

Should Hong Kong legislate on crowdfunding? If so, how?

I. Introduction

Crowdfunding refers to a financing mechanism for a designated purpose, such as a cultural project or a business adventure. It is known for the ‘crowd’ in the concept itself which indicates the financial source attributable to a large group of people each of whom subscribes to a small amount.

Although this mode is not new in terms of the ‘crowd’ feature which could be found in local charitable donations or political campaigns, the essence of crowdfunding rests on its utilization of territorially borderless and popularly accessible internet. This modern technology helps to overcome the detriment of geographical distance to, and thus facilitate public participation in, a specific funding proposal from a person at a remote place. For example, two American advertisement executives succeeded in raising USD 200 million from 5 million people for a corporate acquisition plan within only six months¹.

The efficacy of crowdfunding has prompted world-wide establishments of web-based crowdfunding platforms² to connect fundraisers to potential contributors, including Zopa (UK) in 2005³, Creditease (China) in 2006⁴, Auxmoney (Germany) in 2007⁵, Kickstarter (US) in 2009⁶, FundedByMe (Sweden) in 2011⁷, and Afluenta (Argentina) in 2012⁸. Crowdfunding, as a new industry, gradually accounts for a significant share in economic growth. Until 2012, 1.441 billion has been raised by crowdfunding⁹ to finance start-ups, function as consumer credit, or support other activities.

Beneath the burgeoning growth is the increasing risk inherent in the financial technology¹⁰ (‘FinTech’) innovation assumed by contributors,

¹ Steven C. Bradford, “Crowdfunding and the Federal Securities Laws” (2012) 1 *Columbia Business Law Review* 100, p 6.

² Total number is 452 before 2012. See Richard T. Harrison (ed), *Crowdfunding and Entrepreneurial Finance* (London: Routledge, 2016), p 119.

³ See <http://www.zopa.com/about> (visited 20 January 2016).

⁴ Eleanor Kirby and Shane Worner, Staff Working Paper of the IOSCO Research Department on *Crowd-funding an Infant Industry Growing Fast*, p.38.

⁵ *ibid.*

⁶ David M. Freedman and Matthew R. Nutting, “A Brief History of Crowdfunding including Rewards, Donation, Debt, and Equity Platforms in the USA” (5 November 2015), available at <http://www.freedman-chicago.com/ec4i/History-of-Crowdfunding.pdf> (visited 13 February 2016).

⁷ Ingram Claire and Robin Teigland, “Crowdfunding among IT Entrepreneurs in Sweden: A Qualitative Study of the Funding Ecosystem and ICT Entrepreneurs’ Adoption of Crowdfunding” (1 June 2013), p 19, available at <http://ssrn.com/abstract=2289134> (visited 13 February 2016).

⁸ An Infant Industry (n 4 above), p 38.

⁹ *ibid.*, p 120.

¹⁰ FinTech refers to the combination of finance and technology, which covers crowdfunding. See Douglas W. Arner, Janos Nathan Barberis and Ross P. Buckley, University of Hong Kong Faculty of Law Research Paper on “The Evolution of Fintech: A New Post-Crisis Paradigm?” (2015) 047, p 19

such as collapse of platforms, default or fraud of fundraisers, or ordinary investment risk. On the other hand, general financial regulation frameworks might impose excessive obligations on, or at least result in risk of non-compliance against crowdfunding players, especially where interpretational uncertainty exists. To strike a balance between investor protection and crowdfunding development, the United Kingdom ('UK') and the United States of America ('US') introduced specific crowdfunding legislation in March 2014¹¹ and November 2015¹² respectively. Similarly, the Monetary Authority of Singapore¹³ and the Treasury Department of Australia¹⁴ announced consultation papers last year.

By contrast, there is no equivalent legislative agenda in Hong Kong until now. The only regulatory response is the warning notice issued by the Securities and Futures Commission ('SFC') in May 2014¹⁵, clarifying the application of current financial regulations to certain types of crowdfunding activities and reminding investors of the risks involved. It is still open to debate whether Hong Kong should legislate on crowdfunding, especially considering the new policy vision¹⁶ of developing the city into a FinTech hub last year.

To explore the issue, this research essay investigates the development of, and the application of current regulations to crowdfunding in Hong Kong, which provides local circumstances for the legislative debate from a cost-benefit perspective. Since the provisional conclusion is in the partially affirmative, this essay also provides recommendations for a legislation on crowdfunding with reference to overseas reforms.

II. Crowdfunding Activities in HK: Limited Development

Crowdfunding activities revolve around the operation of crowdfunding platforms all of which are featured with the models it adopts. There are five main models of crowdfunding, i.e. donation, reward, pre-purchase, lending and equity¹⁷, according to the different sorts of consideration

available at SSRN: <http://ssrn.com/abstract=2676553>.

¹¹ Financial Conduct Authority, Policy statement on *the FCA's Regulatory Approach to Crowdfunding & Feedback to CP1313 and Final Rules* (UK: March 2014).

¹² SEC Final Rules (Regulation Crowdfunding), 80 Fed. Reg. 71387 (US: 16 November 2015).

¹³ Monetary Authority of Singapore, Consultation Paper on *Facilitating Securities Based Crowdfunding* (Singapore: February 2015).

¹⁴ Australian Government, Consultation Paper on *Facilitating Crowd-sourced Equity Funding and Reducing Compliance Costs for Small Businesses* (Australia: August 2015).

¹⁵ Securities and Futures Commission, Notice on Potential Regulations Applicable to, and Risks of, Crowd-funding Activities (May 2014), available at <http://www.sfc.hk/edistributionWeb/gateway/EN/news-and-announcements/news/doc?refNo=14PR53> (visited 13 February 2016).

¹⁶ Financial Secretary Tsang C John, Speech moving the Second Reading of the Appropriation Bill 2015 on the 2015-16 Budget (25 February 2015), p.14.

¹⁷ Including interests in share and debt issued by company. See SFC Notice on Potential Regulations (n 15 above), p 1.

fundraisers offer for the financial support of contributors¹⁸. Furthermore, donation, reward and pre-purchase models could be treated as one broad category characterized with non-financial return¹⁹ ('Non-financial Return Models'), while lending and equity as the other broad category characterized with financial return²⁰ ('Financial Return Models').

In Hong Kong, several web-based crowdfunding portals have been founded since September 2012. Until now, fourteen crowdfunding sites²¹ operated or continue to operate in this global metropolis. Among ten adopting models with financial return, four have ceased to operate while another four choose to restrict public funding, which is inconsistent with the original idea of crowdfunding. By contrast, the four platforms adopting models with non-financial return remain in operation and preserve the feature of public funding.

Table 1: HK-based Crowdfunding Platforms

Platforms	Main Model ²²	Public Funding ²³	Founding Time ²⁴	Continue ²⁵
Lifewire	Donation	Yes	2014 November	Yes
Infun	Pre-purchase ²⁶	Yes	2015 February	Yes
Dreamna	Reward	Yes	2012 September	Yes
FringeBacker	Reward	Yes	2012 September	Yes
Crowdbaron	Equity	Yes	2012 September	No
Colony88	Equity	Yes	2013 April	No
BigColors	Equity	No	2013 November	Yes
Fund2.me	Equity	Yes	2013 December	No
Investable	Equity	No	2013 December	Yes
EastFunding	Equity	Yes	2014 May	No
Welend	Lending	No	2013 November	Yes
Golend	Lending	Yes	2013 December	Yes
Bestlend	Lending	No	2015 January	Yes

¹⁸ Crowdfunding and the Federal Securities Laws (n 1 above), pp 14-15.

¹⁹ Strictly speaking, there is no return under a donation model.

²⁰ Shares could be treated as a financial return under an equity model considering that it could produce dividends and be sold for money.

²¹ It includes self-certified crowdfunding sites, e.g. Bestlend, and crowdfunding-like sites, e.g. Investable and Bigcolors.

²² In practice, each of sites might provide more than one kind of crowdfunding model for participates, e.g. Fund2.me, available at <http://www.nanzao.com/tc/hk-macau-tw/14c31504e1cd295/xiang-gang-wang-shang-ji-zi-xin-qu-shi> (visited 8 February 2016).

²³ It is identified with main reference to the introductory information in the official website of each platforms

²⁴ The operation time of each platform is identified mainly according to their self-introduction or first posts in their blog or facebook. Otherwise, the time is identified with reference to relevant news or the linkedin page of their founders.

²⁵ The discontinuance is identified by accessing their official websites.

²⁶ It is categorized as adopting pre-purchase model because there is only one successfully-financed project about publication of a book copies of which will be sent to supporters. It is noteworthy that this platform itself establishes a venture fund which is used to finance selected projects.

Monexo	Lending	Yes	2015 February	Yes
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III. Crowdfunding under HK Law: Imbalanced Application

Albeit there is no overarching legislation to regulate crowdfunding in Hong Kong, various existing laws are applicable to platforms, fundraisers and contributors respectively.

A. Non-financial Return Models: No Positive Obligations

Fundraisers might be criminally or civilly liable if the crowdfunding activity involves illegality, for instances, when the financing purpose is anti-social; the funding campaign itself is a fraud; or the good pre-purchased is prohibited. In these situations, whether contributors and platforms attract liability depends on the degree of their involvement. However, the three players are generally free from any compliance obligations because crowdfunding with non-financial return amounts to an ordinary social or commercial activity where the law generally would not interfere with the autonomy of parties.

B. Financial Return Models: Spider Web Regulations

Contributors act like investors in pursuit of financial return from their investment in a financing object posted by fundraisers through platforms. This characteristic might subject the three parties to financial regulations on the basis of lending, banking, and securities laws in Hong Kong, depending on the specific way crowdfunding-operates in practice.

1. Equity Model

Where an equity model is leveraged for the purpose of crowdfunding, fundraisers issue shares in its companies in exchange of capital offered by contributors in order to finance the venture.

(1) Fundraisers

Under section 38(3) and 38D of Companies (Winding Up and Miscellaneous Provisions) Ordinance ('C(WUMP)O'), a fundraiser must provide investors with a duly-registered prospectus consistent with statutory requirements when offering shares in or debentures of the company unless it is exempted by SFC under section 38A or according to section 38(3) (a), (b) or (c) of the Ordinance. Otherwise, they will be not only punished with a fine but also liable for criminal liability under section 103(1) of Securities and Futures Ordinance (SFO) because the meaning of 'invitation' includes an offer of this kind under section 102 of SFO.

(2) Platforms

Even if all offers are exempted, a platform is still subject to regulations as long as the crowdfunding activities it participates in wholly or partially

constitute one or more of the ‘regulated activities’ under Part 1 of Schedule 5 of SFO. For any equity-based platform, it must have a function to publish capital formation information of fundraisers to attract public financial commitment. It seems likely that it constitutes Type 1 ‘dealing in securities’ under Part 1 because the marketing activity intends to induce people to purchase the shares in the companies and thus satisfy the statutory definition under Part 2 of the Schedule²⁷.

Therefore, an equity-based platform at least needs to apply for a license to conduct Type 1 activity to ensure its operation is in compliance with the current regulation, while other additional value-added services available on the platform might qualify to be other regulated activities, such as Type 4 ‘advising on securities’, Type 6 ‘advising on corporate finance’ and Type 9 ‘asset management’.

(3) Contributors

Contributors remain unregulated to the extent that there is no positive obligation they should comply with when they invest in the companies posted in platforms.

2. Lending Model

Where a lending model is utilized (‘simple model’), platforms usually act as a pure intermediary to match the loan demand from fundraisers as borrowers and the capital supply from contributors as lenders²⁸. According to the type of borrowers, the model could be further divided into Peer to Peer (‘P2P’) model and Peer to Business (‘P2B’) model.

In a variation of simple model (‘complex model’), contributors are not the direct creditors but final holders or assignees of the interest under the original loan agreement between fundraisers and platforms, or between fundraisers and outsiders who cooperate with platforms to issue loan in the first place and assign the chose in action to the platforms²⁹.

(1) Fundraisers

In the P2P model, fundraisers are individual borrowers and thus basically free from any financial regulation. In the P2B model, fundraisers might be subject to the prospectus regime if the loan agreement constitutes a debenture for the purpose of section 38(3) of C(WUMP)O, which evidences the overlap between equity model and lending model. Under respective situation, the complexity of model seems to have no influence on the position of fundraisers.

²⁷ Charltons, Hong Kong Regulation of Crowd Funding (PowerPoint slides), June 2015, available at <http://www.charltonslaw.com/hong-kong-law/hong-kong-regulation-of-crowd-funding/> (visited 10 February 2016).

²⁸ This model is generally called ‘client segregated account model’. *ibid.*, pp 5-6.

²⁹ The second situation is usually referred to ‘notary model’. *ibid.*, p 4.

(2) Platforms

In the simple model, the role of platforms as conduit might prevent them from being treated as conducting most of the ‘regulated activities’ under Part 1 of Schedule 5 of SFO. However, Type 10 ‘providing credit rating services’ might be an exception because they usually provide evaluation service regarding the loan applications submitted by borrowers to attract potential contributors³⁰.

In the complex model, if the platforms directly provide borrowers with loans, they will be regulated by the money lending regime underpinned by Money Lenders Ordinance (‘MLO’), considering that the degree and the frequency of this kind must satisfy the meaning of ‘carrying on that [money lending] business’ under section 2 of MLO. Thus they should apply for a license before engaging in this business. Comparatively, these transactions might not be regarded as banking business under Banking Ordinance (‘BO’) with the result that the platforms do not need to apply for banking license from Monetary Authority of Hong Kong (‘MAHK’).

On the other hand, transfer of the interest under the original loan agreement, which is between fundraisers and an outsider, from the platforms to the contributors might involve issuance of credit linked notes, because the return on investment of the contributors in this complex transaction appears ultimately contingent on the performance of the underlying loan³¹. If it is true, it will fall within the scope of ‘securities’ under Part 1 of Schedule 1 of SFO which probably makes such service constitute one or more of ‘regulated activities’ under Part 1 of Schedule 5 of SFO, Type 1 ‘dealing in securities’ and Type 4 ‘advising on securities’ in particular.

(3) Contributors

In the simple model, when the contributors, as direct lenders, provide money to the fundraiser, whether they should register as money lenders under MLO remains uncertain because the involvement degree and frequency of each contributor varies. In the complex model, contributors as investors have a similar unregulated status as they have in an equity-based model.

Table 2: Summary of Current Regulations on Crowdfunding in HK

Crowdfunding	Fundraisers	Platforms	Contributors
Non-financial Return	N/A	N/A	N/A
Financial Return: Equity	C(WUMP)O: prospectus regime	SFO: license regime	N/A

³⁰ For detailed analysis, see Adrian Fong, “Regulation of Peer-to-Peer Lending in Hong Kong: State of Play, Law and Financial Markets Review” (2015) 9 *Law and Financial Markets Review* pp 254-255.

³¹ *ibid.*, pp 254-255.

Financial Return: Lending	C(WUMPO): prospectus regime	SFO & MLO: license regimes	MLO: license regime
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IV. Legislating on Crowdfunding in HK: Cost-Benefit Evaluation

In light of the local crowdfunding context (see Table 1) and different regulatory environments (see Table 2) that different types of crowdfunding face, it is appropriate to conduct a category-based analysis on whether Hong Kong should legislate on crowdfunding from a cost-benefit perspective.

A. Non-Financial Return Models

1. Real Costs

Since the crowdfunding with non-financial return is free from any positive obligations, legislating on it generally means a new regulation regime to license the platforms and lays out the boundary within which crowdfunding could operate. In addition to expense incurred for regulatory purpose, such as appointing a special regulator, operation costs of platforms will be increased due to the obligation of compliances, which might in turn be transferred to contributors or fundraisers.

2. Uncertain Benefits

A regulation regime of this kind mainly purports to eliminate the illegality the crowdfunding might involve. However, local sites running this type of crowdfunding generally conduct self-screening mechanism which is sufficient to achieve this purpose. For example, FringeBacker, a popular reward-model platform, provides a non-exhaustive list of prohibited projects³² with final discretion in hand, and requires identity verification of fundraisers and contributors to prevent frauds or other misuses³³. This self-regulated measure is effective given that most of approved projects are in relation to sports, arts, charities and cultures³⁴ and thus within the safe harbor of laws.

Even if the benefit exists, the net effect would be very limited. The main risk involved in the crowdfunding is fraud, the scale of which is relatively low with comparison to investment risk in the context of crowdfunding with financial return. Moreover, the ordinary financing size of each

³² See “FringeBacker Project Guidelines”, *FringeBacker*, available at <https://www.fringebacker.com/en/info/guidelines/> (visited 10 February 2016).

³³ “Crowdfunding Makes Dreams Achieved: Risks and Limitations”, 13 October 2015, Sanpoyan, available at <http://sanpoyan.journalism.hkbu.edu.hk/%E7%BE%A4%E7%9C%BE%E9%9B%86%E8%B3%87%E5%8A%A9%E5%9C%93%E5%A4%A2-%E9%A2%A8%E9%9A%AA%E5%B1%80%E9%99%90%E5%A4%9A/> (visited 8 January 2016).

³⁴ See FringeBacker, available at <https://www.fringebacker.com/zh-tw/a/Popularity/1/>; Infun, available at <http://www.infun.hk/>; Dreamna, available at <http://www.dreamna.com/lang/ch/all-projects/>; Lifewire, available at <http://lifewire.hk/zh-hant/directory> (visited 8 January 2016).

project is very small in Hong Kong. Until May 2015³⁵, the equal amount raised is HKD 15,000 in FringeBacker. Lastly, it is impossible to prevent any risk and illegality in advance by way of regulation.

Therefore, it is submitted that the status quo should be maintained, at least currently, because the reform costs obviously outweigh the limited benefits which legislation is expected to bring.

B. Financial Return Models

1. Limited Costs

Since crowdfunding with financial return falls within the ambit of current financial regulation framework, crowdfunding legislation would be either by way of creating a new regulation regime or adjusting the existing framework, usually in the direction of loosening existing regulations. Therefore, the legislative change would inevitably expose investors to the investment risk associated with crowdfunding, which constitutes main costs of the reform. However, the reform could also lay out investor protection measures to offset the costs.

2. Significant Benefits

A specific crowdfunding law, if properly drafted, might bring benefits in the following four aspects.

(1) Fundraisers: Decrease Compliance Expenses

The prospectus regime under C(WUMP)O aggravates the financing cost of start-ups and thus discourages them at the beginning. Although there exists a statutory exception exempting fundraising up to HKD 5 million over a 12-month period under Schedule 17 of C(WUMP)O, the rigid upper limit might rule out many ambitious entrepreneurs and their companies. Therefore, a reform could create a special exemption for fundraisers in crowdfunding to decrease the compliance costs.

(2) Platforms: Simplify Complex Regime

The license regime under SFO is complex in the sense that platform operation might fall within several types of regulated activities. The multiple license requirements restrict the development of crowdfunding platforms in Hong Kong. For instance, Welend planned to evolve to a lending-model crowdfunding platform liberalizing both demand and supply sides of loan business from the outset, but now has to remain as an online licensed money lender under BLO, because it worries about enforcement action of SFC if it opens the door to ordinary lenders to

³⁵ “Crowdfunding In Hong Kong: Young Entrepreneurs Realized Dreams”, 18 May 2015, *Startup Beat*, available at <http://startupbeat.hkej.com/?p=17937> (visited 10 February 2016).

participate in the supply side³⁶. This concern is real especially after the warning notice³⁷ of SFC in May 2014.

Similarly, when Bigcolors started operation in December 2013, it positioned itself as an equity-based crowdfunding platform permitting ordinary people to invest in start-ups and even trade the purchased equity with each other³⁸. But it soon became quiet and appeared as a start-up fund in August 2014³⁹. The main reason for this variation seems self-evident considering the warning notice of SFC⁴⁰ during that period, although its founders explained the reason as business consideration⁴¹. Therefore, a reform could create a well-designed crowdfunding license regime to simplify the burdens on platforms significantly.

(3) Contributors: Increase Regulation Certainty

The uncertainty regarding the obligation to register as money lender under MLO would also keep potential contributors away from crowdfunding with a simple lending model. Although legal crafting might help to circumvent the regulations, it unavoidably increases transaction cost. For instance, Golend, as a lending-based site, cooperates with a law firm to design an extraordinary lending mode in avoidance of license burdens on it and ordinary lenders under SFO and BLO respectively. In this complex business structure, investors enter standardized share subscription agreement with the platform in the first place, and make loan to the platform as shareholders. This is secured by the interest in the real estate, which fundraisers mortgage to borrow money from the platform previously⁴². Therefore, a reform could create clear exemption for contributors participating in the crowdfunding of this kind.

(4) Start-Ups: Alternative Financing Channel

The current regulatory barriers stifle new entrants, whether being platforms, fundraisers or contributors, to this industry, as evidenced by the vote-by-foot decision of a Hong Kong founder of Fundnel to establish this equity-based site in Singapore instead of Hong Kong⁴³ in 2015⁴⁴. In

³⁶ Leona Wong, "2015 Plan: WeLend", 30 March 2015, Startup Beat, available at <http://startupbeat.hkej.com/?p=15970> (visited 10 February 2016).

³⁷ SFC Notice on Potential Regulations (n 15 above).

³⁸ Steven Millward, "Is This the Next Trend after Crowdfunding? Become an Angel Investor with This Startup Stock Exchange" (4 December 2013), available at <https://www.techinasia.com/bigcolors-startup-stock-exchange> (visited 13 February 2016).

³⁹ John Horwitz, "Hong Kong's Bigcolors Acquires Melbourne's Get Viable as it Gradually Morphs into a Seed Fund for Asia" (18 August 2014), available at <https://www.techinasia.com/hong-kongs-bigcolors-acquires-melbournes-get-viable-as-it-gradually-morphs-into-a-seed-fund-for-asia> (visited 13 February 2016).

⁴⁰ SFC Notice on Potential Regulations (n 15 above).

⁴¹ Luo Weiteng, "The Numbers Game", *Chinadaily*, 5 June 2015, available at http://www.chinadaily.com.cn/hkedition/2015-06/05/content_20913178.htm (visited 13 February 2016).

⁴² "Golend CEO Commenting that Crowdfunding Platform Is Legal", 8 July 2014, available at <http://finance.sina.com.cn/money/lcp2p/20140708/102019638838.shtml> (visited 15 January 2016).

⁴³ See <http://unwire.pro/2015/08/04/does-host-rise-conf-really-mean-hk-startup-are-spotlighting/feature/20150804> (visited 8 February 2016).

the end, it compromises the important function of crowdfunding as an alternative financing channel for start-ups and small and medium-sized enterprises ('SMEs'). Therefore, a reform, if achieving the three effects mentioned above, could advance the development of start-ups and thus the economy of Hong Kong in the long term.

Therefore, it is submitted that a specific law addressing crowdfunding with financial return should be introduced because the potential reform benefits obviously outweigh the costs if the reform could supplement appropriate measures for investor protection.

V. Financial Return Crowdfunding Reform in HK: Suggestions

Crowdfunding legislation demands a skillful balance between crowdfunding development and investor protection. The exact wording of such law requires thorough consultation and preparation which is bound to transcend the scope of this essay. Therefore, this essay will only propose a reform skeleton addressing main points mentioned in the previous section vis-à-vis recent reforms in two main common law jurisdictions, UK and US.

A. Fundraisers

In the UK reform⁴⁵, the Financial Conduct Authority ('FCA') relaxed the application of its prospectus exemption to fundraisers in crowdfunding by adding two new types⁴⁶ of investors to which equity-based crowdfunding platforms could promote and sell investment products⁴⁷. Before that, the maximum amount which securities could be offered for over a 12-month period without prospectus has been increased from EUR 2.5 million to EUR 5 million when UK implemented part of a relevant EU directive⁴⁸ in July 2011⁴⁹.

Since Hong Kong has no equivalent restriction on the types of investors, reform should focus on the creation of a crowdfunding exemption with different upper limit from the existing exemption as the US reform creates⁵⁰. The exact scale will be a matter of public and experts

⁴⁴ Fundnel, "Fundnel Launches Collaborative Investment Platform underpinned by Six Completed Transactions Worth US\$5 Million", available at <https://s3-ap-northeast-1.amazonaws.com/fundnel/assets/assets/Fundnel+Press+Release+-+Official+Launch+15+Jan+2016.pdf> (visited 18 January 2016).

⁴⁵ The FCA's Regulatory Approach (n 11 above).

⁴⁶ Dennis Brüntje and Oliver Gajda (ed), *Crowdfunding in Europe: State of the Art in Theory and Practice* (Springer International Publishing, 2016), p 155-156.

⁴⁷ Pinsent Masons, "Financial Regulation: Consultation Paper 13/13: The FCA's Regulatory Approach to Crowdfunding (and similar activities)" (November 2013), p 5, available at <http://www.pinsentmasons.com/PDF/FinancialRegulation-TheFCAsregulatoryapproachtocrowdfunding.pdf>.

⁴⁸ CPAudit, "Decision Tree for Prospectus Exemptions (13/27)", 8 October 2013, available at <http://www.cpaudit.co.uk/news/267/63/Decision-tree-for-Prospectus-Exemptions-13-27> (visited 13 January 2016).

⁴⁹ Ashurst London, "Changes to the Prospectus Directive and Impact on UK ECM Practice" (February 2012), p 1, available at https://www.ashurst.com/doc.aspx?id_Content=7931.

⁵⁰ Securities Act of 1933, (US: May 27, 1933, ch. 38, title I, § 1, 48 Stat. 74), section 4(a)(6).

consultation with reference to a specific investigation about start-ups and the corresponding funding void⁵¹ in Hong Kong which should be subsequently adjustable by relevant regulators, such as SFC.

However, it is argued that a complete exemption without additional disclosure regime, like UK⁵², goes contrary to the investor protection. To offset the high risk it involves, a mandatory disclosure, albeit less than a prospectus requires, is necessary when the exemption is evoked for fundraisers in crowdfunding. In practice, the disclosure level could be proportional to the offering size to lessen the burden on fundraisers as the similar arrangement in the crowdfunding reform in US⁵³.

B. Platforms

The UK reform establishes a license regime for lending-based platforms conducting P2P model⁵⁴ by introducing a new regulated activity called ‘operating an electronic system in relation to lending⁵⁵’. In 2013⁵⁶, a similar authorization system⁵⁷ has been set up for equity-based platforms. The reform in US also chooses this approach⁵⁸.

For Hong Kong, it is suggested that two regulated activities could be introduced under Part 1 of Schedule 5 of SFO. To prevent platforms from engaging in complex and risky business, the scope of such activities should only refer to the intermediary function of platforms in equity-based crowdfunding and lending-based crowdfunding respectively. In UK, lending-based platforms should register and comply with specific reporting requirements⁵⁹ and existing provisions⁶⁰ which have been analogously applied to other similar investment activities⁶¹, in relation to business conduct, capital requirement, fair disclosure, and client money protection. Equity-based platforms should satisfy appropriateness test⁶² before selling to make sure that the investors without advice have enough knowledge and understanding of the risk⁶³. As an expert financial

⁵¹ See Garry A Gabison, JRC Science and Policy Report on *Understanding Crowdfunding and its Regulations: How can Crowdfunding Help ICT Innovation?* (European Commission, Joint Research Centre, 5 March 2015), p 28.

⁵² Louise Gullifer and Jennifer Payne, *Corporate Finance Law: Principles and Policy* (Oxford: Hart Publishing, 2015), p 521.

⁵³ SEC Final Rules (n 12 above), p 71390 and p 71412.

⁵⁴ Financial Conduct Authority, Consultation Paper on *The FCA's Regulatory Approach to Crowdfunding (and similar activities)* (UK: October 2013), p 6.

⁵⁵ Financial Conduct Authority, FCA Handbook on *Conduct of Business Sourcebook* (COBS) (UK: January 2016), section 3.1(2)(e) Ch 14.

⁵⁶ Josh Hall, “Crowdcube open gates to FSA crowdfunding regulation”, 13 February 2013, available at <http://www.simplybusiness.co.uk/knowledge/articles/2013/02/crowdcube-fsa-regulation/> (visited 15 January 2016).

⁵⁷ Financial Conduct Authority, *A Review of the Regulatory Regime for Crowdfunding and the Promotion of Non-readily Realisable Securities by Other Media* (UK: February 2015), p 6.

⁵⁸ Securities Act 1933 (n 51 above), section 4A. Securities Exchange Act of 1934, (US: June 6, 1934, ch. 404, title I, § 1, 48 Stat. 881). See section 3(h).

⁵⁹ Consultation Paper (n 55 above), p 33.

⁶⁰ *ibid.*, p 6.

⁶¹ *ibid.*, p 16.

⁶² COBS (n 55 above), Ch 10.

⁶³ The FCA's Regulatory Approach (n 11 above), p 36.

regulator, the SFC should take charge of the rulemaking of specifics as regards the requirements to implement the new license regimes as its counterpart did in US⁶⁴ with considerations on local circumstances and overseas experience.

For example, the appropriateness test in UK seems too demanding for equity-based platforms and thus should be modified. By contrast, Hong Kong could consider UK's exclusion of P2B model with relatively high risk as equity-based model has from the lending-based regulated activity to maintain the overall low risk of lending-based crowdfunding. This arrangement makes it feasible to set out two separate uniform regulation regimes for equity-based and lending-based platforms. Moreover, the money provided by contributors as loan should be effectively separated from what the platforms themselves own to ensure the interests of lenders in the event of the collapse of platforms.

C. Contributors

Under UK reform, contributors, who signed the 'restricted investor statement'⁶⁵, could invest up to 10% of its net worth in any equity-based crowdfunding within a 12-month period. Similarly, contributors in US are constrained to invest not more than 5%⁶⁶ of the lesser of its annual income or net worth if any of the two is less than USD 100,000, or 10%⁶⁷ if any of the two is more than USD 100,000 in a 12-month period⁶⁸.

The restriction of such kind is necessary for the purpose of protecting investors, while the details should be a matter for the SFC to explore further with reference to public consultation. Moreover, one of US's measures deserves consideration that any particular offering must be through only one funding portal⁶⁹ in favor of the sharing of information among 'crowd'⁷⁰.

For lending-based crowdfunding, Hong Kong could consider UK reform that disallows contributors to lend more than GBP 25,000 if the fundraisers borrow the money for a dominant business purpose⁷¹ to protect contributors from the high risk it contains. It is consistent with its exclusion of P2B model. Particular for Hong Kong, a statutory exemption of money lending license should be introduced for lenders making loan through registered platforms to solve the current uncertainty under MLO

⁶⁴ SEC Final Rules (n 12 above). See p 71388, and pp 71428-71474.

⁶⁵ COBS (n 56 above), section 7.10 of Ch 4.

⁶⁶ If the 5% is less than USD 2,000, then USD 2,000 becomes the upper limit.

⁶⁷ If the 10% is more than USD 100,000, then USD 100,000 becomes the upper limit.

⁶⁸ SEC Final Rules (n 12 above), pp 71393-71394.

⁶⁹ Or if the fundraiser want to conduct the offerings through a registered broker, then it could only relies one.

⁷⁰ SEC Final Rules (n 12 above), p 71395.

⁷¹ Financial Conduct Authority, FCA Handbook on *Glossary* (UK: January 2016).

and thus encourages more potential contributors to participate in crowdfunding.

VI. Conclusion

This essay outlines the overall picture of crowdfunding and the regulatory environment where it operates in Hong Kong which manifests the varying applicability of current regulations to different models of crowdfunding. Through a cost-benefit analysis, it is recommended that legislating on crowdfunding with a non-financial return is unnecessary, at least currently, while legislating on crowdfunding with a financial return is imperative and beneficial for the development of this FinTech innovation in Hong Kong. With reference to overseas crowdfunding reform, it is suggested that a local legislative equivalent could take the form of adjusting current regulation framework.

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