



PUBLIC CONSULTATION PAPER

NO. 2/2014

PROPOSED REGULATORY FRAMEWORK

FOR EQUITY CROWDFUNDING

The Securities Commission Malaysia (SC) invites your written comments in this consultation paper. Comments are due by **5 September 2014** and should be sent to:

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Overview

1. Introduction

- 1.1 This paper is intended to generate discussion as well as obtain views and feedback from interested parties in respect of the SC's proposed regulatory framework for equity crowdfunding (ECF) activities in Malaysia.
- 1.2 The internet has provided new opportunities to seek capital from the public and crowdfunding is one such method. Crowdfunding is 'an umbrella term describing the use of small amounts of money, obtained from a large number of individuals or organisations, to fund a project, a business or personal loan, and other needs through an online web-based platform'.¹
- 1.3 ECF is one of four types of crowdfunding activity. There is no legal definition for ECF but as a concept it refers to a form of corporate fundraising that envisages start-up or other smaller companies (issuers) obtaining seed or other capital through small equity investments from relatively large numbers of investors, with online portals publicising and facilitating such offers to crowd investors (investors).
- 1.4 In addition to ECF, there are three other types of crowdfunding activities which will not be the focus of this paper as they do not fall within the SC's remit and will not be regulated by the SC. They are–
 - (a) **Donation crowdfunding** – the public donates money or makes a financial contribution to a project or cause without any expectation of a financial return on that contribution (charitable causes);

¹ See Crowd-funding: An Infant Industry Growing Fast- Staff Working Paper of the IOSCO Research Department <http://www.iosco.org/research/pdf/swp/Crowd-funding-An-Infant-Industry-Growing-Fast.pdf>

- (b) **Reward crowdfunding** – the public gives money in return for rewards such as gifts, coupons, services or prototype of the product developed of which the money was raised for;² and
- (c) **Peer-to-peer lending** – similar to a loan, the public gives money in return for interest payment and repayment of the capital.

Why has attention been focused on crowdfunding?

- 1.5 Crowdfunding has drawn the attention of various parties including the regulators because of its growth potential and its ability to provide access to capital.³
- 1.6 Crowdfunding is seen as an activity that can facilitate and encourage innovation, with its significance for productivity, competitiveness and growth. Innovation may result from small and medium-sized enterprises (SMEs)⁴ that are early stage start-ups and other small enterprises with creative ideas. These start-ups and other small enterprises may need funds to bring these ideas into fruition. However, the reality is that many of these enterprises may be affected by a capital gap in that they cannot attract further funding from traditional financing sources and at the same time are not yet able to conduct an initial public offer of its securities.
- 1.7 ECF offers the potential to bridge this capital gap for some start-ups and other small enterprises, and also help them move up the 'funding escalator' as their projects and future prospects strengthen. To that extent, investors, collectively as a crowd, have the potential to play an important role in financing an enterprise at its crucial early stage, which may promote productivity and economic growth and foster

² Donation and reward crowdfunding are also described as "crowd sponsoring".

³ Australia, United Kingdom, New Zealand are some of the countries that have issued consultation papers, reports and statements on crowdfunding.

⁴ For the purposes of this paper the term 'small and medium sized enterprises' is to be given its ordinary meaning and not the meaning proposed by SME Corp.

employment, while ideally, returning financial or other forms of benefits to the crowd.

- 1.8 The availability of ECF as a financing option could increase competition among suppliers of capital to start-ups and other small enterprises, resulting in a potentially lower cost of capital for these issuers, including those not utilising ECF. This may help reduce the capital gap within this sector.⁵

⁵ This point was also alluded to in the Corporations and Markets Advisory Committee Report on "Crowd Sourced Equity Funding", May 2014.

2. The SC's proposed regulatory approach for ECF

- 2.1 The SC's regulatory framework discussed in this paper is confined to ECF. The SC is concerned with crowdfunding activities where securities are offered to investors in return for their investments. This is because the SC has a duty to maintain investor confidence in the securities market and also to suppress any illegal or improper practices in dealings in securities.
- 2.2 In developing the regulatory framework for ECF, the SC will rely on its existing regulatory framework and also work within the confines of existing relevant laws such as the *Companies Act 1965*. The SC has also considered the approaches and practises proposed in other jurisdictions but these approaches and practises would only be adopted to the extent they are relevant and applicable in the Malaysian context.
- 2.3 In formulating the regulatory framework the SC is mindful that any regulation imposed must be proportionate to the risk posed to investors investing through ECF.
- 2.4 Whilst ECF has its benefits as discussed above, it also carries with it potential financial risk for investors, given that in many instances investors will be asked to finance innovative projects that do not have the level of maturity that traditional financial market sources require. Funding may be sought from all types of investors, including those with low financial literacy or capacity, to make investments in companies, many of which may fail, leading to the total loss of the funds invested. Investors may also face the risk of never receiving a return on their investment if those controlling the company decide not to issue dividends. In addition, if the business is sold or becomes listed, they may find their share in the profits reduced if the value of shares is diluted by subsequent issuance of new shares. Investors may also face liquidity risk as there may not be a secondary

market for shares that have been acquired through ECF.

- 2.5 Other risks include the risk of platform closure or failure. Despite the relatively short amount of time crowdfunding has been in existence, there has already been a case of a peer-to-peer lending platform closing, leaving behind no data on contracts and resulting in investors losing 100% of their investment. Fraud is another key risk facing investors looking to lend or invest on crowdfunding platforms.
- 2.6 This part of the paper will discuss our proposed regulatory framework with regards to ECF, balancing the need for the growth of the ECF industry and achieving the appropriate level of investor protection.
- 2.7 In this regard, regulatory requirements will be imposed on the ECF operator, in relation to—
 - (a) the operations of the ECF platform;
 - (b) who can seek funding through the ECF platform; and
 - (c) the type of investors who can participate in ECF.

3. Proposed requirements in relation to the operator of the ECF platform

3.1 Different jurisdictions have adopted different approaches in regulating the ECF platform or the ECF operator. In the US, ECF operators are required to be registered as a broker dealer or a funding portal. New Zealand also requires an ECF operator to be licensed for providing a crowdfunding service. This is a new category of regulated activity introduced by the Financial Market Authority of New Zealand. In the United Kingdom (UK), a crowdfunding activity falls under their existing framework governing regulated activities and require an authorisation from the Financial Conduct Authority. In Australia, the Corporations and Markets Advisory Committee proposed that an ECF operator should be required to hold either an Australian Financial Services Licence or an Australian Market Licence.

3.2 The SC is of the view that the online platform operated by an ECF operator can be deemed as a facility where offers to sell or purchase securities are regularly made or accepted and hence it is a stock market for the purposes of the Capital Markets and Services Act 2007 (CMSA).⁶ It is envisaged that the ECF platform will offer some services which are similar to that of an exchange, but on a smaller scale. This may include enabling a crowd investor to access the platform to view the profile of all the issuers⁷ seeking capital in exchange for shares of the issuer. The platform may also provide communication channels for the investor to “engage” with the issuer.

An ECF operator will be subject to Registered Electronic Facility requirements

3.3 Given that the ECF platform is a stock market for the purposes of the CMSA, it is therefore proposed that the stock market operated on the ECF platform including ECF operator be regulated under the registered electronic facility (REF) framework, which is currently set out under Subdivision 4 of Division 2 of Part II of the CMSA.

⁶ See section 2 of the CMSA for definition of stock market.

⁷ Issuers refer to SMEs seeking capital.

3.4 The requirements imposed on an ECF operator under the REF framework are as follows–

(a) *Registration*

For purposes of registration under the REF framework the prospective ECF operator must satisfy the SC that it is fit and proper to operate the ECF platform and has sufficient financial, human and other resources to ensure that the market it operates will be fair and orderly.

Further, it must demonstrate that there are processes and procedures in place to monitor compliance with any obligations imposed on him or on the market, and for identifying and reporting to the SC any breach of the platform rules or material change in relevant circumstances relating to the offering and the issuer.

While we may consider allowing a foreign operator to provide, operate or maintain an ECF platform in Malaysia, the foreign operator would be required to incorporate a local entity.

Any person who operates an ECF platform in Malaysia without being registered as an REF under the CMSA commits an offence under the CMSA and if convicted, may be fined to an amount up to RM5 million or imprisonment up to five years, or to both.

(b) *Imposition of terms and conditions and issuance of directions*

The REF framework enables the SC to impose terms and conditions at any point of time and issue directions to the ECF operator. Terms and conditions imposed can include restrictions on the types of investors or participants who may have access to ECF platform and providing the SC with assistance and all information as may be required by the SC for the purposes of

supervision.⁸ Terms and conditions may also be imposed to prescribe what an ECF operator is permitted or not permitted to do. This will be discussed in further detail below.

3.5 It must be noted that a stock market operated on an ECF platform will be subject to a lesser level of regulation than that imposed on an approved stock market,⁹ given the size of its operation, the risks posed and the amount allowed to be invested or raised through the platform. However, once the ECF platform has commenced operations and the SC is of the view that the platform is more suitably regulated as an “approved stock market”, the SC can require the operator to submit an application to be regulated as an “approved stock market”. A change of status as described above may also be initiated by the operator itself.

Permissible and non-permissible activities of an ECF operator

- 3.6 The SC proposes that an ECF operator be permitted to do the following –
- (a) Host offerings;
 - (b) Provide public communication channel to facilitate discussions about the offerings on the platform;
 - (c) Educate and ensure that only qualified investors participate on the platform; and
 - (d) Provide ancillary services such as screening, preparation of standardised documents and management of investor relations.
- 3.7 The SC proposes that an ECF operator is not be permitted to do the following –
- (a) Feature any trending pitches;
 - (b) Offer investment advice;
 - (c) Negotiate terms for and on behalf of third parties; and

⁸ This will be discussed later in the paper.

⁹ An example of an approved stock market is the stock market operated by Bursa Malaysia Bhd (Bursa Malaysia). Approved stock markets are subjected to an intensive level of regulation which can include the appointment of public interest directors and being subjected to a regulatory audit.

- (d) Compensate its employees, agents or other persons for the solicitation/sale of securities on its ECF platform.

General obligations applicable to an ECF operator

3.8 The SC is of the view that the ECF operator will play a critical role in ensuring that investors have confidence in participating in ECF activities. This includes ensuring compliance by issuers and educating investors about the risks of ECF. The ECF operator should have the right to deny the issuer access to its platform if it is of the view that the issuer is not fit and proper or the proposed offering is not suitable to be hosted on the platform. The ECF operator would be expected to carry out due diligence on the issuer's directors, officers and substantial shareholders.

The SC proposes that an ECF operator be required to—

- (a) ensure fit and properness of the issuer's board of directors, officers and controlling owner by conducting background checks on the issuer;
- (b) monitor and take action against misconduct of the issuer;
- (c) carry out investor education programmes;
- (d) ensure the issuer's disclosure document lodged with the operator is verified for accuracy and made accessible to investors;
- (e) inform investors of any material change to the issuer's proposal;
- (f) monitor issuers to ensure that the fundraising limits imposed on the issuer¹⁰ are not breached;
- (g) monitor investors to ensure that the investment limits imposed on the investors¹¹ are not breached;
- (h) have in place processes to monitor anti-money laundering requirements;
- (i) ensure privacy of information is maintained in accordance with the *Personal Data Protection Act 2010*.

¹⁰ See paragraph 4.18.

¹¹ See paragraph 5.3 – 5.5.

Question 1:

- (a) Given the fact that the ECF operator will be playing a key role in ensuring that investors have confidence in participating in ECF activities, would the proposed ECF operator’s obligations as listed out in 3.8 be sufficient? If not, what other obligations should be imposed on the ECF operator?**
- (b) To what extent should ECF operators be responsible to carry out background checks (“due diligence”) on prospective issuers?**
- (c) Should the regulator specify parameters for background checks? If you are of the view that the regulator should specify the parameters, what should those parameters include?**
- (d) To what extent should ECF operators be responsible for investor education and developing educational material that will ensure investors understand the risk in participating in ECF activities?**
- (e) Do you agree with the list of permitted and non-permitted activities of the operator as proposed in paragraphs 3.6 and 3.7? If not, what are your suggestions?**

Holding of investor funds

3.9 When an issuer seeks funding on an ECF platform, there may be occasions where the issuer does not succeed in raising the amount he intended to raise to fund the project in hand. In such a situation, there are two ways in which the amount raised is dealt with. In the Social Science Research Network paper entitled ‘*Crowdfunding models: keep-it-all versus all-or-nothing*’ issued on 2 June 2014, Cumming, Leboeuf, and Schwienbacher discussed and compared the all-or-nothing and keep-it-all models.

3.10 Under the all-or-nothing model (AON model) the issuer will not be entitled to any part of the proceeds raised on the ECF platform unless the issuer has successfully raised the amount it intended to raise. On the other hand, the “keep-it-all” model (KIA model) is where the issuer sets a fundraising goal and keeps the entire amount raised regardless of whether or not they meet their goal.

- 3.11 According to Cumming, Leboeuf, and Schwienbacher, the AON model offers a guarantee to the crowd that the issuer does not start the project with unrealistically low funding. In contrast, the KIA model is a useful model for issuers who can scale their businesses.
- 3.12 Further, Kimberly Weisul¹² was of the view that investors should get some comfort from the AON model because they do not have to worry about the issuers they have chosen launching a “weaker or less viable product” than anticipated because of failure to meet the funding goal (as in the KIA model). The all-or-nothing model is also considered by jurisdictions like the US, Canada and Australia.¹³
- 3.13 Therefore, the SC proposes that the ECF operator will operate an AON crowd funding model as it presents a stronger case for investor protection. Under this model, an investor will know the minimum (or target) amount of proceeds that will be raised under the offering and will have some assurance that upon completion of the offering, the issuer will have sufficient financial resources to realise his project.
- 3.14 In Australia, monies raised on an ECF platform during the offer period are to be placed in a separate trust account, whilst the US has considered the setting up of escrow accounts for similar purposes where neither the issuer nor the ECF operator has control over the account until the offering has been finalised.
- 3.15 The SC proposes that the ECF operator be required to deposit all funds raised through the platform in a separate trust account with a licensed bank until the offering is completed. If the offering is successful, the funds will be released to the issuer. The ECF operator will also be required to have in place processes to ensure

¹² Editor at large, at Inc.com and co-founder of OneThinkNew, the digital media start-up, previously a senior editor at *BusinessWeek*.

¹³ In the US, an intermediate model known as “minimum-maximum” has also been discussed. In this model, a minimum amount of securities must be sold within the offering period in order for a contingency to be satisfied, and the amount of securities sold may not exceed a pre-determined maximum.

that if the offering is unsuccessful, the investments will be returned to the respective investors.

Question 2:

Do you agree that the AON model should be preferred over the KIA model for the reasons discussed in paragraph 3.13? If not, please state your reasons.

Material adverse change

- 3.16 The ECF operator must always be mindful that during the offer period, situations can arise which can result in a material adverse change in relation to the issuer or the proposed project for which the funding was sought. A material adverse change concerning the issuer, may include any of the following matters:
- (a) The discovery of a false or misleading statement in the disclosure document in relation to the offer;
 - (b) The discovery of a material omission of information required to be included in the disclosure document; or
 - (c) There is a material change or development in the circumstances relating to the offering and the issuer.
- 3.17 With regard to paragraph 3.16(c), a petition to wind-up an issuer, a material litigation that may affect the financial position of the issuer or an enforcement action by a regulatory authority may be considered as a material change or development in circumstances relating to the offering and the issuer.
- 3.18 Our proposals in relation to the consequences of a material adverse change are discussed in paragraphs 4.35–4.38.

Question 3:

- (a) Do you agree that material adverse change should include the circumstances discussed in paragraph 3.16?**
- (b) What other circumstances, if any, should be considered as a material adverse change?**

Proposed condition precedent for release of funds to the issuer

3.19 Given the above, the SC proposes that the funds raised can only be released by the ECF operator to the issuer after the following conditions are met:

- (a) The targeted amount sought to be raised has been met;
- (b) There is no material adverse change relating to the offer during the offer period; and
- (c) The cooling-off period of six business days¹⁴ have expired.

Question 4:

- (a) Do you agree with the proposed condition precedents for release of funds to the issuer provided in paragraph 3.18?**
- (b) Do you think that there should be other condition precedents before the funds are released? If yes, what are the other condition precedents?**

Complaints and dispute resolution mechanism

3.20 In Australia and New Zealand, the ECF operator is required to have in place a process by which investors and issuers can make complaints through internal and external dispute resolution procedures concerning any aspect of the offering.

3.21 Therefore, the SC proposes that the ECF operator, being the conduit between an issuer and an investor, should have in place an internal dispute resolution

¹⁴ It is proposed that investors be given six business days from the time they made their investment decision to reconsider their decision and hence may within that six day period choose to rescind their investment decision.

mechanism to deal with any disputes that may arise between the issuers and investors throughout the offering process. For avoidance of doubt, ECF operators are not expected to resolve disputes that arise after the completion of the offering.

Question 5:

Do you agree that ECF operators should be required to have in place an internal dispute resolution mechanism? If yes, what type of disputes should be included in this mechanism?

Managing conflict of interest

- 3.22 The ECF operator through the ECF platform brings issuers and potential investors together. As discussed above, the ECF operator will play a critical role in ensuring that investors have confidence in participating in ECF activities. It is therefore imperative that ECF operators do not engage in any act that may compromise its neutrality or impartiality in the treatment of issuers and investors.
- 3.23 In the US and Australia, ECF operators are prohibited from holding securities of issuers, and receiving securities of the issuer as fees for services provided. Canada also prohibits ECF operators from holding such securities, though it allows operators to be remunerated in the form of securities, provided that the said remuneration is disclosed and the operator does not hold more than a 10% stake in the issuer. New Zealand allows ECF operators to invest in the securities of the issuer subject to disclosure and having in place processes to manage conflict of interest.
- 3.24 As such, the SC proposes that the ECF operator, its directors and officers be prohibited from directly or indirectly holding any shares in an issuer that is hosted on its platform. However, the SC proposes that an ECF operator be allowed to receive shares from an issuer as a form of payment for fees, provided that this arrangement is disclosed to investors. The rationale is that issuers which seek to raise funds through crowdfunding may not have the resources to pay the fees for utilising the ECF platform and that may prevent them from availing themselves of

the benefit of the said platform. To address the issue of conflict of interest, and to ensure the operator is and perceived to be a neutral and impartial facilitator for all issuers, ECF operators will be required to disclose the arrangement and have processes to manage conflict of interest.

- 3.25 In addition to the above, the SC also proposes that an ECF operator be prohibited from—
- (a) giving advice, soliciting or advertising about securities available for investment on their website;
 - (b) providing any financial assistance to investors to invest in shares of an issuer hosted on its platform;
 - (c) having directors or officers that have an interest in an issuer; and
 - (d) compensating any finder or introducer for providing the operator with information about potential investors.

Question 6:

- (a) Do you agree that ECF operators should be prohibited from investing in the shares of the issuer hosted on its platform?**
- (b) Do you agree that ECF operators should be permitted to receive shares of the issuer as a form of payment for fees?**
- (c) Do you agree with the prohibitions proposed in paragraph 3.24 with regard to managing conflict of interest? Are there any other prohibitions which should be imposed on ECF operators?**

Disposal of shares by existing shareholders and secondary market

- 3.26 Proposals in the US and Canada have suggested that only primary offerings be allowed on an ECF platform. The rationale is that the key purpose of ECF is to provide a means for start-ups to seek funding, rather than operate as a marketplace for existing securities holders to trade securities.

- 3.27 Thus, at this stage, the SC proposes that ECF platforms should only facilitate the

primary offering of the issuer's shares. This means that existing securities holders may not utilise the ECF platform to sell their shares to other investors.

- 3.28 Whilst the ECF platform is not intended to function as a secondary market, existing shareholders may nevertheless dispose of their shares outside the ECF platform. The ability of existing shareholders to dispose or transfer their shares in the issuer will be governed by the issuer's memorandum and articles of association. There may, for example, be a provision in the issuer's memorandum which restricts existing shareholders from offering their shares to outside parties, unless those shares are first offered to other existing shareholders.

Question 7:

- (a) Do you agree that ECF platforms should only be used to facilitate primary offering of the issuer's shares?**
- (b) If you are of the view that there should be a secondary market for the shares acquired through an ECF platform, how should it be facilitated?**

4. Proposed requirements in relation to issuers of ECF

Permitted issuers

- 4.1 SMEs are a critical component of the Malaysian economy. They contribute a third of the gross domestic product and provide job opportunities to more than four million workers, comprising 60% of the total workforce. As of 2013, SMEs account for 97.3% of the total business establishments in Malaysia. SMEs have been integral in poverty alleviation, given the fact that micro enterprises make up more than three quarters of the total SMEs. This sector is also an important source of income and self-employment for low-income households, particularly in the suburban and rural areas.¹⁵ As such, the sustained growth in financing to SMEs is critical to ensure that SMEs continue to play its role in the Malaysian economy.
- 4.2 As discussed in paragraphs 1.6 and 1.7 above, ECF will primarily be used by start-ups and small enterprises to access funding for their business expansions. In most cases, these companies are private companies.
- 4.3 In the case of a private company, the offering of shares on the ECF platform may be seen as making a public offering of its shares.¹⁶ In order to facilitate this, the SC and the Companies Commission of Malaysia (CCM) have been in discussion to create a safe harbour for private companies to be able to offer their shares to the public and avail themselves of the benefits that can be offered by an ECF platform as a funding avenue. The ECF platform will be regulated as a market for the purposes of securities laws and shall be subject to appropriate regulation and supervision by the SC.
- 4.4 Notwithstanding the proposed safe harbour as discussed above, a private company remains responsible for monitoring the current restriction of 50 shareholders

¹⁵ Bank Negara Malaysia, *Financial Stability and Payment Systems Report 2013*.

¹⁶ See section 15 of the current Companies Act 1965 or section 43 of the proposed new Companies Bill.

imposed on it.

- 4.5 The issue discussed above is unique to Malaysia given that the dichotomy between public and private companies is maintained in the *Companies Act* whilst in jurisdictions such as the US, Canada and New Zealand, such dichotomy does not exist. In the UK and Australia, where private companies exist and are imposed similar prohibitions, the crowdfunding initiative is limited to only public companies.
- 4.6 Given the above, we propose that only locally incorporated private companies (excluding exempt private company) will be allowed to be hosted on the ECF platform and offer their shares on the platform. Share offerings by private companies on this platform will not require the SC's approval under section 212 nor would it be subjected to the prospectus requirements under the CMSA.
- 4.7 At this stage, it is not envisaged that public companies will utilise the ECF platform as they are able to seek funding by way of a private placement exercise or engage in an initial public offering of its shares.
- 4.8 Based on the SC's research and soft consultation, there has been interest expressed for microfunds¹⁷ to be able to utilise the ECF platform. The SC may consider extending ECF to microfunds at the next stage of the ECF's development should there be a demand for it.

Non-permitted issuers

- 4.9 Australia, the US and Canada have proposed to prohibit companies with no written business plans (known as blind pools) and investment fund companies which are structurally complex from raising funds on an ECF platform. Blind pools are prohibited as they are deemed to pose high risk to investors, given their lack of business plan. Australia additionally proposes that public listed companies and companies with a capital exceeding US\$10 million be similarly prohibited as these

¹⁷ Microfunds are organisations that provide small amounts of funding to seed-stage businesses.

entities may already be commercially established and thus have other avenues of funding available to them.

4.10 Given the above, the SC proposes that the following entities be prohibited from raising funds through an ECF platform:

- (a) commercially or financially complex structures (i.e. investment fund companies or financial institutions);
- (b) public listed companies and their subsidiaries;
- (c) companies with no specific business plan or its business plan is to merge or acquire an unidentified entity (i.e. blind pool);
- (d) companies that propose to use the funds raised to provide loans or make investment in other entities; and
- (e) companies with paid up share capital exceeding RM5 million.

4.11 It is also proposed that while the entities stated in paragraph 4.10(b) are not allowed to raise funds on an ECF platform they should be allowed to use the platform as a medium of advertising and showcasing their ideas.

4.12 Further, the RM5 million paid up share capital limit proposed in paragraph 4.10(e) refers to the total capital raised from the ECF platform and does not include the issuer's own capital contribution or any funding obtained through private placement.

4.13 The RM5 million capital threshold proposed shall also apply to an issuer who is already hosted on an ECF platform. If the issuer reaches this capital threshold, the issuer will not be allowed to be further hosted on the ECF platform.

Question 8:

- (a) Do you agree that for the first stage of ECF, only locally incorporated private companies (excluding exempt private company) be allowed to be hosted on the ECF platform?**
- (b) What are your views in respect of allowing a local private company that is controlled by a non-Malaysian person to raise funds on the ECF platform?**
- (c) How would you, as an issuer, monitor compliance with the 50 shareholders requirement for private companies under Companies Act?**
- (d) Do you agree that the entities listed in the above paragraph 4.10 should be prohibited from using ECF platform to raise funds? Should the prohibition be extended to any other entities other than those that have been listed in the above paragraph 4.10?**
- (e) Do you agree with the proposed RM5 million capital limit in paragraph 4.10(e)? If not, what is your suggestion?**
- (f) Do you agree that the issuer's own capital contribution and funding obtained through private placement should not be taken into account for the purposes of the RM5 million paid up share capital limit, as proposed in the above paragraph 4.10(e)?**
- (g) Do you agree that the entities specified in the above paragraph 4.10(c) whilst prohibited from using the ECF platform to raise funds should nevertheless be allowed to use the platform for advertising purposes?**
- (h) Do you agree that microfunds should be allowed to utilise the ECF platform in the next phase of ECF development?**

Type of securities permitted for offering

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

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

Question 9:

- (a) **Do you agree that only common shares (ordinary and preference shares) should be made available on the ECF platform?**
- (b) **Do you agree that only a single class of shares be allowed to be offered in any one offering on the ECF platform?**

Limit to amount of funds to be raised and pitching on multiple ECF platforms

- 4.16 In some jurisdictions, the amount that a company can raise from ECF within a specified period is limited. For example, the US has proposed the requirement of only a maximum of US\$1 million to be raised within a year whereas in Canada, it is C\$1.5 million. In Australia, issuers may only raise up to A\$2 million within a year. According to CAMAC, the intention is to limit the fundraising to an amount that would suffice for the majority of start-ups to prove their business plan on a small scale and subsequently attract further capital, through traditional means for further product development.
- 4.17 The US, Canada and Australia have taken the position that all information regarding the same issuer or offering should be provided on a single platform, to facilitate the monitoring of the fundraising and investment caps or limits in relation to the offering.
- 4.18 Taking into account that the ECF industry is still relatively new in Malaysia and that ECF is aimed at start-ups and small enterprises, the SC proposes the following:
- (a) To limit the maximum amount that can be raised by an issuer to a sum of

- RM3 million within a 12-month period;
- (b) The sum of RM3 million shall apply irrespective of the number of projects an issuer may seek funding for during the 12-month period;
 - (c) An issuer can only utilise the ECF platform to raise a maximum amount of RM5 million. Upon meeting the RM5 million threshold, the issuer will no longer be eligible to further raise funds through an ECF platform; and
 - (d) An issuer shall not be allowed to be hosted concurrently on multiple ECF platforms.

4.19 The examples below explain how the above proposals would work:-

Example 1:

Issuer A, on 1 January 2013, successfully raised a sum of RM1 million on ECF platform A. On 15 June 2013, issuer A now seeks to raise an additional sum of RM2 million and this sum is sought to be raised on ECF platform B. Issuer A will not be allowed to do so; as at any one time, issuer A is only permitted to raise a sum of up to RM3 million within a 12-month period through a single ECF platform. However, issuer A on 2 January 2014 can raise the additional sum of RM2 million.

Example 2:

Issuer A, on 1 January 2013, successfully raised a sum of RM3 million on ECF platform A. On 2 January 2014, issuer A again successfully raised an additional sum of RM2 million. After 2 January 2014, issuer A is no longer allowed to raise any further funding from any ECF platform as he has reached the capital threshold of RM5 million.

Example 3:

Issuer A, on 1 January 2013, sought to raise a sum of RM1 million on ECF platform A. On the same day, issuer A separately sought to raise another sum of RM 2 million on ECF platform B for the same project. Issuer A will not be allowed to do so, as

concurrent pitching on multiple platforms is not allowed.

Question 10:

- (a) Do you agree with the proposal to limit the funds raised by an issuer on an ECF platform within a 12 month period to RM3 million only? If not, what are your suggestions?**
- (b) There may be a situation where an issuer and his related company or person may seek to raise funding separately on the ECF platform (collectively known as issuer's group). Should the proposed caps of RM3 million and RM5 million proposed above be applied to the issuer's group?**
- (c) Should an issuer be allowed to pitch concurrently on multiple ECF platforms for different projects?**

Oversubscription

4.20 Where an issuer's offering has been oversubscribed, the United States, Canada and Australia have proposed to allow the issuer to accept the oversubscribed funds, so long as the oversubscribed funds do not exceed the issuer's cap on fundraising and the issuer discloses to the investors how the oversubscribed amount will be utilised. Allowing oversubscription would grant the issuer more flexibility in raising funds in excess of the initial target where there is stronger than anticipated interest from investors.

4.21 The SC proposes to allow the issuer to accept the oversubscribed funds, subject to-

- (a) The entire amount not exceeding the issuer's cap of RM3 million within 12 months,¹⁸ or the capital threshold of RM5 million in total,¹⁹ and
- (b) Disclosure being made by the issuer to investors on the utilisation of the oversubscribed funds.

4.22 For example, issuer A initially intended to raise RM2 million, but received offers

¹⁸ See paragraph 4.18.

¹⁹ See paragraph 4.18(c).

totalling RM2.5 million. Issuer A is allowed to retain the RM2.5 million in offers, given that the issuer is still within the cap of RM3 million, but disclosures must be made to the investors of its plans for utilising the oversubscribed amount.

4.23 In this regard, the SC also expects the ECF operator to notify investors in the event a particular offering is oversubscribed.

4.24 Unless there is a material change in relation to the offering or the issuer, investors should not expect to be given the option to withdraw from their investment after being notified of an oversubscription.

Question 11:

(a) Do you agree with the proposal to allow an issuer to retain oversubscribed funds? If yes, do you agree that it should be subject to the requirement that the issuer discloses to the investors its plans for utilising the oversubscribed amount?

(b) Should the ECF operator be responsible to notify the investors in the event of an oversubscription? If not, should this responsibility be imposed on the issuer?

Disclosure

4.25 The US, Canada, New Zealand and Australia have proposed that a prospective issuer should be required to lodge with the ECF operator, a standardised disclosure document. This disclosure document will be made available to potential investors only through the ECF platform.

4.26 In Malaysia, offerings made by private companies on the ECF platform will not be subjected to the prospectus requirements of the CMSA as such offerings are currently exempted by virtue of paragraph 17 of Schedules 6 and 7 of the CMSA.

4.27 This however does not mean that investors would not be receiving any disclosure

document that will assist them in making their investment decision.

- 4.28 The SC proposes that the issuer be required to lodge a standardised disclosure document with the ECF operator when the issuer applies to the ECF operator to host its offering on the platform, based on a self-declaratory approach. It is expected that this disclosure document will include basic information about the issuer and the offering (for example, its purpose, targeted offering amount, closing deadline or offer period,²⁰ regular updates).
- 4.29 Disclosures made by the prospective issuer must be accurate and must not contain any false or misleading statement. Liability for false or misleading statements is provided under subsection 92A(2) of the CMSA.

Question 12:

- (a) Do you agree that ECF operators should require issuers to lodge with them a standardised disclosure document which would then be made available to investors through the platform's website?**
- (b) Do you agree with the information proposed to be included in the standardised disclosure document, as set out in paragraph 4.28? Do you think there is any other information that should be included?**
- (c) Should ECF operators be required to carry out some verification of the information contained in the disclosure document or does it suffice for the issuer to self-declare that all the information contained in the disclosure document is true and accurate?**
- (d) If ECF operators are expected to carry out some verification of the information contained in the disclosure document, should the verification be done before the offering is hosted or post-offering?**
- (e) Should there be a prescribed timeframe for which an offer remains open ("offer period")?**
- (f) If there is a prescribed offer period, who should determine it – the ECF operator or the issuer?**

²⁰ In Canada, an offer cannot remain open for more than 90 days while Australia is proposing a limited period (say, 3 months).

Advertisement

- 4.30 In the US, issuers are prohibited from advertising the terms of the offer. An issuer is only allowed to provide a notice that directs investors to ECF platforms for the information relating to its offering. In Canada, an issuer may only advise potential investors that the issuer is proposing to make an offer and refer the potential investors to the ECF platform where the offer is being made. Australia, on the other hand, is considering adopting its existing framework under the *Corporations Act* in relation to advertising and publicity of permitted securities offer, before and after the disclosure document is lodged.
- 4.31 The SC proposes that the advertisement for any offering of shares by an issuer on an ECF platform be governed by a framework similar to section 241 of the CMSA. In this regard, any notice by the issuer with regard to the offering must direct investors to the disclosure document that has been lodged with the ECF operator and made available on the platform.
- 4.32 An issuer is also prohibited from advertising its offering other than through the ECF platform. This is to ensure that investors are only referred to one source of information relating to the offering to assist them in making an investment decision. Notwithstanding this, an issuer may use social media to direct potential investors to the registered ECF platform. However, in doing so, an issuer must be mindful to ensure that such communication does not include any element of advice as this may trigger the relevant licensing requirements under section 58 of the CMSA.

Question 13:

- (a) Do you agree that an issuer should be prohibited from promoting its offering to the public except through the ECF platform?**

(see next page)

Question 13 (continued):

- (b) Do you agree that the standardised disclosure document should be the only advertising material used by the issuer for its offering?**
- (c) Do you agree that any notice provided by the issuer (other than the standardised disclosure document) should only be used for the purposes of directing the attention of prospective investors to the disclosure document on the ECF platform?**

Financial disclosures

4.33 As discussed above, it is expected that the ECF operator will carry out background checks on the issuer,²¹ as well as verify the disclosure document submitted by the issuer. To perform these functions, the ECF operator will be assisted by the financial disclosures that would be made by the prospective issuer to the ECF operator.

4.34 Hence, the SC proposes that the financial disclosures that are to be made to the ECF operator will be dependent on the amount sought to be raised through the ECF platform.

(a) Offerings below RM300,000

- No requirement to file financial information, but the ECF operator has the discretion to request for certified financial statements/information by the issuer's management for verification purposes.

(b) Offerings between RM300,000 – RM500,000

- Audited financial statements where applicable (e.g. where the issuer has been established for at least 12 months).
- Where audited financial statements are unavailable (e.g. the issuer is newly established), certified financial statements/information by the issuer's management may instead be filed with the ECF operator.

²¹ As discussed in paragraph 3.8.

- (c) Offerings above RM500,000
- Audited financial statements.

Question 14:

- (a) **Do you agree that the financial disclosures be filed with the ECF operator only?**
- (b) **Do you agree with the proposed financial disclosure requirements as set out in paragraph 4.34?**

Opt-out option where there is a material adverse change relating to the offer

- 4.35 Should a material adverse change relating to the offer or the issuer occur during the offering period, investors should be provided with adequate notice of the change. Canada and Australia have taken the view that there should be a procedure in place to notify investors of any changes that have occurred that may affect their investment decision. Canada has proposed that investors be required to reconfirm their commitment to the investment upon notification (opt-in), failing which their investment will be deemed cancelled and their monies refunded. Australia, on the other hand, has proposed that investors be presumed to agree with the change unless they elect to cancel their investment (opt-out).
- 4.36 The SC proposes to adopt the opt-out approach, namely investors are deemed to agree to the change unless they elect to withdraw from the investment within a period of 2 weeks from the date of notification. This is to ensure that the offering does not fail simply because there is a lack of response from investors after being notified of the material change.
- 4.37 What constitutes a material adverse change has been discussed in paragraph 3.16. In this regard, the issuer is responsible for communicating the occurrence of a material change to the operator in a timely manner. The ECF operator, in turn, is

responsible for notifying all relevant investors of the said change.

- 4.38 In addition, the SC also proposes that investors be informed of their opt-out rights in the disclosure document.

Question 15:

- (a) **Do you agree with the proposed two weeks opt-out period for investors upon being notified of the material adverse change by the ECF operator?**
- (b) **Do you agree that the ECF operator should be responsible for notifying the investors of the material adverse change or should the responsibility rest with the issuer?**

Cooling-off period

- 4.39 The US, Canada and Australia have proposed to offer cooling-off rights to ECF investors. In the US and Canada, investors are allowed to withdraw from their investment up until 48 hours before the closing of the offering. Australia is considering a limited period (say, five working days) after accepting the offer.
- 4.40 Currently, unit trust investors in Malaysia are given six working days as a cooling-off period. To ensure consistency, the SC proposes that an investor under ECF shall also be given a cooling-off period of six business days after making the investment (after the payment by the investor has been received by the ECF operator or its trustee), during which they may reflect on their decision and are free to withdraw their investment should they change their minds.

Question 16:

Do you agree with the proposed cooling-off period of six business days to be given to all ECF investors?

5. Proposed requirements in relation to investors

5.1 As discussed in Chapter 2, while ECF has its benefits, it also carries with it risks to investors.

Offering to sophisticated and retail investors

5.2 The UK, for example has allowed only sophisticated investors and some classes of retail investors to participate in ECF. However, other jurisdictions such as the US, Canada and Australia have allowed retail investors to invest, subject to limits being imposed on the amount in order to reduce their exposure to such risks.

5.3 The SC proposes that all types of investors should be allowed to have access to and participate in ECF. However, investors' participation is subject to the following restrictions:

- (a) Sophisticated investors:²² No restrictions on investment amount; and
- (b) Retail investors: A maximum of RM3,000 per issuer with a total amount of not more than RM30,000 within a 12 month period.

The above RM3,000 limit per issuer is to ensure that a retail investor will not be excessively exposed to any single issuer, and to encourage diversification of their investment and risks.

5.4 While maximum limits are imposed on retail investors, SC recognizes the difficulty in enforcing these requirements. As such, SC proposes that investors will be required to self-declare to the ECF operator that they are within the investment limit before they invest. In the event a retail investor breaches these investment limits, it is unlikely that the SC or the ECF operator will take action to enforce the said limits.

²² Sophisticated investors comprise of accredited investors, high-net worth entities and high-net worth individuals, as provided under Part 1 of Schedules 6 and 7 of the CMSA. Retail investors are investors who are not sophisticated investors.

However, the investor will not be allowed to withdraw his excess investment. This is to ensure that there is certainty in the transactions effected through the ECF platform and that a breach by an investor does not result in a detrimental effect on an issuer.

5.5 The examples below explain how the proposal in 5.3(b) would work:-

Example 1:

Mr. A, on 1 January 2013, invested RM3,000 in an offering made by Issuer X. On 1 February 2013, Mr. A intends to invest another RM3,000 with Issuer X. He is not allowed to do so, as he has already invested RM3,000 in Issuer X, which is the maximum limit imposed on a retail investor per issuer.

Example 2:

Mr. A, on 1 January 2013, invested RM1,000 in an offering in project A made by Issuer X. On 1 June 2013, Mr. A intends to invest RM2,000 for project B with Issuer X. He is allowed to do so, as he has not exceeded the maximum limit of RM3,000 per issuer.

Example 3:

Mr. A, on 1 January 2013, invested RM3,000 in an offering made by Issuer X. For the next 9 consecutive months, Mr. A invests RM3,000 in offerings made by 9 other issuers, bringing his total investment for the year 2013 to RM30,000. In December 2013, Mr. A intends to invest another RM3,000 in an offering made by Issuer Z. He is not allowed to do so, as he has reached the maximum limit of RM30,000 imposed on a retail investor within 12-month period.

Question 17:

- (a) Do you agree that sophisticated investors should be allowed to participate in ECF without any cap imposed on the amount they may invest?**
- (b) Do you agree with the proposed cap on investment that is to be imposed on retail investors? If not, what should the proposed cap be?**

Risk acknowledgement

- 5.6 The US, Canada, New Zealand, Australia and UK have proposed to require retail investors and high net worth investors to provide the ECF operator with a self-declared acknowledgement of risk before investing on an ECF platform. This acknowledgement is to encourage them to consider all the relevant matters and risks and to take it on themselves to ask all relevant questions prior to investing on an ECF platform.
- 5.7 In this regard, the SC proposes that retail investors and high net worth investors²³ must self-declare to the ECF operator that they–
- (a) fall within the investment limits;
 - (b) understand that they may lose their entire investment; and
 - (c) understand the illiquid nature of the investments and are aware of resale restrictions, if any.

Question 18:

- (a) Do you agree that retail investors and high net worth investors should provide risk acknowledgement described in paragraph 5.6?**
- (b) Do you agree that high net worth investors should also provide risk acknowledgement?**

²³ As defined by Part 1 of Schedules 6 and 7 of the CMSA.

Appendix: Key References

["Crowdfunding in the EU—Exploring the added value of potential EU action"](#), European Commission Consultation Paper (October 2013);

Kirby and Worner, ["Crowd-funding: An Infant Industry Growing Fast"](#), Staff Working Paper of the IOSCO Research Department (February 2014);

["Crowd Sourced Equity Funding Discussion Paper"](#), Corporations and Markets Advisory Committee (September 2013);

["Crowd Sourced Equity Funding Report"](#), Corporations and Markets Advisory Committee (May 2014);

"Staff Consultation Paper 45-710 [Considerations for new capital raising prospectus exemptions](#)", Ontario Securities Commission (December 2012);

"Notice 45-712 [Progress Report on Review of Prospectus Exemptions to Facilitate Capital Raising](#)", Ontario Securities Commission (August 2013);

["Consultation: Licensing crowd funding"](#), Financial Markets Authority (November 2013);

["Crowdfunding Part B1: Your guide to applying for a market service licence"](#), Financial Markets Authority (April 2014);

"CP13/13 - [The FCA's regulatory approach to crowdfunding \(and similar activities\)](#)", Financial Conduct Authority (October 2013);

"PS14/4 - [The FCA's regulatory approach to crowdfunding over the internet, and the promotion of non-readily realisable securities by other media - Feedback to CP13/13 and final rules](#)", Financial Conduct Authority (March 2014);

[SEC Crowd-funding proposed rules](#), Release No. 33-9470, U.S. Securities and Exchange Commission (October 2013);

[Proposed Rule Amendments for Small and Additional Issues Exemptions Under Section 3\(b\) of the Securities Act](#), Release No. 33-9497, U.S. Securities and Exchange Commission (December 2013);