdfunding

Regulators face various challenges. Companies show little willingness for disclosure[54] and platforms are no natural guardians of investors' interests. Additionally, non-institutional investors have barely any ways to acquire all relevant information about the envisaged investment, to monitor the recipients of their funding or to mimic sophisticated investors.

Based on these findings, the regulatory focus of crowdfunding must be, and actually is, on the investment risk to which retail investors are subjected.[55] The regulatory dilemma consists in finding the right balance between supporting a new and positively viewed funding model and providing the right level of investor protection.[56]

Mandatory disclosure requirements are an obvious approach. To reduce negative effects from information asymmetries, companies are generally required to provide relevant information to potential investors when addressing the public. Securities regulation tackles this information dilemma and provides rules tailored to protect the vulnerable position of unsophisticated investors. Such rules require issuers of securities to provide relevant information, enabling markets to price securities accurately.[57]

But stakeholders in the crowdfunding model strive for exceptions because companies seeking investments through crowdfunding cannot afford the expenses resulting from compliance with general disclosure requirements under securities regulation schemes. In addition, the value of such mandatory disclosure is questionable in the context of crowdfunding. Retail investors usually ignore such information, sophisticated investors are absent and markets where information translates into prices do not exist.[58]

As an alternative, some authors point to theories of reputational safeguards. Investors suffering losses due to undisclosed risks lose confidence in the intermediary platform and avoid it for future investments.[59] Negative news can be

2007 1, 14-43 (Conference Paper for the Federal Reserve Bank of Atlanta's 2009 Financial Markets Conference of 2009); Robin H. Huang, *The Regulation of Shadow Banking in China - International and Comparative Perspectives*, 30 BANKING & FIN. L. REV. 481 (2015). For Singapore, see Christian Hofmann, *Shadow Banking in Singapore*, SING. J. LEGAL STUD. 18 (2017).

54. On companies' reluctance to disclose much information about themselves, see Ajay K. Agrawal et al., *Some Simple Economics of Crowdfunding*, 14 NBER/INNOVATION POLICY AND THE ECONOMY 63, 74 (2014).

55. *See* Arjya Majumdar and Umakanth Varottil, *Regulating Equity Crowdfunding in India: Walking a Tightrope*, *in* GLOBAL CAPITAL MARKETS: A SURVEY OF LEGAL AND REGULATORY TRENDS 1, 5 (P.M. Vasudev & Susan Watson eds., 2017).

56. "In all, by providing a viable alternative means of funding start-ups, equity crowdfunding is immensely beneficial to both entrepreneurs as well as investors forming part of the crowd." *Id.* at 4.

57. JOHN ARMOUR ET AL., PRINCIPLES OF FINANCIAL REGULATION, 160 (2016).

58. *See* Armour & Enriques, *supra* note 7, at 5 (general arguments), 8 (costs of producing a prospectus), 12-13 (absence of markets, especially secondary markets). For details on the concept and objectives of mandatory issuer disclosure regulation, see Armour at al., *supra* note 57, at 160-84.

59. Douglas W. Arner et al., *The Evolution of Fintech: A New Post-Crisis Paradigm?*, 47 GEO. J. INT'L L. 1271, 1320 (2016); Ibrahim, *supra* note 11, at 598.

spread via social networks. The platforms and companies can find their reputations tarnished by these social media reports[60] and, consequently, self-regulate in the interest of non-professional investors. However, such self-regulatory approaches are generally applied cautiously in financial regulation and may have little impact on crowdfunding platforms that strive for high initial profits.[61]

For non-securities-based investments, the conventional regulatory tool box has little to offer. Retail investors that lend to companies directly find themselves in a position uncommon to them: as lenders of money, not borrowers. Therefore, established models of consumer credit protection, such as the EU Consumer Credit Directive[62], are of no relevance for the crowdfunding phenomenon. New approaches must be developed. The analysis below shows that non-securitized lending remains mostly unregulated in Singapore (see Part II) in contrast to other jurisdictions (see Part III) and therefore requires regulatory attention (as explained in Part IV).

PART II: THE BUSINESS MODELS AND REGULATION OF CROWDFUNDING PLATFORMS IN SINGAPORE

This part of the article discusses the regulatory rules governing crowdfunding in Singapore. Regulation in Singapore establishes preconditions that must be met before platforms are allowed to engage in crowdfunding services. In alignment with regulations in other parts of the world, securities-based crowdfunding is subject to a different and stricter regime than non-securities-based lending. The analysis below includes an account of the business models of platforms that are currently active in Singapore.

Crowdfunding Regulation in Force in Singapore

Singapore pursues a common approach to the regulation of crowdfunding. Its legislative body has remained inactive and so far has not passed tailor-made legislation for crowdfunding. The regulator, the Monetary Authority of Singa-

60. Wroldsen, *supra* note 20, at 40.

61. As explained above p. 230.

62. European Parliament and the Council of the European Union, *Directive 2008/48/EC on Credit Agreements for Consumers and Repealing Council Directive 87/102/EEC*, 133 OFFICIAL J. OF E.U. 66 (2008). In exception thereto, the directive applies when lending in EU member states goes to consumers, i.e. in B2C and C2C lending arrangements. Crowdlending to consumers is insignificant in Singapore and therefore remains outside the scope of our discussion here.

pore (MAS), applies existing rules that constrain financial intermediation in general.[63] MAS has voiced its support for the crowdfunding phenomenon and emphasized the importance of crowdfunding for start-ups and SMEs, which create about 70% of jobs in Singapore.[64]

License Requirement for Moneylenders

Any person engaged in the business of moneylending, be it as a principal or as an agent, is required to hold a moneylender's license from Singapore's Registrar of Moneylenders.[65] Such a license requires a deposit of SG$20,000[66] and a qualified and experienced person who is responsible for managing the moneylending business.[67] A relevant exception applies, however, if the lending goes exclusively to business entities or accredited investors.[68] This lending is then executed by "excluded moneylenders".[69]

As money raised by crowdfunding platforms typically goes to business entities, most commonly start-ups and SMEs, the exception becomes the rule in the context of lending-based crowdfunding. The typical crowdfunding platforms are therefore not required to hold a moneylender's license in Singapore. Only platforms that allow lending to non-accredited natural persons, i.e. a very narrow form of P2P-lending, need a license.

With regard to regulatory principles and objectives, the traditional approaches to the regulation of lending arrangements fail to adequately address the crowdfunding phenomenon. It is evident that in a scenario where an individual lends to businesses via crowdfunding, the lender, not the borrower, is the party that requires protection, i.e. a moneylender's (or other) licensing requirement is of limited value. The most common regulatory response therefore focuses on the platform and entails a licensing process (as immediately discussed below) and

63. See Monetary Authority of Singapore, *Response to Feedback Received – Facilitating Securities-Based Crowdfunding* 1, 8 (2016) [hereinafter *MAS Response to Feedback Securities-Based Crowdfunding*] ("MAS' approach is to regulate SCF [securities-based crowdfunding] within our existing regulatory framework, and accord lower regulatory requirements (such as financial requirements) in accordance with the risks and characteristics of the business model …").

64. MAS has also emphasized that crowdfunding complements or substitutes lending from commercial banks, government-sponsored financing schemes, and more traditional forms of market financing. MAS Consultation Paper Facilitating Securities-Based Crowdfunding, *supra* note 1, at 3.

65. *See* Moneylenders Act, c. 188, §§ 4-5 (amended 2010) (Sing.); *see also* Sandra Booysen, *The New Moneylenders Act 2008—A Lost Opportunity?*, 21 SING. ACAD. L.J. 394 (2009).

66. Moneylenders Act § 5(5)(c).

67. *Id.* § 7(e).

68. *Id.* § 2(e)(ii)-(iii). For the definition of accredited investors, see *id.*, referring to *Securities and Futures Act*, *infra* note 72, § 4A(1)(a). Such investors are designated by their wealth: in order to qualify as accredited investors, individuals must own net personal assets exceeding $2 million or have had an income of no less than $300,000 within the preceding 12 months, and corporations own net assets exceeding $10 million. Securities and Futures Act, *infra* note 72, § 4A(1)(a). Monetary Authority of Singapore can require different numbers for individuals and corporations, set requirements for trustees, and widen the scope of application by naming further eligible persons. *See id.* For more detail, see Booysen, *supra* note 65.

69. Moneylenders Act §§ 2, 5 ("excluded moneylender").

duties vested in them in the interest of investors (as discussed subsequently for Singapore and under Part III for the UK).[70]

In Singapore, there is no additional specific protection for crowdfunding investors unless such lending requires the purchase of debentures, to which principles of securities regulation apply (as discussed below). Ordinary principles of contract law and torts provide a measure of protection against fraud and misrepresentation, but may be of limited practical value. The lender's contractual partner, the company, is likely to be wound up or may no longer own sufficient unencumbered assets when investors learn about the schemes to which they have fallen victim. Attempts to pierce the corporate veil to obtain compensation from directors or shareholders are burdensome and the outcomes often unpredictable.[71] A lender's only hope is a claim against the platform, but unless the platform has participated in a fraudulent scheme or contractually assumed and breached specific obligations, such as to disclose relevant information about the investment or to continuously monitor the company, the platform remains an outsider to the transaction and cannot be held liable.

License Requirement for Crowdfunding Platforms

Platforms in their roles as financial intermediaries may be subject to licensing requirements under Singapore's Securities and Futures Act (SFA).[72] The Second

70. An atypical approach is pursued by Germany where lending of more than occasional nature (and the regulator assumes categorically that all crowdfunding investors are such non-occasional lenders) is limited to licensed credit institutions, i.e. banks. Germany thereby turns the approach pursued elsewhere upside-down: simple non-securitized lending is subject to the strictest requirements, stemming from the definition of a credit institution in the Banking Act: "the granting of money loans and acceptance credits (credit business)" constitutes a credit institution and requires a license as such. Banking Act (Gesetz über das Kreditwesen), §1(1) (amended 2014) (Ger.) [hereinafter *Banking Act*], https://www.bafin.de/SharedDocs/Downloads/EN/Aufsichtsrecht/dl_kwg_en.html (English translation, last visited Jan. 17, 2018, 9:00AM). However, the German regulator (BaFIN) permits that loans originated with banks are assigned to platform investors so that the risks may ultimately be borne by (retail) investors. *See* BaFIN Merkblatt – Hinweise zum Tatbestand des Kreditgeschäfts, Nr. 1 a) bb) Abs. 4. (2016) https://www.bafin.de/SharedDocs/Veroeffentlichungen/DE/Merkblatt/mb_090108_tatbestand_kreditgeschaeft.html (last visited Jan. 17, 2018, 9:00AM). For more detail on Germany, see Moritz Renner, *Peer-to-Peer Lending in Germany*, 5 J. EUR. CONSUMER MKT. L. 224, 224-26 (2016). In contrast, securitized-lending profits from lower requirements. It is subject to the EU Prospectus Regulation and crowdfunding platforms profit from the many exemptions provided therein, see below at Part III.

71. Singaporean case law on veil piercing is (as much as its UK counterpart to which Singaporean courts refer) strongly based on considerations specific to a particular case. *See* Tan Zhong Xing, *New Era of Corporate Veil-Piercing*, 28 SING. ACAD. L.J. 209, 238 (2016).

72. Securities and Futures Act, c. 289 (amended 2006) (Sing.). The SFA aims to regulate all financial intermediaries in a single Act by providing a single licensing regime that covers all regulated activities of such intermediaries. *See* Monetary Authority of Singapore, *Consultation Paper on the Review of Licensing Regime under the Securities Industry Act and Futures Trading Act* (2000), http://www.mas.gov.sg/~/media/resource/publications/consult_papers/2000/Consultation%20Paper%20On%20The%20Review%20Of%20Licensing%20Regime%20Under%20The%20SI%20Act%20And%20FT%20Act.pdf. MAS specifies which regulated activities are covered by the license (Securities and Futures Act § 86(2)), issues regulations (Securities and Futures Act § 341), and regulates specific powers under several further provisions of the Securities and Futures Act.

Schedule of the SFA contains a comprehensive list of financial activities that are reserved to holders of a Capital Markets Services (CMS) license granted by MAS.[73]

The activity of dealing in securities falls within the regulatory ambit of the SFA and requires a CMS license.[74] The definition of securities is broad in Singapore and includes debentures,[75] e.g. typical debt-instruments such as bonds and notes.[76] Consequently, a CMS license is required for all equity-based and such debt-based crowdfunding that is executed by way of a sale of securities issued by a company.

However, if a platform strictly reserves its role to the intermediation of B2B- or P2B-loans, no dealing in securities is involved. It can avoid the requirement of prior authorization unless it advises on corporate finance, which also requires a CMS license.[77] In addition, corporate financial advisors must obtain a license under the Financial Advisers Act (FAA),[78] but holders of a CMS license under the SFA are exempted.[79] Some provisions of the FAA nevertheless apply, but as explained below, typical crowdfunding platforms can find ways to avoid them.[80]

If "advising on corporate finance" is understood broadly,[81] platforms can only avoid the CMS license requirement if they abstain from all services that platforms typically offer. It is common practice that platforms provide standardized loan terms, but if they operate without a CMS license, they must leave it to the parties to negotiate such terms. They may forward information issued by the companies to investors, but must not provide any advice on how to read this

See id. For more detail, *see* HANS TJIO, PRINCIPLES AND PRACTICE OF SECURITIES REGULATION IN SINGAPORE 136 (2d ed. 2011).

73. *See* Securities and Futures Act §§ 82 (requirement of a CMS license), 88 (authority of MAS to grant a capital markets services license), 99 (exemptions mostly for financial intermediaries that require other types of service licenses).

74. Dealing in securities is named as one of the activities that require a CMS license. *See* Securities and Futures Act § 342 Second Schedule, Regulated Activities Part I. Dealing in securities is defined as "(whether as principal or agent) making or offering to make with any person, or inducing or attempting to induce any person to enter into or to offer to enter into any agreement for or with a view to acquiring, disposing of, subscribing for, or underwriting securities." *Id.* § 342 Second Schedule, Regulated Activities Part II.

75. Securities and Futures Act Art. 2 (defining "securities"); Monetary Authority of Singapore, *Frequently Asked Questions (FAQs) on Lending-Based Crowdfunding* (2016) [hereinafter *MAS FAQs on Lending-Based Crowdfunding*], http://www.mas.gov.sg/~/media/MAS/Regulations%20and%20Financial%20Stability/Regulations%20Guidance%20and%20Licensing/Securities%20Futures%20and%20Fund%20Management/Regulations%20Guidance%20and%20Licensing/FAQs/FAQs%20on%20Lending%20based%20Crowdfunding.pdf.

76. For a definition of debentures, see Securities and Futures Act § 239(3). *See also* Singapore Academy of Law, Ch.17 Corporate Finance and Securities Regulation ¶ 17.3.6 (2015), http://www.singaporelaw.sg/sglaw/laws-of-singapore/commercial-law/chapter-17 (last visited Jan. 17, 2018 9:00AM).

77. Securities and Futures Act § 342 Second Schedule, Regulated Activities Part I.

78. Financial Advisers Act, c. 110, § 6 (amended 2007) (Sing.). For more details on providing financial advisory services, see Tjio, *supra* note 72, at 524-27.

79. Financial Advisers Act § 23(1)(d); *see* Tjio, *supra* note 72, at 132.

80. If the platforms provide financial advisory service, Financial Advisers Act §§ 25-29, 32, 33, 34 and 36 apply.

81. The exact meaning of the term has so far not been clarified in Singapore.

information or offer any in-house research services. It is evident that such platforms have a lower chance of successful intermediation than those engaging in a wider range of services. This leads to the assumption that unlicensed platforms are unlikely to become substantial players in the Singaporean crowdfunding landscape. But, as mentioned below (at *Business Models of Platforms in Singapore*), such platforms still exist.

Generally, a CMS license requires – among other preconditions[82] – that applicants satisfy the base capital requirements for their regulated activities[83] and place a sum of SG$100,000 as a security deposit with MAS,[84] thereby allowing MAS to compensate retail investors who suffer losses from the misconduct of license holders and their agents.[85] In reaction to concerns voiced during a crowdfunding consultation process, MAS clarified that crowdfunding platforms could benefit from eased entry requirements for CMS licenses, i.e. benefit from lower base capital requirements and an exemption from the security deposit requirement.[86] These eased requirements only apply when: platforms do not handle, hold or accept customer monies, assets, or positions; do not act as a principal in transactions with investors; and only raise funds from accredited and institutional investors (more on these investor groups in detail below).[87]

The precondition that platforms abstain from handling, holding or accepting any customer monies aims to protect investors from any mishandling of their means by the platforms. It also seeks to minimize losses from platforms' insolvencies, as does the additional requirement that platforms do not act as principals in transactions with investors.

If a CMS license is granted, platforms may go well beyond the simplest form of financial intermediation. They are allowed to deal in securities, advise on corporate finance, engage in fund management and securities financing, and provide

82. On the full list of requirements, *see* Monetary Authority of Singapore, *Guidelines on Criteria for the Grant of a Capital Markets Services Licence Other Than for Fund Management and Real Estate Investment Trust Management (amended 2016)* [hereinafter *MAS Guidelines on Criteria for the Grant of Capital Markets Services Licenses*], http://www.mas.gov.sg/~/media/MAS/Regulations%20and%20Financial%20Stability/Regulations%20Guidance%20and%20Licensing/Securities%20Futures%20and%20Fund%20Management/Regulations%20Guidance%20and%20Licensing/Guidelines/SFA04G01GuidelinesCriteriaForGrantOfCMSL%201Nov2016.pdf.

83. Ranging from $50,000 to 1,000,000, *see* Securities and Futures Act, *Securities and Futures (Financial and Margin Requirements for Holders of Capital Markets Services Licences) Regulations, First Schedule*, ¶ 3 (amended 2004) (Sing.) [hereinafter *Securities and Futures (Financial and Margin Requirements) Regulations*]. For an explanatory version of these rules, see MAS Guidelines on Criteria for the Grant of Capital Markets Services Licenses, *supra* note 82, at annex 1. Dealing Licensees that deal with retail investors are required to maintain a base capital of $500,000. *See* MAS Consultation Paper Facilitating Securities-Based Crowdfunding, *supra* note 1, at 7.

84. Securities and Futures Act, Securities and Futures (Licensing and Conduct of Business) Regulations §7 (2004) (Sing.).

85. MAS Response to Feedback Securities-Based Crowdfunding, *supra* note 63, at 5.

86. *Id*.

87. On the general and lowered requirements, see Securities and Futures (Financial and Margin Requirements) Regulations, First Schedule, tbl.(1)(f).

credit rating services and custodial services for securities.[88] They may even become the central party to the crowdfunding arrangement and mimic the business model of established financial intermediaries to a much larger extent than the typical crowdfunding platform model.

Prospectus Requirements and Exceptions Thereto

A prospectus must accompany every offer of securities.[89] An offer is defined as "any invitation to a person to deposit money with or to lend money to an entity." If "the indebtedness of the entity in respect of any money that is or may be deposited with or lent to the entity in response to such an invitation" is acknowledged or evidenced by a document, then the offer is made by way of a debenture.[90] As debentures are securities (see above) and shares and units of shares are securities as well,[91] the prospectus requirement applies to all securitized debt- and equity-based investments.

Producing a prospectus is a costly task because the prospectus must contain all compulsory information,[92] and any mistake in its contents[93] may result in liability for the issuer,[94] its directors, all underwriters and any person who has made a statement and consented to being named in the prospectus.[95] Companies seeking financing through crowdfunding platforms are therefore interested in avoiding the prospectus requirement to the greatest extent possible. Under the existing rules of securities regulation, the following exemptions apply: small offers,[96] private placements,[97] and offers to institutional investors or accredited investors are not required to provide a prospectus.[98]

The small offers exception applies when the total amount raised from all offers by the issuer of securities within any period of 12 months does not exceed

88. Securities and Futures Act § 342 Second Schedule, Regulated Activities Part I.

89. Securities and Futures Act §§ 240, 239(3). On the information a prospectus must contain, see *id.* § 243.

90. *Id.* § 239(3).

91. *Id.* § 239(1)(a) (defining "securities"); *see* Tjio, *supra* note 72, at 341. Issuers of securities must provide certain information in the prospectus where there are offers of unlisted shares or units in such shares. *See* Securities and Futures Act § 243; Securities and Futures Act c. 289, Securities and Futures (Offers of Investments) (Shares and Debentures) Regulations, Sixth Schedule (2005) (Sing.).

92. Securities and Futures Act § 243 prescribes all requirements for the content of the prospectus. It must contain "all the information that investors and their professional advisers would reasonably require to make an informed assessment of the matters specified in subsection." *Id.* § 243(1)(a).

93. Criminal and civil liability results from false or misleading statements or omissions in the prospectus. *Id.* §§ 253(1), 254(1).

94. The issuer of securities is "the entity that issued or will be issuing the securities being offered." *Id.* § 239(1).

95. For the full list of persons subject to criminal liability, *see id.* § 253(4). For those subject to civil liability, *see id.* § 254(3).

96. *Id.* § 272A.

97. *Id.* § 272B.

98. *Id.* § 275.

the amount of SG$5 million (or its equivalent in a foreign currency).[99] Additionally, the offeror must explicitly declare to all offerees that the offer is exempted from the prospectus requirement and therefore not accompanied by a prospectus registered with MAS.[100] The offeror must also alert the offerees that secondary trade of the securities is restricted, i.e. subject to similar restrictions that apply to their primary sale.[101] The offer must not be advertised,[102] but instead be made directly to "a person who is likely to be interested in that offer" based on previous contact, professional relationship or indication by the addressee.[103]

The private placement exception provides a prospectus exemption for purchase offers made to a limited number of people in a specific time period. To fall under this prospectus requirement exception, the offer must not be made to more than 50 persons within any 12-month period and must not be accompanied by any advertisement that draws attention to the offer.[104] As the limitation in number of offers is essential and likely subject to attempts of circumvention, the relevant provisions define in detail how MAS counts the number of offers. Entities and trustees are counted as one person if "the entity or trust is not formed primarily for the purpose of acquiring the securities which are the subject of the offer" whereas in the opposite case, every member of the entity or beneficiary of the trust is counted individually.[105]

An issuer of securities could also potentially avoid the prospectus requirement by limiting the number of primary acquirers of securities followed by large-scale secondary sales. However, such attempts are accounted for by the rule providing that where an offer of securities is made to a person in reliance on the private placement exemption, but these exempted securities are offered for sale to another person afterwards, both persons shall be counted for the purposes of determining whether offers of the securities are made to no more than 50 persons.[106]

Offers to institutional investors are categorically exempted from the prospectus requirement.[107] Offers made to accredited investors are exempted if certain conditions are met.[108] Accredited investors are defined as wealthy individuals with net personal assets exceeding SG$2 million in value (or the equivalent in a foreign currency) or with an income in the past 12 months of not less than

99. *Id.* § 272A(1)(a). The amount is calculated in accordance with *Id.* § 272A(4).

100. *Id.* §272A(1)(b)(i).

101. On the restrictions that apply to the resale of the securities, see *Id.* §§ 272A(1)(b)(ii), (3), (8).

102. *Id.* § 272A(1)(c).

103. *Id.* § 272A(3).

104. *Id.* § 272B (1)(a)-(b).

105. For entities and trusts that were not formed primarily for the purpose of acquiring securities, *see id.* § 272B(5)(a). For entities and trusts that were formed primarily for the purpose of acquiring securities, *see id.* § 272B(5)(b).

106. *Id.* § 272B(5)(g).

107. *Id.* § 274. For the definition of institutional investors, see *id.* § 4A(1)(c).

108. *Id.* § 275.

SG$300,000 (or the equivalent in a foreign currency). Corporations with net assets exceeding SG$10 million in value (or the equivalent in a foreign currency) are also accredited investors.[109] To profit from the exemption from the prospectus requirement, offers to accredited investors must not be accompanied by an advertisement that calls attention to the offer, MAS must receive prior notice in writing about the intention to make the offer, and addressees must be informed in writing about the regulatory exemptions that apply to the offer.[110] The same exemption and conditions apply when a person who acquires the securities as a principal pays a consideration of not less than SG$200,000 (or its equivalent in a foreign currency) for each transaction.[111]

All these exceptions rely on situations in which securities are offered, but where specific provisions exempt such offerings from the prospectus requirement. In addition to these exceptions, companies seeking to raise funds without a prospectus can avoid compliance with the principles of securities regulation altogether by issuing promissory notes. Promissory notes are not securities for the purposes of the SFA[112] and therefore not subject to the wide range of regulations that apply to securities. They are also carved out from the definition of debentures as long as the promissory note has a face value of not less than SG$100,000 and a maturity period of not more than 12 months.[113] Consequently, companies may issue such promissory notes without a prospectus,[114] but each promissory note may only be issued to one investor and cannot be a consolidated or collective note that bundles smaller contributions made by several investors.[115]

However, in light of the general regulatory paradigm pursued in the SFA, the promissory note exception makes little sense. The SFA aims to cover all forms of documented payment obligations through a very wide definition of debentures and to exempt only certain types of such documented obligations in cases where the investors seem in little or no need of regulatory protection. This general concept can be pursued more effectively when promissory notes are included in the definition of debentures. Under the current regime, however, MAS does not exercise the same level of control over promissory notes as it does over debentures,

109. *Id.* § 4A(1)(a).

110. *Id.* § 275(1).

111. *Id.* § 275(1A). MAS has explicitly confirmed that these exemptions from the prospectus requirement apply to offers of securities provided via crowdfunding platforms. *See* MAS Response to Feedback Securities-Based Crowdfunding, *supra* note 63, at 5.

112. Promissory notes are explicitly exempted from the definition of securities. *See* Securities and Futures Act § 2(1).

113. *Id.* § 239(1). Note that the definition of debentures in Securities and Futures Act § 2(1) does not apply to part XIII that deals with offers of securities, i.e. the part of the SFA on which our analysis here is based. Debentures for the purposes of this Part XIII are separately defined in Securities and Futures Act § 239(1).

114. *See* MAS FAQs on Lending-Based Crowdfunding, *supra* note 75, at 2-3.

115. MAS Response to Feedback Securities-Based Crowdfunding, *supra* note 63, at 10; MAS FAQs on Lending-Based Crowdfunding, *supra* note 75, at 3.

and even retail investors can become holders of promissory notes as long as the minimum amount and maximum maturity period requirements are observed. Therefore, no prospectus is required. More problematic even, platforms that deal exclusively in promissory notes are not required to hold a CMS license[116] and thus important safeguards do not apply (see below at II. 2.) and monitoring by MAS is not warranted.

MAS evidently shares these concerns because it has announced that it will seek legislative amendments to the SFA to remove the promissory note exception.[117] According to MAS, the promissory note exception was never meant to be used for crowdfunding purposes. Instead, it is intended to facilitate the issuance of short-term notes like commercial papers and promissory notes issued to cover the short-term financing needs of companies. These short-term notes are typically issued by entities with solid credit profiles and bought by institutional or accredited investors.[118] However, since the exception stems from the SFA, MAS cannot single-handedly remove it without legislative action.

No General Customer Knowledge Assessment

Holders of CMS licenses are required to assess their customers' understanding of financial products and their investment goals prior to executing transactions if these transactions involve 'specified investment products'.[119] Such an assessment requires an evaluation of the customer's educational qualifications, investment experience and relevant work experience.[120] However, an assessment is not required for transactions in 'excluded investment products'. The list of excluded products comprises debentures and stocks or shares issued or proposed to be issued by a corporation or body unincorporated unless the entity is a collective investment scheme.[121]

116. MAS Response to Feedback Securities-Based Crowdfunding, *supra* note 63, at 10 n.12.

117. *Id.* ¶ 4.1. This is based on the assessment that "a promissory note has characteristics akin to that of any other debenture, and should hence be subject to securities regulation so investors can enjoy the corollary investor protections." *See* Monetary Authority of Singapore, *Response to Feedback Received – Proposed Amendments to the Securities and Futures Act on Regulation of Financial Benchmarks* 1, 3-4 (2016), http://www.mas.gov.sg/~/media/Response%20Proposed%20Amendments%20to%20SFA%20on%20Benchmarks.pdf; MAS FAQs on Lending-Based Crowdfunding, *supra* note 75, at 4.

118. MAS FAQs on Lending-Based Crowdfunding, *supra* note 75, at 3.

119. Monetary Authority of Singapore, *Securities and Futures Act Notice on the Sale of Investment Products* 1, 18 (amended 2015), http://www.mas.gov.sg/~/media/MAS/Regulations%20and%20Financial%20Stability/Regulations%20Guidance%20and%20Licensing/Securities%20Futures%20and%20Fund%20Management/Notification/2015_04_24%20CKACAR%20NoticeSFA%20%20FINAL.pdf.

120. *Id.* at 19.

121. *Id.* at Annex 1 (a), (f).

The same exceptions apply to the otherwise required customer assessment exercise, which is due prior to any recommendation on investment products provided by holders of a CMS license.[122] This 'know your customer' requirement is therefore not applicable to crowdfunding platforms as long as they offer typical crowdfunding services.

However, platforms are required to assess investors' investment experience and expectations in a limited number of situations under the current rules (see immediately below). As argued further below (at Part III and Part IV), the crowdfunding investor protection regime in Singapore should be more widely based on such 'know your customer' and individualized risk warning principles.

Investor Profile Assessment and Risk Disclosure

The above exemptions relieve companies asking for financing of the prospectus burden and thereby fall in line with wide-spread calls for low regulatory hurdles for crowdfunding, but leave investors without the protection of a prospectus. However, as further discussed below (at Part IV) the benefits of the prospectus requirement are questionable in the context of crowdfunding anyway. Instead, more efficient mechanism of investor protection are needed that keep individual investors safe from loss against which they cannot sufficiently hedge on their own.

Retail investors have access to small offers (as defined above)[123] and for these investors MAS requires an 'investor pre-qualification process' when small offers are communicated via crowdfunding platforms. The pre-qualification process is intended to ensure that every crowdfunding platform assesses whether "potential investors either have sufficient knowledge or experience to invest" in crowdfunding products or that these investments "are suitable for them in light of their investment objectives and risk tolerance".[124] Crowdfunding platforms thereby profit again from lowered compliance requirements because MAS formerly required that both criteria were met cumulatively, not alternatively, when investors were addressed by small offers in securities.[125]

Under the new regime, MAS requires the offerors to execute a 'Knowledge or Experience Test' which ensures that investors possess sufficient knowledge or experience to understand the risks of the investment. Alternatively, offerors can rely on the 'Suitability Assessment Test' that warrants that investments are

122. Monetary Authority of Singapore, *Financial Advisers Act Notice on Recommendations on Investment Products* (amended 2017), http://www.mas.gov.sg/~/media/MAS/Regulations%20and%20Financial%20Stability/Regulations%20Guidance%20and%20Licensing/Financial%20Advisers/Notices/2017_03_30%20CKACAR%20Notice_FAA.pdf.

123. This fact is clear from the law, i.e. the SFA, and has explicitly been confirmed by MAS. *See* MAS Response to Feedback Securities-Based Crowdfunding, *supra* note 63, at 6.

124. *Id.* at 7.

125. *Id.*

suitable for investors in light of their investment objectives and risk tolerance.[126] Investors pass the knowledge or experience test for small offers if they have either work experience or a higher education in a field related to finance, or have engaged in investments under the small offers exemption before.[127] The suitability test assesses whether investors have understood the risks entailed in the investments. It requires the offeror to evaluate their investment strategies, horizons and preparedness for total loss.[128]

In addition, MAS provides a sample 'Risk Disclosure Statement' that needs to be signed by every investor providing funds under the small offers exemption.[129] It emphasizes the high risk of total loss, the lack of sale and redemption options, and for equity-based investments the high risk of no dividends being paid and holdings being diluted. It also contains the warning that platforms that handle investors' monies may fail, resulting in the loss of the investment. It further warns that the investment may be based on insufficient information because regulation does not require the platform or the recipient of funding to provide adequate information.[130]

Through such regulatory requirements for small offers, Singapore pursues an approach that many other regulators around the globe prefer. Retail investors are allowed to engage in crowdfunding investments, although it is obvious that the risks are disproportionately high. The potential returns even in the best-case scenarios may be too low to outweigh the risk of total loss, and retail investors may fail to understand this. Their investments are only conditional upon either a 'Knowledge or Experience Test' or a 'Suitability Assessment Test', and additionally they must sign a form containing explicit warnings about only the gravest of risks.

Alternatively, MAS could consider restricting all crowdfunding investments to institutional and accredited investors. Such a move could, however, be seen as overly paternalistic and deprive some retail investors of an investment opportunity of their choice. It may also marginalize crowdfunding altogether because

126. *Id.*

127. Monetary Authority of Singapore, *Shares and Debentures Guidelines 4: Guidelines on Personal Offers Made Pursuant to the Exemption for Small Offers* Appendix 1 (amended 2016) ("(i) The investor has a minimum of 3 consecutive years of working experience in finance-related fields in the past 10 years; (ii) The investor has a diploma or higher qualification in a finance-related field or professional qualification in a finance-related field; or (iii) The investor has transacted in at least similar investments to the offers of securities made under the small offers exemption in the preceding 3 years").

128. *Id.* ("Suitability Assessment Test Sample questions that the specified person should ask the investor, at a minimum, to facilitate the assessment that the investment is suitable for the investor in light of his or her investment objectives and risk tolerance include but are not limited to: (i) Are you prepared and able to lose all of your capital? (ii) Are you prepared and able to hold on to your investments for 10 years or more without being able to cash out? (iii) Which best describes your preference on investment returns? (e.g. capital preservation, stable returns, high variability in returns)? (iv) What best describes your investment objective? (e.g. retirement planning, children's education, capital appreciation) (v) What would you say is your risk tolerance? (e.g. conservative, balanced, aggressive)?").

129. *Id.* ¶ 6.10 Step 4.

130. *See id.* at Appendix 2.

institutional investors are unlikely to invest substantial amounts of money into start-ups during the initial phase (see above at Part I) and reliance on accredited investors alone might generate insufficient funding for the SME sector.

However, the protective mechanisms mandated for small offers should also cover private placements and, for as long as the exception still exists, the issuance of promissory notes. In all these instances, regulation permits platforms to address non-institutional investors without a prospectus. To guarantee a minimum level of risk-awareness from investors, crowdfunding platforms should be required to follow the few basic steps required for small offers because the different objectives of the small offer and private placement exemptions do not justify a different treatment. According to MAS, small offers limit the overall amount of raised funds while private placements limit the reach of the offer to a maximum of 50 people,[131] but this distinction is of no relevance for a 'Knowledge or Experience Test' or a 'Suitability Assessment Test'. Put differently, if MAS imposes such tests, both objectives can be reached while simultaneously increasing the level of protection for retail investors.

There are good reasons to include accredited investors in these tests as well. While accredited investors are wealthy, they may not necessarily be investment-savvy people. The argument that they are in a better position to protect their own interests[132] does not necessarily entail that they are making use of their wealth to get outside advice that assesses whether certain investments are suitable for them. MAS evidently thinks similarly, as it plans to introduce an opt-in regime under which accredited investors have the option to benefit from the full range of safeguards applicable to retail investors.[133]

In addition to all of the above, platforms may be required to assess investors' profiles and provide product-specific information as a result of provisions in the FAA. When supplying financial advice to customers, a person licensed under the FAA, but also holders of a CMS license must comply with a number of provisions in the FAA.[134] These requirements apply to a crowdfunding platform if it

131. Monetary Authority of Singapore, *Response to Feedback Received – Consultation Paper on Draft Amendment Bill to the Securities and Futures Act and Financial Advisers Act* 1, 3 (2004), http://www.mas.gov.sg/~/media/resource/publications/consult_papers/2004/MAS_%20Response%20to%20Feedback%20Received%20%20Consultation%20Paper%20on%20Draft%20Amendment%20Bills%20to%20the%20Securities%20and%20Futures%20Act%20and%20Financial%20Advisers%20Act.pdf.

132. *See* Monetary Authority of Singapore, *MAS Enhances Regulatory Safeguards for Investors* (amended 2016), http://www.mas.gov.sg/News-and-Publications/Media-Releases/2015/MAS-Enhances-Regulatory-Safeguards-for-Investors.aspx (last visited Jan. 17, 2018 9:00AM).

133.On the standalone exemption to prospectus requirements if an investor passes a "knowledge test" considered by MAS in the past (but ultimately dropped), see Monetary Authority of Singapore, *Response to Feedback Received – Policy Consultation on Amendments to the Securities and Futures Act and the Financial Advisers Act* 1, 14 (2006), http://www.mas.gov.sg/~/media/resource/publications/consult_papers/2006/MAS%20Response%2025Sep06%20paper.pdf.

134. Financial Advisers Act, c. 110, § 2, Second Schedule (amended 2007) (Sing.) (providing that a financial advisory service consists of "advising others, either directly or through publications or writings, and whether in electronic, print or other form, concerning any investment product … or advising others

provides financial advice to investors on the securities offered.[135] If a platform recommends securities, it is required to disclose to its clients all material information relating to this investment product.[136] The platform must also ensure to provide a reasonable recommendation that is based on sufficient relevant information about the investment and a good understanding of the client's investment objectives and financial situation.[137] How platforms can avoid these duties is currently unclear, but MAS provides some guidance by requiring that all information be of purely factual nature.[138] A clear disclaimer that the platform abstains from any advice or recommendation and only connects investors with issuers of securities should be sufficient. In contrast, platforms should be careful when they point to their quality assessments of issuers of offered securities. From such statements MAS might conclude that platforms implicitly recommend these offered securities.

Restrictions on Advertising

As explained above, exemptions from the prospectus requirement are linked to advertising restrictions. Exempted offers must not be accompanied by any advertisement that makes an offer or calls attention to an offer. As discussed, platforms and issuers of securities may only communicate with investors under the following conditions: in the case of small offers after investor profiles have been assessed and investors have been warned of the investment risks; in the case of private placements, if no more than 50 investors are addressed; and in the case

by issuing or promulgating research analyses or research reports, whether in electronic, print or other form, concerning any investment product").

135. MAS Consultation Paper Facilitating Securities-Based Crowdfunding, *supra* note 1, at 5; MAS FAQs on Lending-Based Crowdfunding, *supra* note 75, at 2.

136. Financial Advisers Act § 25 requires that the licensed adviser disclose to the client "all material information relating to any designated investment product that the licensed financial adviser recommends to such person, including (a) the terms and conditions of the designated investment product; (b) the benefits to be, or likely to be, derived from the designated investment product, and the risks that may arise from the designated investment product; (c) the premium, costs, expenses, fees or other charges that may be imposed in respect of the designated investment product." For further information and details on these requirements, see Monetary Authority of Singapore, *Financial Advisers Act Guidelines on Standards of Conduct for Financial Advisers and Representatives*, Guideline No. FAA-G04 (amended 2010), http://www.mas.gov.sg/~/media/resource/legislation_guidelines/fin_advisers/fin_advisers_act/guidelines/FAA_G04.pdf; Monetary Authority of Singapore, *Financial Advisers Act Notice on Information to Clients and Product Information Disclosure*, Notice No. FAA-N03 (amended 2013), http://www.mas.gov.sg/~/media/MAS/Regulations%20and%20Financial%20Stability/Regulations%20Guidance%20and%20Licensing/Financial%20Advisers/Notices/FAAN03%20%20Product%20Information%20and%20Disclosure%2020%20Feb%2013.pdf.

137. Financial Advisers Act § 27.

138. *See* Monetary Authority of Singapore, *Securities and Futures Act Guidelines on the Advertising Restrictions in Sections 272A, 272B and 275* 1, 2-3 (2016), http://www.mas.gov.sg/~/media/MAS/News%20and%20Publications/Consultation%20Papers/Crowdfunding/Annex%20B%20%20Guidelines%20on%20Advertising%20Restrictions.pdf.

of accredited investors, if the platform insures that only persons who meet the requirements for this investor group are targeted.[139]

Open access crowdfunding platforms are incompatible with these restrictions because a selection process that ensures that only qualified investors are exposed to the provided information would be impossible.[140] Therefore, all information about offers must be provided on platforms with restricted access.[141] Crowdfunding platforms comply with these requirements by implementing an account registration system where prospective investors have to sign up before obtaining access to the current offers.

However, advertisements about the platform and its services do not infringe the advertising restrictions. The platform may provide information about its own services and mention past offers that were initiated and completed through it, but the publicly accessible announcements must not provide information about current or future offers.[142]

Business Models of Platforms in Singapore

The beginnings of crowdfunding in Singapore were most informal. Platforms started operating without a CMS license until MAS clarified that all platforms engaging in the offering of securities need such a license. Thus, nowadays, the majority of platforms hold CMS licenses.[143] But there are some exceptions; most platforms remaining without a CMS license restrict their business to the intermediation of non-securities-based lending to business entities. If such platforms do not provide investment advice and therefore do not fall under the FAA, they are not subject to the licensing requirement.[144]

All currently active platforms in Singapore engage in debt-based and some additionally in equity-based crowdfunding. In Singapore, there is no restrictive regulation in force that limits the financial exposure of retail investors to prevent losses that exceed certain percentages of their income or assets.[145] Instead, the regulator relies on basic warnings in case of small offers that signal to investors to look out for themselves. Regulation does not hinder platforms from providing services to anyone on both sides of the funding deal. Nevertheless, most platforms in Singapore only admit institutional and accredited investors, while some

139. *Id.* at 2.

140. *Id.* at 3.

141. *Id.* at 2-3.

142. *Id.* at 3.

143. At the time this article was written, CapBridge Pte. Ltd., Crowdonomic Media Pte Ltd, Funded Here Pte. Ltd., Fundnel Pte. Ltd., Funding Societies Pte. Ltd., Moolahsense Pte. Ltd. and OurCrowd Management (SG) Pte. Ltd. held a CMS license.

144. *See supra* Part I *The Business Model and Types of Crowdfunding*; *infra* Part IV *Non-securitized Lending.*

145. Such maximum amount limitations are in force in the U.S. and to limited extents in the UK. On the U.S., see Ibrahim, *supra* note 11, at 572; Schwartz, *supra* note 40, at 617. On the UK, see *infra* Part III.

platforms exclusively specialized in debt-based funding are also open to retail investors.[146]

To some extent, platforms' interest in the success of their business serves as a self-regulatory mechanism (above Part I). Platforms often set access requirements for companies in order to mitigate the investors' risk of loss. In addition, they gather information about the companies' business plans and forward such information to investors (below at *Assessment of Customers' Suitability*). The principle of investor protection is also reflected in the way platforms handle investors' monies (below at *Holding and Managing Investors' Funds*), but the business models pursued by some platforms raise concerns of potential regulatory arbitrage (below at *Deviations From the Basic Crowdfunding Model*).

Assessment of Customers' Suitability

Some platforms cater to the needs of brand new start-ups that lack any type of initial funding and have come to life only recently. Others only admit companies which meet criteria that show that the company has been in business for a minimum period of time, has secured initial funding or has generated promising revenue during its time of existence. Such criteria include, for example, that companies shall:

- have been incorporated in Singapore and submitted their financial statements to the Accounting and Corporate Regulatory Authority (ACRA) for some time, e.g. no less than three months[147] or one year[148],
- have secured funding from an institutional investor,[149]
- have generated turnover or revenue in the past financial year exceeding certain threshold amounts, e.g. SG$ 100,000[150] or SG$ 200,000[151] of annual turnover or SG$10,000,000 of revenue[152],
- have Singaporean directors,[153]and/or
- have a paid-up capital of certain minimum amounts, e.g. of no less than SG$ 30,000.[154]

Such admittance criteria provide some information about recipients of funding, but they are too basic to guide investors. In fact, there are no rules in force in Singapore that require the platforms to gather information about the companies, to assess their good standing, or to evaluate the quality of their business plans. Here, Singapore pursues an approach different from other jurisdictions

146. Funding Societies Pte. Ltd., Moolahsense Pte. Ltd., Capital Match Platform Pte. Ltd. and NewUnion (SG) Investment Pte. Ltd. accept retail investors.

147. FundedHere Pte. Ltd..

148. MoolahSense Pte. Ltd.; NewUnion Pte. Ltd.; Capital Match Pte. Ltd.

149. CapBridge Pte. Ltd.

150. Capital Match Pte. Ltd.

151. MoolahSense Pte. Ltd.

152. CapBridge Pte. Ltd.

153. MoolahSense Pte. Ltd.; Capital Match Pte. Ltd.

154. FundedHere Pte Ltd.

where such checks are required by regulation.[155] It is, however, in the platforms' own best interest to select the more promising candidates if they intend to stay in business. It can therefore be assumed that all platforms run due diligence checks with respect to basic criteria such as companies' solvency, and directors' and executive officers' bankruptcy and criminal history. However, little information about these check patterns is available.

In the absence of regulatory requirements, some platforms choose to remain silent on their principles of risk assessment, and even those that disclose their practices typically use only vague language. This makes it difficult for investors to compare the standards and principles applied by platforms and to select the platform that fits their needs and expectations best. The platforms that issue some information about their assessment procedures state in general terms that they run financial checks on companies prior to admitting them. These checks may consist of reviewing the financial and bank statements as well as tax assessments, and making inquiries about the financial situation and prior work experience of company directors.[156]

However, under the small offers exemption from the prospectus requirement, platforms are required to apply the 'Knowledge or Experience Test' or alternatively the 'Suitability Assessment Test'. For the latter, platforms can only arrive at a conclusion as to whether an investment is suitable for a particular investor[157] if the platforms possess detailed information about the issuer as well as the investor's investment objectives and risk tolerance. The same is true for the 'Knowledge or Experience Test' because it requires platforms to evaluate whether investors possess sufficient knowledge or experience to understand the risks of the investment. The platforms can only draw the necessary conclusions if they have assessed the risks of a particular investment and have further determined that the investors possess sufficient knowledge or experience to understand them. Such assessments cannot be made without access to detailed information about the company and its business plans.

It has been argued here that MAS should consider applying these tests in all instances where securities are offered without a prospectus. This would lead to a more standardized process of gathering and distributing information, thus creating greater transparency about the opportunities and risks related to each project

155. For a summary of the regulatory due diligence requirements in a number of countries including the U.S., see Corporations and Markets Advisory Committee, *Crowd Sourced Equity Funding Report* 1, 99 (2014), http://www.camac.gov.au/camac/camac.nsf/byheadline/reportsfinal+reports+home.html (last visited Jan. 17, 2018 9:00AM).

156. For examples of what companies say about their assessment procedures, see Crowdo, Frequently Asked Questions, https://crowdo.com/information/faq (last visited Jan. 17, 2018 9:00AM); Fundnel, Fundnel Knowledge Centre, https://fundnel.com/knowledge-centre/category/4 (last visited Jan. 17, 2018 9:00AM); Funding Societies, Investor's FAQ, https://fundingsocieties.com/faq (last visited Jan. 17, 2018 9:00AM). MoolahSense, FAQ for Investor, https://www.moolahsense.com/support-center/ (last visited Jan. 17, 2018 9:00AM).

157. This is the purpose behind the Suitability Assessment Test. *See* MAS Response to Feedback Securities-Based Crowdfunding, *supra* note 63, at 7.

and making it easier for retail investors to compare the services of different funding portals.[158]

Holding and Managing Investors' Funds

A minority of crowdfunding platforms hold funds collected from investors in their own accounts before disbursing them to the recipients.[159] The majority of platforms, however, channel payments through trust companies[160] or direct clients to make payments into trust accounts with custodian banks[161] to avoid comingling of the platforms' own funds and investors' monies. In these cases, funds are disbursed to the issuers of securities if funding targets are reached but otherwise returned to the investors.[162]

Currently, it is less clear in Singapore than in other jurisdictions, e.g. the U.S,[163] to what extent crowdfunding platforms are prohibited from holding or managing the investors' funds or securities. The above-discussed (at *License Requirement for Crodfunding Platforms*) statement of MAS that platforms required to hold a CMS license could benefit from lowered base capital and operational risk capital requirements[164] if they "do not handle, hold or accept customer monies, assets, or positions and do not act as principal in transactions with investors"[165] clashes with provisions that prohibit such handling of customer monies.

Part III of Securities and Futures (Licensing and Conduct of Business) Regulations (short LCB Regulations)[166] applies to all holders of CMS licenses and requires them to segregate and place all monies they receive from customers into trust accounts and assets into custody accounts.[167] If subject to this requirement, platforms must place all monies into trust accounts with banks, merchant banks, or finance companies.[168] Holding monies in their own accounts, but even their

158. *See infra* Part IV.

159. Capital Match, Learn about Investment Risks with Capital Match, https://www.capitalmatch.com/risks.html (last visited Jan. 17, 2018 9:00AM).

160. Trust Companies Act, c. 336 (amended 2006) (Sing.) (providing for the licensing and regulation trust companies in Singapore). For the requirements of such a license, see *id.* §5, First Schedule. Examples of platforms that make use of the services of trust companies are Capital Spring Board, Crowdo, New Union, Funding Societies, Validus, Capital Match.

161. Examples of platforms that direct clients to pay into trust accounts with custodian banks are MoolahSense and CoAssets.

162. This payment model is adopted by Capbridge, Crowdo, Fundedhere and Funding Societies. For more details, see Crowdo, Membership Agreement with Investor (SG) § 7.5, https://investmentsg.crowdo.com/pages/investor_membership_agreement_sg (last visited Jan. 17, 2018 9:00AM); Funding Societies, *supra* note 156.

163. *See* 15 U.S.C. § 78c(a)(81)(D) (2012).

164. Securities and Futures Act, Securities and Futures (Financial and Margin Requirements for Holders of Capital Markets Services Licences) Regulations, First Schedule, tbl.(1)(f).

165. MAS Response to Feedback Securities-Based Crowdfunding, *supra* note 63, at 5; *see also supra* Part II.

166. Securities and Futures Act, Securities and Futures (Licensing and Conduct of Business) Regulations (amended 2004) (Sing.).

167. *Id.* §§ 16(1), 17(1), 25(1), 26(1).

168. *Id.* § 17(1).

commonly applied practice of depositing clients' monies with trust companies or escrow agents would fall short of this requirement.

It should follow from these LCB regulations that any arrangement that does not protect customers from the risk of the platform's insolvency or embezzlement is inadmissible. Consequently, all platforms that are required to hold a CMS license are prohibited from holding any clients' monies in their own accounts. Only platforms that are not required to hold a CMS license remain outside the scope of application of these provisions. However, as clients' monies are as much at risk here as in all situations that require a CMS license, there is no justification for this exception. Platforms should be prohibited from keeping clients' monies in their own accounts under all circumstances.

In contrast, the requirements of the LCB Regulations are overly strict in instances where platforms deposit clients' monies with trust companies or escrow agents. Such practices are no less safe than paying received monies into trust accounts with banks and should therefore be permitted.

Deviations From the Basic Crowdfunding Model

Most of the platforms in Singapore offer only the standard service of connecting companies and investors and enter into service agreements with parties on both sides of the funding transaction. As a result, the platforms are not parties to the investment contracts.[169]

In at least two cases, however, platforms go beyond these standard services and set up investment models that strengthen their roles as financial intermediaries. In the first instance, a platform facilitates investments in Private Equity projects. Investors become limited partners in limited partnerships registered outside of Singapore. With the funds received, the partnerships invest in equity of portfolio companies which are also located outside of Singapore.[170]

This example, illustrates a point briefly mentioned above (at Part I): the business models pursued by crowdfunding platforms are diverse. Here, the platform does not directly intermediate between the investor and the ultimate recipient of funding, but establishes the contact between investors and other financial intermediaries, in the particular case Private Equity funds.[171] The resulting risks are

169. This applies to CapBridge, Capital Match, Crowdo, Fundnel, Funding Society and MoolahSense.

170. *See* OurCrowd, Standard Terms, https://www.ourcrowd.com/how_it_works/standard_terms (last visited Jan. 17, 2018 9:00AM). OurCrowd holds a CMS license, *see* Jacqueline Woo, *Crowdfunding start-up OurCrowd opens office in Singapore*, THE STRAITS TIMES (Nov. 16, 2016), http://www.straitstimes.com/business/companies-markets/crowdfunding-start-up-ourcrowd-opens-office-in-singapore.

171. Private equity funds are subject to regulation applicable to Collective Investment Schemes, see Securities and Futures Act, c. 289, § 2 (amended 2006) (Sing.). Collective Investment Schemes require authorization from MAS. *Id.* §§ 286-287. On the activities and the regulation of private equity in Singapore see Low Kah Keong and Felicia Maria Ng, *Singapore*, in PRIVATE EQUITY REVIEW 177-186 (Stephen Ritchie ed 6th ed 2017).

not necessarily higher than in the case of direct intermediation because default risks and returns depend in either situation on the performance of the ultimate recipients of funding. Regulation of the platform, the Private Equity fund and the fund managers[172] combined should warrant the same level of protection in multi-level as compared to single-level intermediation. However, the issue arises why such more established types of financial intermediation should benefit from the new concept of crowdfunding. The emphasized benefits of crowdfunding for projects that have no access to more conventional funding sources (above Part I) support eased regulatory requirements for crowdfunding platforms and crowdfunding projects, but it contradicts the crowdfunding narrative when crowdfunding platforms specialize in connecting investors with more established providers of investment opportunities. For as long as crowdfunding enjoys preferential regulatory treatment because it is seen as a welcome and necessary gap-filler for start-ups and other SMEs with little or no access to funding, other financial intermediaries should not be allowed to participate in the crowdfunding model on either side of the transactions.

In the other instance, the platform purchases securities issued by companies and subsequently enters into interest-bearing loan contracts with crowdfunding investors. The platform names this process 'pre-funding' because it first invests its own money in the funding projects before collecting money from investors who are meant to commit to a project. However, investors never really invest in a particular project because they contract exclusively with the platform and do not enter into any legal relationship with the securities-issuing companies.[173] The platform advertises the speediness of such deals because the funding project can start immediately without having to wait until funding thresholds have been reached.[174]

This conceptual design is problematic for reasons different from those related to the multi-layered intermediation model. The intermediary does not engage in any additional form of maturity transformation because its contracts with investors state that the intermediary owes repayment to them only when it receives payments on the underlying securities. Consequently, the intermediary does not provide any early redemption options. Payments in this model, however, depend on the intermediary's solvency and liquidity, but here the requirements to separate the clients' from the platform's own monies and to keep clients' monies in trust accounts should help to reduce this risk. Yet, it is not clear whether the platform complies with such principles of separation of funds. According to its own statements, it operates without a CMS license.[175] The platform evidently seeks to avoid the list of financial services that require such a license under the

172. *See* for Singapore Lin Lin, *Private Equity in Singapore*, in HANDBOOK ON FINANCIAL SERVICES at III A (Dora Neo & Hans Tjio, eds, forthcoming 2018).

173. *See* New Union, FAQs, https://www.newunion.sg/faq (last visited Jan. 17, 2018 9:00AM).

174. *See id*.

175. *See id.*

SFA because it emphasizes that it does not provide any investment advice to investors nor facilitates the sale of debentures and other securities to investors. If the platform's assumptions are correct, the requirement to keep clients' monies in trust accounts does not apply (as explained above at *Holding and Managing Investors' Funds*).

From a purely formalistic perspective, it may be argued that such a platform does not deal in securities (an activity that triggers the license requirement),[176] but since the financial interests of its investors are tied to the financial success of a securities-based investment[177] there is no justification why such a platform should be allowed to operate without a license and all the restrictions and business of conduct requirements that come with it.

PART III: THE COMPARATIVE PERSPECTIVE: CROWDFUNDING REGULATION IN THE UK

The analysis in the preceding part of this article has shown that Singapore has eased the requirements for offering securities and obtaining CMS licenses to support the crowdfunding business for platforms and recipients of securities-based funding. At the same time, it has been pointed out that the risks for non-institutional investors are substantial and that a few simple approaches could help mitigate these risks further. These findings call for a discussion about approaches that enhance investor protection without creating disproportionately high burdens for companies and platforms. Since regulators in all financial centers are faced with this regulatory challenge, such a discussion is best done from a comparative perspective. If it can be shown that other jurisdictions manage to set adequate standards of investor protection without stalling the crowdfunding business, proposals for regulatory improvements in Singapore become more credible.

As the UK is a global leader in crowdfunding volumes and (stemming from colonial times) Singapore's often-followed legal and regulatory idol, UK law is used here for this comparison. It also comes with the advantage that regulation for securities-based crowdfunding in the UK is based on EU law, and thus similar principles apply in the rest of the EU, i.e. in 27 more European countries including other important European financial markets like Germany, France, Italy and Luxembourg.

176. In detail see above at *License Requirement for Crowdfunding Platforms.* The requirement stems from Securities and Futures Act § 342 Second Schedule, Regulated Activities Part 2 (defining dealing in securities as "(whether as principal or agent) making or offering to make with any person, or inducing or attempting to induce any person to enter into or to offer to enter into any agreement for or with a view to acquiring, disposing of, subscribing for, or underwriting securities").

177. *See* New Union, *supra* note 173.

EU Rules of Relevance for Regulating Crowdfunding

The most relevant legislative acts of EU law that regulate crowdfunding in all 28 member states are the Prospectus Regulation of 2017[178] that replaces the Prospectus Directive of 2003[179] and the Markets in Financial Instruments Directive (MiFID).[180] The Prospectus Regulation is in force, but to give the member states time to prepare for its application, some of its provisions will not apply before 21 July 2018 and others not before 21 July 2019. The relevant provisions of the Prospectus Directive remain applicable until replaced by the Regulation.[181] This is of relevance for crowdfunding regulation in the UK that is still based on the Directive (and in light of Brexit negotiations it must be anticipated that all late-stage provisions of the Regulation will never directly be applied there). Some relevant differences between the Regulation and Directive are analysed below in the part that discusses the UK rules.

The Prospectus Regulation and its Effect on Crowdfunding in the EU

Under the Prospectus Regulation, every offer of securities to the public[182] must be accompanied by a prospectus[183] that informs potential investors about the project in adequate ways.[184] It has to contain a summary that focuses on the most essential information presented in a compact way using easily-understandable language.[185] In certain situations, the Regulation exempts issuers of securities from the prospectus requirement. These exceptions are explained here to the extent that they are relevant to crowdfunding scenarios.

178. Regulation (EU) 2017/1129, of the European Parliament and of the Council of 14 June 2017 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market, and repealing Directive 2003/71/EC, 2017 O.J. (L 168) 12.

179. Directive 2003/71/EC, of the European Parliament and of the Council of 4 November 2003 on the prospectus to be published when securities are offered to the public or admitted to trading and amending Directive 2001/34/EC, 2003 O.J. (L 345) 64, as amended by Directive 2010/73/EU, of the European Parliament and of the Council of 24 November 2010 amending Direction 2003/71/EC on the prospectus to be published when securities are offered to the public or admitted to trading and 2004/109/EC on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market, 2010 O.J. (L 327) 1.

180. There is no regulation specifically tailored to the crowdfunding phenomenon in place in the EU yet, but this may change in the near future. *See* European Commission, *supra* note 5.

181. Regulation (EU) 2017/1129 Art. 49(2) ("… this Regulation shall apply from 21 July 2019, except for Article 1(3) and Article 3(2) which shall apply from 21 July 2018 and points (a), (b) and (c) of the first subparagraph of Article 1(5) and the second subparagraph of Article 1(5) which shall apply from 20 July 2017").

182. *Id.* art. 2(d) (defining offer of securities to the public as "a communication to persons in any form and by any means, presenting sufficient information on the terms of the offer and the securities to be offered, so as to enable an investor to decide to purchase or subscribe for those securities. This definition also applies to the placing of securities through financial intermediaries").

183. On the content of the prospectus, see *id.* art. 6. On the summary it must contain, see *id.* art. 7.

184. *Id.* art. 3(1).

185. *Id.* art. 7, recitals 29-32.

Exception Equivalent to the SG Small Offers Exemption

The Regulation establishes a regime of three amount-dependent layers in recognition of the high financial burdens resulting from a prospectus requirement for offers of smaller volumes. The shift from the Directive to the Regulation comes with significantly eased standards for offers of securities because the amounts below which no prospectus is required have been increased drastically. All member states must require a prospectus for offers of securities to the public above EUR 8,000,000 (up from EUR 5,000,000 under the Directive).[186] On the lower end, the prospectus requirement is eliminated for offers with a total consideration of less than EUR 1,000,000 (up from EUR 100,000 under the Directive).[187] For all offers in between, i.e. ranging from EUR 1,000,000 to 8,000,000, member states are free in their decision whether to require a prospectus in their national regimes.[188]

Regardless of the exemptions to the prospectus requirement, the Prospectus Regulation authorizes national regulators to make the disclosure of essential information compulsory for as long as such disclosure does not "constitute a disproportionate or unnecessary burden in relation to such offers of securities".[189]

Exception Equivalent to the SG Private Placement Exemption

Another exception affects offers of securities to a restricted number of investors. Offers may not be addressed to more than 150 natural or legal persons for this exemption to apply.[190]

Exception Equivalent to the SG Exemption for Institutional Investors

A prospectus is also not required for offers that are exclusively addressed at 'qualified investors' if any consecutive resale to the public is excluded.[191] The

186. *See id.* art. 3(1)-(2). For the Prospectus Directive, *see* Directive 2003/71/EC, art. 1(2)(h), 2003 O.J. (L 345) 64 as amended by Directive 2010/73/EU, art. 1(a), 2010 O.J. (L 327) 1.

187. Regulation (EU) 2017/1129 art. 1(3), recital 12; Directive 2003/71/EC art. 3(e).

188. Regulation (EU) 2017/1129 Art. 3(b), recital 13. Such exempted offers do not profit from the EU passport benefit that allows offers that comply with the regulatory requirements in their country of origin to be offered throughout the EU (and even EEC) unless such issuers voluntarily comply with the prospectus requirement. *Id.* art. 4, recital 23.

189. *Id.* recital 12 (for offers below 1,000,000), recital 13 (for offers not exceeding 8,000,000).

190. *Id.* art. 1(4)(b), recital 15 (explaining that the scope of application of this exception is very narrow as the regulation pictures a "limited number of relatives or personal acquaintances of the managers of a company").

191. *Id.* art. 1(4)(a), recital 25.

Prospectus Regulation uses the term qualified investors in the same way the MiFID[192] defines 'professional investors'. This group of investors includes: financial institutions, very large companies, and government bodies as well as other institutional investors whose main activity is to invest in financial instruments.[193]

Exception Based on Minimum Investment Amounts Per Unit or Investor

The prospectus requirement exempts securities when the denomination of the securitized unit amounts to at least EUR 100,000,[194] or when securities are acquired for a total consideration of at least EUR 100,000 per investor. The rationale for these exceptions lies in the assumption that the strong investment capacity of such investors lowers their need for high levels of regulatory protection. It explains why the Regulation requires a prospectus if such exempted issues may be resold to non-qualified investors.[195]

The New EU Growth Prospectus Regime

The above four exceptions eliminate the prospectus requirement entirely. They apply in all situations in which the conditions for the exemptions are met and are not limited to crowdfunding scenarios. This is different for the EU Growth Prospectus regime. To facilitate the funding of SMEs[196] whose difficulties in accessing market financing the EU recognizes just like Singapore and other parts of the world, the Regulation introduces a new type of prospectus. It applies to companies which need lower amounts of financing compared to more traditional issuers of securities.

The new regime applies when aggregated amounts of all offers do not exceed EUR 20,000,000.[197] Assuming that no other exceptions apply (see above b. to d.), such companies are subject to the mandatory prospectus requirement as a prospectus is compulsory for offers of securities to the public above EUR 8,000,000 (above at a.).

192. For more details on the MiFID, *see infra* Part III *The MiFID and its Effect on Crowdfunding in the EU*.

193. Regulation (EU) 2017/1129 art. 2(e); Directive 2014/65/EU (MiFID II), of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU (recast), 2014 O.J. (L 173) 349, Annex II Section I.

194. Regulation (EU) 2017/1129 art. 1(4)(c).

195. *Id.* recital 21.

196. *Id.* art. 2(f) (defining SMEs as "companies, which, according to their last annual or consolidated accounts, meet at least two of the following three criteria: an average number of employees during the financial year of less than 250, a total balance sheet not exceeding EUR 43,000,000 and an annual net turnover not exceeding EUR 50,000,000"); MiFID II art. 4(1)(13) (defining SMEs as "companies that had an average market capitalisation of less than EUR 200,000,000 on the basis of end-year quotes for the previous three calendar years"). For the requirements all non-SME types of companies must meet to be treated like SMEs, see Regulation (EU) 2017/1129 art. 15(1)(b)-(c).

197. Regulation (EU) 2017/1129 recital 51.

The EU Growth Prospectus rule does not remove the prospectus requirement altogether because such amounts pose significant risks to a vast number of investors. Instead, this more cost-efficient type of prospectus is exclusively available to SMEs.[198] The EU thereby seeks to strike a balance between lower funding costs for SMEs and sufficient investor protection by requiring a "proportionate disclosure regime" in a prospectus that focuses on the most material information from an investor's perspective.[199] It is "a document of a standardized format, written in a simple language and easy for issuers to complete".[200]

The Special Regime Applicable to Debt-Based Securitized Investments

For debt-based securities,[201] a further exemption is available that promises to lessen the burden for issuers. When issuers of debt-based securities are required to provide a prospectus, they may do so by way of a "base prospectus" instead of a standard prospectus.[202]

A base prospectus is a simplified prospectus that contains "the necessary information concerning the issuer and the securities offered to the public".[203] The base prospectus may be limited to more general information that leaves the specific details of the offered securities unaddressed. The details containing the final terms of the specific security may be provided separately at a later stage, but a final summary must ultimately be provided to investors and contain the key information from both the base prospectus and the final terms of the offered securities.[204]

The MiFID and its Effect on Crowdfunding in the EU

The Prospectus Regulation answers the questions when the issuers of securities are required to provide a prospectus and what information they must disclose in it. In contrast, the MiFID addresses the risks stemming from financial intermediation and harmonizes the authorization requirements for financial intermediaries and their obligations in relation to investors to whom they provide services across the EU.

198. *Id.*

199. *Id.* art. 15(1), recital 52. The prospectus must contain a summary, but the requirements for its summary are lower than those that apply to summaries in a standard prospectus. *See id.* arts. 7, 15(2).

200. *Id.* art. 15(1).

201. Regulation (EU) 2017/1129 calls debt-based securities "non-equity securities." *Id.* art. 8. "Non-equity securities" are defined as "all securities that are not equity securities." *Id.* art. 2(c).

202. *Id.* recital 35.

203. *Id.* art. 8(1).

204. *Id.* art. 8(9).

License Requirement

In order to be within the MiFID scope, a firm needs to provide MiFID services or activities in relation to MiFID financial instruments, and not fall under one of the exemptions.[205] Such exemptions apply to a whole list of more established and conventional financial intermediaries and are irrelevant for crowdfunding platforms.[206]

The most relevant financial instruments covered by MiFID are transferable securities and units of collective investment undertakings. Transferable securities as commonly offered via crowdfunding platforms, be they equity-based like shares or debt-based like debentures, fall under this definition of financial instruments.[207] Only atypical investment models that do not rely on transferable securities remain outside of the scope of application of the MiFID. However, one such scenario is relevant in the context of crowdfunding: if platforms connect borrowers and lenders who enter into a non-securitized loan contract, MiFID is inapplicable and regulation is a national matter.[208]

Firms are subject to regulation by MiFID when they provide investment services and activities, e.g. take and execute buy-orders for financial instruments from investors or provide investment advice.[209] Crowdfunding platforms that advise their clients on investment opportunities are undoubtedly subject to MiFID, but whether the standard service of connecting companies and investors constitutes the activity of taking and executing buy-orders is less clear. Some platforms have voiced opinions that their services do not amount to the execution of buy-orders, but solely constitute 'communications of interest' from one party to the investment contract to another.[210] As the issue has not been resolved – and can with EU-wide authority only be resolved by the Court of Justice of the European Union (CJEU) – it is impossible to predict with absolute certainty whether the national regulators will subject all securities-based crowdfunding services to the MiFID regime or exempt some of them.

205. European Securities and Markets Authority, *Advice: Investment-Based Crowdfunding* 1, 44 (2014), https://www.esma.europa.eu/sites/default/files/library/2015/11/2014-1560_advice_on_investment-based_crowdfunding.pdf.

206. For the exemptions, see Directive 2014/65/EU (MiFID II), of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU (recast), 2014 O.J. (L 173) 349, art. 2.

207. European Securities and Markets Authority *supra* note 205, at 46.

208. Some platforms in EU member states avoid MiFID regulation by offering investors forms of participation which are not considered to be transferable securities or otherwise qualify as MiFID financial instruments, e.g. in Austria, Belgium, Germany and Sweden. *See id.* at 47. For the regulatory reactions of member states, see *id.* at 49.

209. MiFID II arts. 2(2), 4(1) (explaining that an investment firm is a legal person that provides one or more investment services or activities). For the list of such investment services and activities, *see id.* Annex 1 Section A.

210. European Securities and Markets Authority, *supra* note 205, at 50-51.

However, it is very likely that regulators and courts will arrive at the conclusion that the MiFID applies.[211] The simple execution of online orders is covered by the scope of application of the MiFID.[212] The service of a crowdfunding platform consists of activities that in essence amount to the execution of buy-orders in securities, and a platform does even more than a typical online broker because it provides the market for the orders it collects. The UK (as discussed below) shares this assessment as can be derived from the fact that its regulation of securities-based crowdfunding follows the MiFID regime.[213] Furthermore, the statements of the CJEU in a most recent preliminary ruling strongly point in the direction of the opinion submitted here. The Court stated that a service constitutes an investment service in the meaning of the MiFID when it "refers to bringing together two or more investors . . . in the context of the reception and transmission of orders" and "for the purpose of completing transactions in relation to one or more financial instruments".[214] According to the Court, "brokering with a view to concluding a contract covering portfolio management services" is not caught by the MiFID,[215] but in our scenario here, matters are different. Platforms bring together parties for the immediate execution of a transaction covered by the MiFID, i.e. the purchase of transferable securities and hence financial instruments in the language of the MiFID. In contrast, brokering for portfolio management services is merely an activity executed prior to the conclusion of the contract under which financial transactions will actually take place.

Non-securities-based lending transactions are different. In these cases, platforms provide an unprecedented service that does not mimic the services of brokers and investment firms and, as already stated, does not fall within the scope of MiFID. It shows again that the purely lending-based form of crowdfunding, unlike other forms, has no precedent and accordingly is the most under-regulated.

Crowdfunding platforms that intermediate investments in securities are therefore held to the requirement of authorization.[216] Such authorization requires initial capital endowment[217] and compliance with organizational requirements.[218] However, in exception thereof, member states can exempt persons from the MiFID license requirement if their activities are instead authorized and regulated under national law and the persons do not hold funds or securities of their clients.[219]

211. *Id.* (agreeing with our assessment here, but explaining that national authorities may potentially arrive at a different conclusion).

212. *See* MiFID II art. 24(4).

213. *See infra* Part III *Securities-Based Crowdfunding (Securitized Debt- and Equity-Investments).*

214. European Court of Justice of June 14, 2017, C-678/15 *Khorassani*, ECLI:EU:C:2017:451, ¶ 37 (2017)).

215. *Id.* ¶ 44.

216. MiFID II art. 5.

217. *Id.* art. 15.

218. *Id.* art. 16.

219. *Id.* art. 3(1)(a).

This shift from the supranational EU regime to a purely national regulation therefore requires that investors are not exposed to the platform's credit risk. Since platforms often avoid handling investors' monies by relying on trust accounts (see the discussion above for Singapore at Part II), platforms could design their services in a way that would comply with the requirement. It would, however, deprive them of the European passport that allows them to offer their services throughout the EU (and EEA) on the basis of their home-country authorization.[220] This disadvantage is the reason why member states are unlikely to opt out of the MiFID regime for providers of financial services in their jurisdiction.[221]

Conduct of Business Obligations

In addition to the licensing requirement, providers of financial services and activities are subject to MiFID rules that seek to ensure the protection of investors. The core requirements are the duties of disclosure and assessment of whether the financial services or activities envisaged for the client are suitable and appropriate.[222] An investment firm must act honestly, fairly, and professionally in accordance with the best interests of its clients.[223] It must provide clients with easily understandable[224] information about itself and the services it offers, the financial instruments, all costs and related charges and – if applicable – the proposed investment strategies.[225]

When providing investment advice or portfolio management, the firms' duties are the strictest. They must assess their clients' knowledge and experience in the relevant investment field and the investment objectives including their risk tolerance. They must also evaluate their financial situation including their ability to bear losses. All gathered information must be processed in a way that enables the investment firm to recommend suitable investment services and financial instruments to the client.[226]

Even when not providing such investment advice or portfolio management services, investment firms owe[227] clients these assessments. They do not result in investment recommendations, but in warnings if the firm arrives at the conclusion that intended investments are unsuitable for their clients.[228]

220. European Securities and Markets Authority, *supra* note 205, at 58.

221. *But see* European Commission, *supra* note 5, at 35 (indicating that Italy and Portugal indeed rely on national regimes).

222. MiFID II arts. 24, 25.

223. *Id.* art. 24(1).

224. *Id.* art. 24(5).

225. For detail on the requirements this information must meet, see *id.* art. 24(4).

226. *Id.* art. 25(2).

227. However, clients may choose to withhold information from the firm, in which case the firm must inform the client that it cannot evaluate the appropriateness of the envisaged investment. *Id.* art. 24(3).

228. *Id.*

Investment firms can avoid these strict duties by providing execution-only services. In that case, firms only receive, transmit, and execute client orders and are not required to engage in the suitability assessment.[229] However, the list of financial instruments eligible for such services is limited, and firms are restricted to executing trades in standard financial instruments whose characteristics are generally well-known and which come with moderate risks such as shares and bonds or other forms of securitized debt admitted to trading on a regulated market.[230] It is unlikely that crowdfunding investments would fall under the exception given their typical risk profile.[231] The high credit risk of the recipients of funding, the lack of secondary markets for these investments and the overall low experience of investors in markets for crowdfunding products should disqualify crowdfunding investments from the group of mostly standardized and low-risk financial engagements.[232]

The UK Crowdfunding Regulation

As a current member of the EU (because divorce papers have been filed, but the separation will take legal effect on 29 March 2019), UK financial regulation must reflect the rules of the Prospectus Regulation/Directive and MiFID. In unison with regulators (and most commentators) around the world, the FCA considers illiquid securities-based investments in companies to be much riskier than P2P-lending to individuals, especially for retail investors.[233] As a result, the FCA distinguishes P2P-lending from illiquid securities-based debt- or equity-investments and subjects the latter to stricter regulation.

229. *Id.* art. 24(4).

230. *Id.* art. 25(4)(a)(i)-(ii).

231. Consequently, the FCA denies crowdfunding platforms any benefits from MiFIDs execution-only exemptions. *See infra* Part III *Securities-Based Crowdfunding (Securitized Debt- and Equity-Investments)*.

232. ESMA discussed whether bonds offered by crowdfunding could be eligible for the exception, but ultimately denied the question because it concluded that these investment products could not be considered non-complex. *See* European Securities and Markets Authority, *supra* note 205, at 48. This conclusion is further supported by the fact that ESMA's assessment was based on the rules applicable under MiFID I of 2004 whose art. 19(6) did not yet contain the requirement of MiFID II of 2014 art. 25(4)(a)(ii) that debt-based securities must be admitted to trading on a regulated market or on an equivalent third country market. Under the new requirements it looks even less likely that the authorities would consider debt-based investments offered by crowdfunding platforms eligible for the execution-only exception.

233. FCA Policy Statement PS14/4, *supra* note 1, at 39 ("many of the companies offering unlisted equity or debt securities are early-stage companies and … research indicates that around 50% to 70% of early-stage businesses fail …. In contrast, P2P loan agreements often involve lending to individuals rather than companies, are usually re-paid over three to five years, and currently have low default rates. So at present, in the P2P loan market, we consider it reasonable to assume a lower risk of significant capital losses, and less need for consumer protection measures").

Loan-Based Crowdfunding

Platforms that do not intermediate investments in securities but exclusively direct lending are not subject to the MiFID regime (as discussed above). Nevertheless, operating non-securities-based P2P-, P2B- and B2P-lending platforms is a regulated activity in the UK[234] and requires a specific permission granted by the FCA.[235] These platforms must comply with minimum capital requirements, named 'financial resource requirements'. Share capital, reserves, interim net profits, and eligible subordinated debt qualify as such financial resources.[236] A lending-intermediation platform must maintain the higher of a fixed sum of GBP 50,000 or a volume-based measure calculated as a percentage of the total amount of loaned funds.[237]

In addition, the FCA has put in place strict rules for the handling of investors' monies by crowdfunding platforms. It emphasizes that platforms hold such money on trust for the investors and are therefore subject to a fiduciary duty[238] and requires that organizational safeguards are in place to protect this fiduciary position.[239] Records and accounts must always distinguish money held for one client from client money held for another,[240] and client money must be deposited with institutions that have undergone a due diligence test.[241] For money related to lending-based investments this institution must be a bank, and the bank must acknowledge that the money in the account is held for the firm's clients and that the bank cannot recover the firm's debts from these accounts.[242]

Wide-ranging duties relating to disclosure of relevant information apply. The following only offers a brief summary of some of the most important aspects.[243] All communications from the platform must be fair, clear, and not misleading

234. Financial Services and Markets Act 2000, c. 8, § 22 (UK). Any regulated activity is prohibited without a license. *Id.* § 19.

235. A crowdfunding platform is an entity that operates "an electronic system which enables the operator … to facilitate persons … becoming the lender and borrower" under lending agreements, and the operator decides "which agreements should be made available" to the lender and borrower. *See* The Financial Services and Markets Act 2000 (Regulated Activities) Order 2001, art. 36H (UK). Exempted from this requirement are platforms that exclusively cover B2B lending and some forms of P2P, B2P and P2B lending when the amounts borrowed and lent exceed GBP 25,000. *See id.* arts. 36H(5)-(6), 36(J)(2).

236. See Financial Conduct Authority, *Interim Prudential sourcebook: Investment Businesses (IPRU(INV))* ch. 12 at 12.3.2R (2016), https://www.handbook.fca.org.uk/handbook/document/ipru-inv/IPRU-INV_FCA_20160901.pdf.

237. The measure requires 0.2% of the first £50 million of that total value; 0.15% of the next £200 million of that total value; 0.1% of the next £250 million of that total value; and 0.05% of any remaining total value. *See id.* at 12.2.6R; FCA Consultation Paper CP13/13, *supra* note 14, at 20; Pekmezovic & Walker, *supra* note 11, at 435.

238. FCA Consultation Paper CP13/13, *supra* note 14, at 23; Financial Conduct Authority, *FCA Handbook*, CASS 7 §§ 7.11.34R – 7.11.40R [hereinafter *FCA Handbook*].

239. FCA Consultation Paper CP13/13, *supra* note 14, at 23; FCA Handbook, *supra* note 238 § 7.12.

240. FCA Consultation Paper CP13/13, *supra* note 14, at 23; FCA Handbook, *supra* note 238 § 7.15.

241. FCA Consultation Paper CP13/13, *supra* note 14, at 23; FCA Handbook, *supra* note 238 § 7.13.8R.

242. *Id.*

243. For the complete list, see FCA Consultation Paper CP13/13, *supra* note 14, at 28-33.

such that they can easily be understood by the target audience. Platforms must provide adequate and sufficient information about themselves, the investment projects and submit relevant periodic financial statements.[244]

Platforms must provide adequate descriptions of the nature and risks of the investment so that lenders are in the position to take informed decisions. Investors must understand the high risk of borrower defaults, the factors that influence such defaults, the due diligence efforts of the platform and whether conducting further research of their own is advised. When discussing benefits to investors, platforms must simultaneously warn of relevant risks and abstain from any attempts to downplay important warnings. If platforms grade the risk attributable to loans, investors must be put in the position to understand how these grades are generated and upon what information and methods the platforms rely.[245]

The FCA emphasizes these points particularly in relation to the often prominently emphasized return figures that lack any mention of the impact that charges, default rates and taxation have on the ultimate benefits to investors. It intends to intervene in cases where platforms suggest that their financial services are comparable to deposits, be it by way of terminology, e.g. when platforms call lenders savers, or use comparisons that point out low interest rates paid for deposits.[246]

In terms of information about themselves, platforms must disclose details that are of relevance to investors. These include conflicts of interest policies, performance reports that lenders can expect, the costs and charges for the platforms' services, and details about its client money safeguards.[247]

Securities-Based Crowdfunding (Securitized Debt- and Equity-Investments)

Stricter principles apply to platforms that promote the sale of 'non-readily realizable securities' because the FCA sees a higher need for investor protection (as explained above) when investors buy illiquid securities from SMEs.[248] The FCA does not prohibit such a business model outright,[249] but aims to ensure that

244. In terms of financial statements, platforms must inform the lenders about executed transactions and financial statements at least once a year. FCA Consultation Paper CP13/13, *supra* note 14, at 33.

245. FCA Consultation Paper CP13/13, *supra* note 14, at 30-31.

246. FCA Consultation Paper CP13/13, *supra* note 14, at 29.

247. *Id.*; FCA Handbook, *supra* note 238, CASS 6 § 6.1.

248. Non-readily realisable securities are securities for which an acceptable secondary market is not available. These are mostly unlisted shares and unlisted debt securities, but also include securities that are traded, or soon to be traded, on a recognised investment exchange or designated investment exchange. FCA focuses on the liquidity issue and includes all securities that are not 'readily realisable.' *See* FCA Consultation Paper CP13/13, *supra* note 14, at 37.

249. It is different for units in unregulated collective investment schemes (UCIS), warrants and derivatives that may only be offered to professional clients, retail clients who are certified or self-certify as sophisticated investors, and retail clients who are certified as high net worth investors. *Id.* at 36-38; FCA Handbook, *supra* note 238, COBS 4 §§4.12, 4.7.6R.

only investors who can understand and cope with the various risks involved in the purchase of 'non-readily realizable securities' are invited to invest in them.[250]

Platforms must hold a license,[251] and 'non-readily realizable securities' may only be offered to professional clients and additionally to retail clients who qualify as sophisticated investors or high net-worth investors. Included are retail investors who certify that they receive regulated investment advice or investment management services from an authorized person in relation to the promoted investment, and investors whose financial exposures are low because they will not invest more than 10% of their net investible portfolio[252] in 'non-readily realizable securities'.[253]

In addition, the platforms must assess whether the investments are appropriate for the investors.[254] The principles laid down in the MiFID apply[255] as implemented in the FCA handbook.[256] Platforms must ensure that "the client has the necessary experience and knowledge in order to understand the risks involved in relation to the product or service offered or demanded."[257] The 'experience and knowledge' assessment is mandatory because 'execution only'-exceptions in the FCA handbook (based on MIFID)[258] are not applicable to non-readily realizable securities.[259]

The platform must warn the clients when it arrives at the conclusion that investments are not appropriate for them or declare that appropriateness assessments are impossible in circumstances where the clients have failed to provide sufficient information. If the clients insist on the transactions, the platform must consider the circumstances before deciding whether to oblige or to reject the deals.[260]

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250. FCA Consultation Paper CP13/13, *supra* note 14, at 36.

251. The Financial Services and Markets Act 2000 (Regulated Activities) Order 2001, art. 25(1)-(2) (UK). This requirement implements the MiFID rules discussed above.

252. This excludes their primary residence, pensions and life cover.

253. FCA Handbook, *supra* note 238, COBS 4 §§4.7.7(2), 4.7.9-10; FCA Consultation Paper CP13/13, *supra* note 14, at 38.

254. FCA Consultation Paper CP13/13, *supra* note 14, at 7; FCA Policy Statement PS14/4, *supra* note 1, at 42-43.

255. FCA Policy Statement PS14/4, *supra* note 1, at 42-43.

256. FCA Handbook, *supra* note 238, COBS 10. If the platform advises its clients, the suitability test of the FCA Handbook COBS 9 applies.

257. *Id.* COBS 10 §10.2(a). For further details, *see id.* §§ 10.2.2-10.2.8. For professional clients, COBS 10 §10.2(b) applies and platforms may assume that these clients have the necessary experience and knowledge to understand the risks involved in investments for which the client is classified as a professional client.

258. *See supra* Part III *Conduct of Business Obligations*.

259. This is because they lack the criterion that "there are frequent opportunities to dispose of, redeem, or otherwise realise the instrument at prices that are publicly available to the market participants and that are either market prices or prices made available, or validated, by valuation systems independent of the issuer" which is one of the core requirements for execution-only deals that waive the appropriateness requirement. FCA Handbook, *supra* note 238, COBS 10 §10.4(3)(b). For parallels with the MiFID regime, see *supra* Part III *Conduct of Business Obligations*.

260. FCA Handbook, *supra* note 238, COBS 10 §. For parallels with the MiFID regime, see *supra* Part III *Conduct of Business Obligations*.

In addition, prospectus requirements apply. Unless exempted, offers of securities must be accompanied by a prospectus[261] and platforms are required to ensure compliance with the rules.[262] All available exemptions are based on the currently applicable EU prospectus regime. As most provisions of the new Prospectus Regulation only take full effect in July 2019 (see above at I. 1.), the current regime in the UK is still based on the Prospectus Directive that was implemented through provisions in the UK Financial Services Markets Act 2000 (FSMA).

As a result, the exceptions are slightly different from the principles explained above (at I. 1. for the Regulation). Offers directed at qualified investors, or at fewer than 150 persons in total, as well as offers for a minimum consideration per person of EUR 100,000 (or the equivalent amount in some other currency) are exempted.[263] In respect to these three exceptions, the current rules fully correspond with the Prospectus Regulation, but the small offers exemption is different. The rule mirrors the current Prospectus Directive and exempts offers of securities under EUR 5,000,000.[264]

The new exemptions created by the Regulation for debt-based securities that allow for a base instead of a standard prospectus and under the EU Growth prospectus regime have no equivalents in the Directive. Furthermore, since maximum amounts for exemptions are generally lower under the current regime the new EU rules in the Regulation will lead to significantly eased prospectus requirements for SMEs and platforms in terms of compliance with prospectus requirements. However, these eased standards for crowdfunding platforms and issuers of securities will only apply in the EU member states from mid-2019 onward. As things currently stand, they will not become part of UK law because the principles of the Great Repeal Bill indicate that UK law will not autonomously transpose EU law after the UK has left the Union.[265] Instead, the UK will likely make use of its legislative freedom and enact new rules autonomously. It will be free to maintain its current rules or to ease standards for crowdfunding platforms and issuers of securities.

261. Financial Services and Markets Act 2000, c. 8, § 85(1) (UK).

262. FCA Policy Statement PS14/4, *supra* note 1, at 40-41.

263. These exemptions correspond with the three exemptions of the Regulation. *See supra* Part III *The Prospectus Regulation and its Effect on Crowdfunding in the EU.*

264. Financial Services and Markets Act 2000 § 85(5)(a), schedule 11A ¶9. For the corresponding EU rule, *see* Directive 2003/71/EC, of the European Parliament and of the Council of 4 November 2003 on the prospectus to be published when securities are offered to the public or admitted to trading and amending Directive 2001/34/EC, art. 1(2)(h), 2003 O.J. (L 345) 64, as amended by Directive 2010/73/EU, of the European Parliament and of the Council of 24 November 2010 amending Direction 2003/71/EC on the prospectus to be published when securities are offered to the public or admitted to trading and 2004/109/EC on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market, art. 1(a), 2010 O.J. (L 327) 1.

265. On the effects of the bill, in particular the fact that future EU law will no longer automatically become part of UK law, see Department for Exiting the European Union, *Policy Paper: Information about the Withdrawal Bill* (amended 2018), https://www.gov.uk/government/publications/information-about-the-withdrawal-bill (last visited Jan. 16, 2018, 9:00AM).

PART IV. CONCLUSIONS AND OUTLOOK

Singapore has so far adopted a wait and see attitude toward crowdfunding. It has eased requirements for offers in securities to facilitate raising funds for companies. It has also lowered regulatory prerequisites for CMS licenses to promote the business of running crowdfunding platforms. But as volumes of crowdfunding transactions rise, the need for adjustments increases.

Non-securitized Lending

Currently, non-securities-based crowdfunding is an unregulated activity when financing goes to companies and for as long as platforms stay clear of the activities for which a CMS license is required, particularly abstain from providing any investment advice. Such platforms are exempted from license requirements under the Moneylenders Act and FSA. They are consequently not subject to capital requirements, they are not required to keep investors' monies in trust accounts and are under no obligation to assess investors' knowledge or experience or to perform an investment suitability test.[266]

The comparison has shown that the UK has relevant regulatory mechanisms in place for non-securitized lending. Such lending is not required by EU legislation but the UK has passed national regulation that ensures that platforms engaging in non-securitized lending come under FCA supervision.[267] These UK rules are a good approach to early-stage crowdfunding regulation. The regulatory burden for platforms is far from overwhelming, yet investors are not without protection.

Singapore commonly pays close attention to UK legislation and regulation and may consider following the FCA's example. Whereas purely lending-based investments are less complex than securitized investments, at least minimal safeguards should be in place that warrant that retail lenders are aware of the substantial risks of their investments and do not fall victim to fraudulent schemes.

Any crowdfunding intermediation, including the facilitation of non-securitized lending to companies, should be conditional upon prior authorisation and perpetual supervision by MAS. A new type of license reserved for crowdfunding platforms could be introduced. It should require platforms to do at least all of the following:

keeps all clients' monies in trust accounts;
issue warnings about the general risks of crowdfunding;
provide sufficient information about itself and the recipients of funding to potential investors to enable them to make informed decisions; and
assess investors' knowledge and experience and run a suitability test.

266. *See supra* Part II *License Requirement for Moneylenders*.
267. *See supra* Part III *The UK Crowdfunding Regulation.*

Securitized Lending and Equity Investments

Different from the current regime that applies to non-securitized lending, platforms that facilitate securities-based crowdfunding need a CMS license in Singapore. Resulting from that, they must comply with modest capital and deposit requirements and are restricted when they handle clients' monies.[268]

In addition, offers in securities must be accompanied by a prospectus, but due to a number of exceptions the prospectus requirement is easy to avoid. Singapore is no exception in this respect. The EU regime applicable to offers in securities[269] provides wide exemptions and gives crowdfunding platforms sufficient options to avoid the prospectus imperative.[270] In light of growing skepticism regarding the efficacy of this requirement based on empirical findings that investors neither read nor understand prospectuses,[271] there is value in the trend to replace the prospectus by alternative means of investor protection.

The EU's MiFID and consequently the UK's crowdfunding regulations ensure that the platform is burdened with the obligation to plainly communicate the risks of securitized investments and assess whether investors' expectations are compatible with them.[272] It is arguably a mechanism that is preferable to a mandatory prospectus because it ensures that the most vulnerable party, the non-professional investor, receives a clear warning instead of an overdose of undigested information. It also helps the financially weak recipient of funding to avoid the costs of a prospectus. In contrast, the party pulling the strings in the triangular legal constellation underlying the crowdfunding model, i.e. the platform, is subjected to stringent duties.

Crowdfunding regulation in force in Singapore does not pursue this approach, and it is submitted here that it might want to consider following suit. With the exception of the small offers exemption, the waiver of the prospectus requirement is not compensated by any other protective mechanism. Non-professional investors are exposed to substantial risks without safeguards that ensure that these investors are fully aware of them. Under the small offers exemption, platforms must apply the 'Knowledge or Experience Test' that makes certain that investors possess sufficient knowledge or experience to understand the risks of the investment or the 'Suitability Assessment Test' that intends to warrant that the investment is suitable for the investors in light of their investment objectives

268. *See supra* Part II *License Requirement for Crowdfunding Platforms* and *Holding and Managing Investors' Funds*.

269. Currently based on the Prospectus Directive, soon on the Prospectus Regulation. *See supra* Part III *The Prospectus Regulation and its Effect on Crowdfunding in the EU*.

270. *See* the exemptions to the prospectus requirement discussed *supra* Part III *The Prospectus Regulation and its Effect on Crowdfunding in the EU*.

271. Ibrahim, *supra* note 11, at 594-95; Armour & Enriques, *supra* note 1, at 5-13. *See also supra* Part I.

272. *See supra* Part III *The MiFID and its Effect on Crowdfunding in the EU* and specifically for the UK supra Part III *Securities-Based Crowdfunding (Securitized Debt- and Equity-Investments)*.

and risk tolerance.[273] These tests do not burden platforms disproportionately and should be applied in all cases when securities are offered to non-institutional investors. Both tests should be applied cumulatively, i.e. the special exception granted to crowdfunding platforms allowing them to select which one to use should be revoked because only the two tests combined enable a platform to issue proper individualized risk warnings.[274]

To comply with these individualized risk warnings, the platforms must be obliged to conduct serious due diligence to gather relevant information about the recipients of funding. MAS might consider issuing guidelines similar to those published by the FCA[275] for the processes of information sharing, risk warnings and knowledge, experience and suitability assessment.

These proposals argue for aligned regimes for non-securitized lending and securities-based debt- or equity-investments which is based on the assumption that the situation of investors is similar in both instances. The FCA's argument that individuals default on their obligations less frequently than companies[276] applies to P2P-lending which is rare in Singapore because it requires a money-lender's license,[277] but non-securitized lending to companies is on the same risk-level as securitized debt-based investments. The important point made by the FCA is of similar relevance to all such investors: non-institutional investors may mistake their crowdfunding investments for something similar to and equally secure as bank deposits. The FCA announces to intervene when platforms suggest that their facilitated investments are similar to bank deposits,[278] but one could argue more broadly that non-institutional investors that seek revenue-generating investments in times of no interest-bearing bank deposits require clear warnings about the risks of *any type* of crowdfunding investment.

Maximum thresholds for investments could be considered. But here again, the UK approach that chooses such limits only as one of many mechanisms of retail investor protection is preferable to an across-the-board cap on investments. Sufficiently experienced, informed and warned investors should be allowed to

273. *See supra* Part II *Investor Profile Assessment and Risk Disclosure*.

274. On the reasons for the inclusion of accredited investors, *see supra* Part II *Investor Profile Assessment and Risk Disclosure*.

275. On the FCA guidelines, *see supra* Part III *Securities-Based Crowdfunding (Securitized Debt- and Equity-Investments)*.

276. FCA Policy Statement PS14/4, *supra* note 1, at 39 ("many of the companies offering unlisted equity or debt securities are early-stage companies and … research indicates that around 50% to 70% of early-stage businesses fail …. In contrast, P2P loan agreements often involve lending to individuals rather than companies, are usually re-paid over three to five years, and currently have low default rates. So at present, in the P2P loan market, we consider it reasonable to assume a lower risk of significant capital losses, and less need for consumer protection measures").

277. *See supra* Part II *License Requirement for Moneylenders*.

278. *See supra* Part III *Loan-Based Crowdfunding*.

go beyond maximum thresholds that are in place for their less experienced peers.[279]

Finally, platforms should be subject to a set of disclosure requirements about themselves, their business models and, as already stated, the companies for which they intermediate funding. Such standardized disclosure requirements do not only help investors to understand the risks better, but also enable them to compare offers and pick the most suitable ones.

It is obvious that all these requirements increase the costs of crowdfunding platforms, and it is almost certain that such costs are passed on to the clients. One of the main advantages of crowdfunding is thereby diluted. However, from a macroeconomic cost-benefit perspective it appears that such expenses are well-spent. Non-institutional investors' ability to look out for themselves is likely more limited in crowdfunding scenarios than in more established and conventional types of investments. The reasons are that it takes time until reliable data about chances and risks of crowdfunding become available, and that in the absence of internationally aligned regulation crowdfunding does not result in a standardized and easily-understood financial service. If crowdfunding platforms are not required to comply with requirements of disclosure and not subject to a moderate set of duties in the interest of investors, crowdfunding products and services remain difficult to understand, compare and assess and a potential source of significant losses for non-institutional investors.

Systemic risk and regulatory arbitrage

The rising volumes of crowdfunding transactions and the trend of platforms to replace the basic agency model of the early days of crowdfunding with more sophisticated forms of intermediation bear the potential of financial stability risks. The closer platforms imitate the business model of other intermediaries the closer they come to the three forms of risk transformation typical of the financial industry. Such developments are currently possible in Singapore because a CMS license allows them to engage in a whole range of financial activities.[280]

If platforms provide early redemption options to investors they should be subject to regulation that applies to financial intermediaries that engage in maturity transformation, e.g. the fund industry. Otherwise, the issue of regulatory arbitrage arises and boosts crowdfunding for all the wrong reasons.[281] Attempts to avoid stricter regulation, not authentic and sustainable support for the business model of crowdfunding might drive volumes of crowdfunding transactions. As

279. On the UK rules, see *supra* Part III *Securities-Based Crowdfunding (Securitized Debt- and Equity-Investments)*.

280. *See* Securities and Futures Act, c. 289, § 342 Second Schedule, Regulated Activities Part I (amended 2006) (Sing.); *supra* Part II *License Requirement for Crowdfunding Platforms*.

281. For the phenomenon of regulatory arbitrage, *see* FCA Feedback Statement FS16/13, *supra* note 51, at 11, 17.

explained above,[282] the question could be raised why crowdfunding platforms that facilitate investments in Private Equity funds, i.e. established types of financial intermediation, instead of moving into a funding gap left by more traditional financial intermediaries should benefit from eased regulatory requirements. The same could be asked for platforms that become principals on both sides of the financial transactions.

Platforms that accept investments from systemically important financial intermediaries, e.g. banks, must come under close scrutiny by the financial regulator. Such platforms form part of a subsector of the financial industry whose business model exposes systemically important institutions to the risk of loss and contagion. Such risks must either be mitigated, e.g. by limits to volumes available for funding by systemically important institutions, or adequately be provided for, e.g. by prudential regulation that applies to systemically important investors. In this respect, Singapore profits from the design of its financial architecture. The MAS is the micro- and macroprudential regulator that watches over the activities of all financial intermediaries and the movements and developments in the Singaporean financial market.[283] Its multiple role should make it easy for MAS to monitor build-ups of systemic risk and to intervene swiftly.

These proposals help prevent crowdfunding from growing into a new shadow banking sector.[284] Additionally, Singapore could consider the proposal submitted here (above at 1 and 2). A requirement for all platforms to hold a specific crowdfunding license for non-securitized lending and securitized investments alike could be combined with stringent restrictions on the activities of crowdfunding platforms. Crowdfunding could thereby be limited to the transactions for which it has enjoyed much initial goodwill: basic intermediation to support funding for start-ups and SMEs from private investors and entities outside of the financial industry.

282. *See supra* Part II *Deviations from the Basic Crowdfunding Model.*

283. For the principal objectives and tasks pursued by MAS, see Monetary Authority of Singapore Act, c. 186, § 4 (amended 1999) (Sing.); Monetary Authority of Singapore, About MAS, http://www.mas.gov.sg/About-MAS.aspx (last visited Jan. 16, 2018, 9:00AM).

284. On shadow banking, see FCA Feedback Statement FS16/13, *supra* note 51, at 11, 17.