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## Working Paper

### Regulation of Equity Crowdfunding in Singapore

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## Regulation of Equity Crowdfunding in Singapore

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### **ABSTRACT:**

Equity crowdfunding, a fairly new form of financing, has promise as a means of financing legitimate start-up businesses or projects which may not be able to obtain funds from traditional sources, e.g., banks, venture capitalists and angel investors. However, the cost of complying with existing securities regulations is likely to make equity crowdfunding impractical for the businesses most likely to need it. This paper will consider the rationale for facilitating equity crowdfunding in Singapore, assess the need for additional exemptions for crowdfunding under existing securities regulations, and propose legal reforms which seek to strike a balance between capital formation and investor protection.

## REGULATION OF EQUITY CROWDFUNDING IN SINGAPORE

by Hu Ying

### I. INTRODUCTION

Crowdfunding is the practice of raising many small sums of money from a large number of people through online portals (crowdfunding platforms) to fund a project, cause or business.<sup>1</sup> The key is to leverage the power of the crowd. This is hardly a novel strategy. The same idea is behind any public fund-raising, be it a charity event to help tsunami victims in Indonesia or an initial public offering of shares in Alibaba.

The main difference between crowdfunding and traditional forms of public fund-raising is the way funds are raised. Crowdfunding involves the use of crowdfunding platforms, i.e., websites which connect investors and fundraisers. Fundraisers create a dedicated webpage on such platforms to showcase their projects, causes or businesses. Typically, they would indicate, amongst others, the amount of funds they are seeking to raise and the type of return investors can receive for their contribution. Investors can compare various proposals posted on the platform and interact with fundraisers by asking questions through the dedicated webpage. Similarly, fundraisers can answer those questions and provide updates of their projects in the same webpage. If an investor decides to contribute to a project, he can transfer his money to the relevant fundraiser through an online payment system.

Commentators have classified crowdfunding into different categories by the type of return people receive for their contributions. These include:

- Donation-based: people donate money to support a project or cause;
- Reward-based: people give money to fundraisers in exchange for a specific reward (product or service);
- Loan-based: people lend money to fundraisers to receive interest payments in addition to repayment of the principal; and

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<sup>1</sup> Steven Bradford, “Crowdfunding and the Federal Securities Laws” 2012 Colum. Bus. L. Rev. 1, 10; Monetary Authority of Singapore, *Facilitating Securities-based Crowdfunding* (Consultation paper February 2015) at para.1.1.

- Equity-based: people purchase securities (e.g., debt or equity securities) issued by fundraisers.<sup>2</sup>

This paper focuses on equity crowdfunding. Equity crowdfunding is interesting from a legal perspective because it involves an offer of securities to the public, which is regulated by securities laws in many jurisdictions. It is also seen by many as a way to fund small businesses which are denied funding through traditional means, e.g., from banks, finance companies, venture capitalists (VCs), angel investors and stock exchanges.<sup>3</sup> A number of jurisdictions have recently taken steps to remove restrictions to equity crowdfunding in their respective jurisdiction. For example, the United States enacted the Jumpstart Our Business Startups (JOBS) Act on 5 April 2012,<sup>4</sup> which carves out limited exemptions within the existing US securities regulatory framework for equity crowdfunding.<sup>5</sup> Various forms of exemptions for equity crowdfunding have also been enacted or proposed in countries such as Canada, Australia, New Zealand and Italy.<sup>6</sup>

The purpose of this article is to examine whether Singapore should undertake law reform to facilitate equity crowdfunding. Part II of this paper briefly describes the crowdfunding industry generally and its present status within Singapore. Part III examines the reasons for facilitating equity crowdfunding in Singapore. Part IV identifies existing regulations under Singapore law which (it is submitted) unnecessarily inhibit the development of equity crowdfunding. Finally, Part V identifies the key risks of equity crowdfunding while Part VI briefly explores a framework for tailored regulation to facilitate equity crowdfunding in Singapore.

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<sup>2</sup> See, e.g., Financial Conduct Authority, *The FCA's Regulatory Approach to Crowdfunding over the Internet, and the Promotion of Non-readily Realisable Securities by Other Media* (PS14/4 March 2014); Monetary Authority of Singapore, *Facilitating Securities-based Crowdfunding* (Consultation paper February 2015) at para.1.1.

<sup>3</sup> Steven Bradford, "Crowdfunding and the Federal Securities Laws" 2012 Colum. Bus. L. Rev. 1, 101.

<sup>4</sup> Jumpstart Our Business Startups Act, Pub. L. No. 112-106, 126 Stat. 306 (2012).

<sup>5</sup> The publication of detailed rules by the US Securities Exchange Commission implementing the JOBS Act is still pending as of the date of this paper.

<sup>6</sup> See Corporations and Markets Advisory Committee, *Crowd Sourced Equity Funding* (Report May 2014) for a summary of the positions in these jurisdictions.

## II. CROWDFUNDING IN SINGAPORE

Crowdfunding is a relatively recent phenomenon.<sup>7</sup> ArtistShare, a website launched in October 2003 which enables fans to fund artists' new creative projects, claims to be the first crowdfunding platform.<sup>8</sup> Kirby and Worner (2014) notes that modern peer-to-peer lending and equity crowd-funding started in the United Kingdom in 2006, spread to the United States in 2007 and took off in China in 2009.<sup>9</sup>

Singaporeans are no stranger to crowdfunding. According to Kickstarter, a United States (US) reward crowdfunding platform, Singapore contributed US\$6,710,981 dollars to projects on Kickstarter and ranked the number ten country in terms of investor contribution.<sup>10</sup> Singapore entrepreneurs have also successfully funded projects on Kickstarter: among the 52 projects shown to originate from Singapore as of 9 March 2015, 26 have been successfully funded, and six are new projects which have not reached the deadline for meeting their funding targets.<sup>11</sup> The numbers are understated because they do not include companies which are based in Singapore, but incorporated subsidiaries in the US, e.g., the 3D printer project founded by students at Nanyang Technological University.<sup>12</sup> A number of Singapore-based crowdfunding platforms have also emerged in recent years. Notably, two reward crowdfunding platforms, Crowdonomic<sup>13</sup> and Crowdtivate,<sup>14</sup> have been launched with the aim to facilitate entrepreneurship in Singapore and Asia.

Equity crowdfunding, however, is less common in Singapore. Only a few foreign

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<sup>7</sup> See Florian Danmayr, *Archetypes of Crowdfunding Platforms: A Multidimensional Comparison* (Wiesbaden : Springer Gabler 2014) Chap 1.

<sup>8</sup> ArtistShare's website <http://www.artistshare.com/v4/Home/About> (accessed 9 March 2015).

<sup>9</sup> Eleanor Kirby and Shane Worner, "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> (accessed 9 March 2015).

<sup>10</sup> Kickstarter website <https://www.kickstarter.com/1billion> (accessed 9 March 2015).

<sup>11</sup> Kickstarter website [https://www.kickstarter.com/discover/places/singapore-sg#/discover/advanced?category\\_id=0&woe\\_id=1062617&sort=magic&\\_suid=1425866228923010696719897305334](https://www.kickstarter.com/discover/places/singapore-sg#/discover/advanced?category_id=0&woe_id=1062617&sort=magic&_suid=1425866228923010696719897305334) (accessed 9 March 2015). The success rate is significantly higher than the average success rate for projects on Kickstarter, which is around 37 percent.

<https://www.kickstarter.com/help/stats> (accessed 9 March 2015).

<sup>12</sup> Trevor Tan, "Pirate3D: Its Buccaneer 3-D Printer Took the Crowdfunding World by Storm" *The Straits Times* 8 August 2014 <http://www.straitstimes.com/digital-life/more-digital-life-stories/story/pirate3d-its-buccaneer-3-d-printer-took-the-crowdfundin> (accessed 9 March 2015).

<sup>13</sup> Crowdonomic website <https://www.crowdonomic.com/files/uploads/Press%20release%20Crowdonomic%20Launch%20English%2021012013.pdf> (accessed 9 March 2015).

<sup>14</sup> Crowdtivate website <http://www.starhub.com/about-us/newsroom/2014/april/starhub-i3-introduces-online-social-launchpad-crowdtivate--to-co.html> (accessed 9 March 2015).

equity crowdfunding platforms enable companies featured on those platforms to raise funds from Singaporean investors. Examples of such platforms include Crowdcube, a leading UK-based equity crowdfunding platform, and Fundedbyme, a Swedish-based platform offering both reward and equity crowdfunding projects.

At present, there does not appear to be any consistent approach adopted by the platforms towards equity crowdfunding. Crowdcube takes an active role in overseeing the funding process. It conducts some due diligence on companies featured on the platform to ensure that the information they present is fair, clear and not misleading.<sup>15</sup> Each company has 60 days to raise its target amount. During the 60-day funding period, interested investors can indicate the amount they wish to invest (starting from 10 pounds) and fill in their payment details at Crowdcube. If the funding target is reached before the expiration of the funding period, Crowdcube will introduce the company to a law firm to prepare the necessary legal documents (e.g., articles of association). After legal documentation is completed, investors' money will be transferred to the company's bank account and share certificates can be issued. Investors will be sent a copy of the articles of association by electronic mail and given seven working days to review the same. During this period, investors are free to edit or withdraw their investment.<sup>16</sup> In contrast, Fundedbyme is less involved in the funding process. It purports to be a meeting platform and does not conduct any due diligence on the companies or help those companies complete the funding process after their funding targets are reached. The companies will contact interested investors directly to finalise the terms of their investment and to arrange for transfer of funds and issuance of shares.<sup>17</sup>

Domestic equity crowdfunding platforms are yet to emerge. Fundedhere purports to be Singapore's first equity crowdfunding platform, but it is yet to provide equity crowdfunding services.<sup>18</sup> As will be discussed below, the author believes that an important reason for the slow development of equity crowdfunding in Singapore is the existence of legal restrictions which make it impractical for small businesses to raise funds through equity crowdfunding.

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<sup>15</sup> Crowdcube website <https://www.crowdcube.com/pg/how-investing-on-crowdcube-works-41> (accessed 9 March 2015).

<sup>16</sup> Crowdcube FAQs <https://www.crowdcube.com/pg/crowdcube-faq-20> (accessed 9 March 2015).

<sup>17</sup> Fundedbyme website <https://www.fundedbyme.com/en/terms-of-service/> (accessed 9 March 2015).

<sup>18</sup> Fundedhere website <http://www.fundedhere.com/proposals> (accessed 9 March 2015).

## II. REASONS FOR FACILITATING EQUITY CROWDFUNDING

### A. Crowdfunding Exemptions in Other Jurisdictions

A number of jurisdictions have recently taken steps to remove restrictions to equity crowdfunding. For example, the United States has enacted the JOBS Act on 5 April 2012, which contains a framework for facilitating equity crowdfunding. Amongst other things, the JOBS Act:

- Creates a general equity crowdfunding exemption. Under this exemption, transactions of US\$1 million or less involving the offer of securities through a qualifying broker or funding portal are exempt from certain registration requirements and prohibitions.<sup>19</sup>
- Allows general solicitation for offers of securities to accredited investors.<sup>20</sup>

In Australia, the Corporations and Markets Advisory Committee (CMAC) has proposed the creation of a new type of public company, an exempt public company, to facilitate equity crowdfunding.<sup>21</sup> The company would be exempt for up to three to five years from certain compliance requirements for public companies, including requirements for continuous disclosure,<sup>22</sup> holding annual general meetings (AGM),<sup>23</sup> executive remuneration reporting,<sup>24</sup> appointment of an independent auditor and having financial reports audited (unless certain thresholds are met).<sup>25</sup> The CMAC has further proposed that eligible equity crowdfunding issuers should be subject to reduced disclosure requirements based on a disclosure template tailored for equity crowdfunding.<sup>26</sup>

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<sup>19</sup> See Title III of the JOBS Act.

<sup>20</sup> See Title II of the JOBS Act.

<sup>21</sup> Corporations and Markets Advisory Committee, *Crowd Sourced Equity Funding* (Report May 2014).

<sup>22</sup> Sections 111AC(1), 111AF, and Chapter 6CA of the Corporations Act.

<sup>23</sup> Section 250N of the Corporations Act.

<sup>24</sup> Section 300A of the Corporations Act.

<sup>25</sup> Sections 327A and 301 of the Corporations Act.

<sup>26</sup> Corporations and Markets Advisory Committee, *Crowd Sourced Equity Funding* (Report May 2014), para. 4.7.3.

## B. General Reasons for Facilitating Equity Crowdfunding

The main rationale for facilitating equity crowdfunding in these jurisdictions is the perceived need to increase funding resources for start-ups and small businesses. Start-ups and small businesses are major sources of innovation and economic growth.<sup>27</sup> They are a key element to a vibrant and resilient economy. However, a significant number of otherwise viable start-ups fail because they suffer from “capital gap”, that is, inability to raise the additional capital that they need to continue to the next stage of development.

A critical factor leading to the capital gap is the difficulty start-ups and small business have raising funds from traditional sources, e.g., banks, VCs and angel investors.<sup>28</sup> Commercial banks are profit-driven and risk-adverse; they are often reluctant to lend to young companies that do not have a proven track record in the absence of adequate security (which many start-ups and small business cannot provide).<sup>29</sup> Furthermore, with the implementation of minimum capital adequacy requirements under Basel III, banks are even less likely to lend to smaller businesses.<sup>30</sup> VCs tend to exclusively invest in start-ups with high-growth potential and a high likelihood of going public within a few years;<sup>31</sup> they typically have minimum investment thresholds that are much higher than the financial needs of start-ups and small businesses and are highly selective in their investment.<sup>32</sup> Angel investors are more willing to invest in start-ups. However, even in the United States where angel investment is more developed, there are still far fewer angel investors compared to the number of proposed projects.<sup>33</sup>

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<sup>27</sup> See, e.g., Corporations and Markets Advisory Committee, *Crowd Sourced Equity Funding* (Report May 2014), para.2.1.2;

<sup>28</sup> See, e.g., Steven Bradford, “Crowdfunding and the Federal Securities Laws” 2012 Colum. Bus. L. Rev. 1, 100-104.

<sup>29</sup> Gmeleen Tomboc, “The Lemons Problem in Crowdfunding” 30 J. Info. Tech. & Privacy L. 253, 256.

<sup>30</sup> Singapore Business Federation, SME Committee Recommendations for Budget 2013, para. 4.4. [http://www.sbf.org.sg/download/docs/sbfnews/pressroom/SME\\_Committee\\_Budget\\_2013\\_Recommendations\\_FINAL.pdf](http://www.sbf.org.sg/download/docs/sbfnews/pressroom/SME_Committee_Budget_2013_Recommendations_FINAL.pdf) (accessed 9 March 2015).

<sup>31</sup> Securities and Exchange Commission, Proposed Rules: Crowdfunding, pp.330-332 <http://www.sec.gov/rules/proposed/2013/33-9470.pdf> (accessed 9 March 2015).

<sup>32</sup> For example, in the United States, venture capitalists invest between 2 to 10 million in a company. See Gmeleen Tomboc, “The Lemons Problem in Crowdfunding” 30 J. Info. Tech. & Privacy L. 253, 256.

<sup>33</sup> Gmeleen Tomboc, “The Lemons Problem in Crowdfunding” 30 J. Info. Tech. & Privacy L. 253, 256.

Equity crowdfunding is expected to bridge this capital gap, providing much needed capital to start-ups and small business. Moreover, by injecting additional funds to the start-up industry, equity crowdfunding may increase competition between various suppliers of capital, resulting in lower costs of capital for start-ups. Equity crowdfunding also allows entrepreneurs to showcase their projects to a wider group of prospective investors and to demonstrate the existence of a market for their products or services, thereby making it easier for them to obtain subsequent funding from angel investors and VCs. A survey<sup>34</sup> of companies which have raised funds through major crowdfunding platforms shows that 28 percent of the companies obtained funding from angel investors or VCs within three months of the completion of the crowdfunding investing round, and an additional 43 percent were in discussions with institutional investors.<sup>35</sup> Another benefit of equity crowdfunding is that it enables local entrepreneurs to tap into the international funding market. For example, OurCrowd is an Israeli equity crowdfunding platform that attracts accredited investors worldwide to invest in Israeli start-up companies: only ten percent of its investors are from Israel (and more than 40 percent are from the US).<sup>36</sup> OurCrowd's strong international presence is evidenced by the fact that it has recently hosted a global investor summit which was attended by over 1000 investors from 27 countries.<sup>37</sup>

The second key reason for facilitating equity crowdfunding is that it helps bring entrepreneurs closer to their consumers at an earlier stage. Finding customers is not easy for start-ups and small businesses that lack financial resources to conduct extensive market research. Indeed, a 2014 survey of euro-zone small and medium enterprises (SMEs) revealed that finding customers was a pre-dominant concern amongst the surveyed SMEs.<sup>38</sup>

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<sup>34</sup> The survey was conducted by Nesta, the University of Cambridge, and the University of California, Berkeley.

<sup>35</sup> Congressional Testimony before the Subcommittee on Investigations, Oversight and Regulations of the United States House of Representatives Committee on Small Business, "SEC's Crowdfunding Proposal: Will it work for small business?" 16 January 2014, p. 41.

<sup>36</sup> Gwen Ackerman, "Israeli Startup Chips Away at Venture Capital's Ivory Tower" Bloomberg 1 August 2013 <http://www.bloomberg.com/news/articles/2013-07-31/israeli-startup-chips-away-at-venture-capital-s-ivory-tower> (accessed 9 March 2015).

<sup>37</sup> OurCrowd website <http://content.ourcrowd.com/global-investor-summit-2014> (accessed 9 March 2015).

<sup>38</sup> European Central Bank, *Survey on the Access to Finance of Small and Medium-sized Enterprises in the Euro Area, April 2014*, p.4 <http://www.ecb.europa.eu/pub/pdf/other/accesstofinancesmallmediumsizedenterprises201404en.pdf> (accessed 9 March 2015).

Understanding customer needs is essential for the success of any start-up. The recent “lean” start-up movement emphasises the importance for entrepreneurs to reach out to customers at the product development stage and to tailor their products in accordance with customer feedback.<sup>39</sup> Equity crowdfunding facilitates this strategy. It allows start-ups to test the market through pitching their ideas and products to the public as part of the crowdfunding process. Entrepreneurs benefit from the process even if they fail to attract sufficient investors: they are able to save the costs of developing products/services which are unlikely to be well-received by the market. The Alternative Finance Industry Report confirms that entrepreneurs report having received various non-financial supports from investors through equity crowdfunding, including networking and connections, proof of concept/market validation, marketing/advocacy, help with their expertise and knowledge, help with follow-on funding, and assistance with business/product development.<sup>40</sup>

### C. Reasons for Facilitating Equity Crowdfunding in Singapore

The above-mentioned rationales for facilitating equity crowdfunding apply equally in Singapore. SMEs are an important pillar of Singapore’s economy. They consistently account for over 99 percent of all registered enterprises in Singapore<sup>41</sup> as well as contributing more than 50 percent of economic output and 70 percent of employment.<sup>42</sup> In 2012, about 39,000 out of the total SME population are active startups, i.e., enterprises less than five years old which has at least one employee.<sup>43</sup>

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<sup>39</sup> Stephen Blank, *The Four Steps to the Epiphany: Successful Strategies for Products that Win* (Foster City, California, 2<sup>nd</sup> edition, 2006); Eric Ries, *The Lean Startup: How Today's Entrepreneurs Use Continuous Innovation to Create Radically Successful Businesses* (New York: Crown Business, 2011).

<sup>40</sup> Peter Baeck, Liam Collins & Bryan Zhang, *Understanding Alternative Finance, the UK Alternative Finance Industry Report*, November 2014, p.57  
<http://www.nesta.org.uk/sites/default/files/understanding-alternative-finance-2014.pdf> (accessed 9 March 2015).

<sup>41</sup> Keith Pond, “Bank Lending Operations in the SME Market – A Case Study from Singapore”  
[http://www.wbiworldconpro.com/uploads/singapore-conference-2014/banking/1408440853\\_609-Pond.pdf](http://www.wbiworldconpro.com/uploads/singapore-conference-2014/banking/1408440853_609-Pond.pdf) (accessed 9 March 2015).

<sup>42</sup> Ministry of Trade and Industry, “Government Enhances Support for SMEs to Achieve Quality Growth”, 11 Mar 2013, para. 3. <http://www.mti.gov.sg/NewsRoom/Pages/GOVERNMENT-ENHANCES-SUPPORT-FOR-SMEs-TO-ACHIEVE-QUALITY-GROWTH.aspx> (accessed 9 March 2015).

<sup>43</sup> Spring Singapore’s website <http://www.spring.gov.sg/NewsEvents/PR/Pages/New-Private-Sector-Leadership-at-Action-Community-for-Entrepreneurship-Set-to-Lead-Engage-Singapore-Start-Up-Commu-20140929.aspx> (accessed 9 March 2015).

According to the World Bank Ease of Doing Business Index for 2014, Singapore ranks number one in the world in ease of doing business and sixth in starting one.<sup>44</sup> It is also considered one of the jurisdictions that have the most SME-friendly policies among the major markets.<sup>45</sup> However, a brief survey of the main start-up funding sources in Singapore below shows that the government plays a pre-dominant role in funding start-ups. It is estimated that close to 70 percent of the early stage funding sources are primarily backed by the government.<sup>46</sup> It is submitted that equity crowdfunding has a crucial role to play in supporting worthwhile start-ups that are unable to receive government funding and in diversifying the financial resources available for start-ups generally.

#### (1) Access to Traditional Funding Sources

The main sources of finance for start-ups in Singapore include commercial banks, VCs, angel investors, and the government.<sup>47</sup> The costs of raising funds from stock exchanges or trading platforms are likely to be prohibitively high for start-ups.<sup>48</sup>

##### (a) Commercial Banks

Commercial banks in Singapore, like banks in other jurisdictions, are profit-driven risk-adverse entities. To encourage bank lending to SMEs, the Singapore government introduced the Micro Loan Programme (MLP) in 2001. Under the MLP, the government shares 50 percent of the default risks on loans of up to S\$100,000 by commercial banks to eligible SMEs. The minimum interest rate is 5.5 percent per annum and the maximum tenure of such loans is four years. To be eligible, an SME must (1) be registered and operates in Singapore; (2) have no more than ten

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<sup>44</sup> World Bank Group's website <http://www.doingbusiness.org/rankings> (accessed 9 March 2015).

<sup>45</sup> The Association of Chartered Certified Accountants, *Global SME Performance Review 2013/14*, October 2014 <http://www.accaglobal.com/content/dam/acca/global/PDF-technical/small-business/pol-tp-bitg.pdf> (accessed 9 March 2015).

<sup>46</sup> Spring Singapore's website, Entrepreneurship Review Committee (ENRC) Unveils Eight Recommendations to Enhance Entrepreneurship Landscape, 17 January 2014. <http://www.spring.gov.sg/NewsEvents/PR/Pages/Entrepreneurship-Review-Committee-Unveils-Eight-Recommendations-to-Enhance-Entrepreneurship-Landscape-20140117.aspx> (accessed 9 March 2015).

<sup>47</sup> Financial Handbook for SMEs [http://www.abs.org.sg/pdfs/Financial/SMEs\\_Publications/Financial\\_Handbook\\_For\\_SME\\_29Mar07.pdf](http://www.abs.org.sg/pdfs/Financial/SMEs_Publications/Financial_Handbook_For_SME_29Mar07.pdf) (accessed 9 March 2015).

<sup>48</sup> For example, the estimated costs of raising funds through OTC Capital, a trading platform for unlisted companies, are around S\$250,000 to S\$350,000. <http://www.tradechakra.com/economy/singapore/over-the-counter-capital-in-singapore-48.php> (accessed 9 March 2015).

employees or have annual sales of no more than S\$1 million; (3) have at least 30 percent local shareholding; and (4) if it belongs to a group, the group must have no more than 200 employees or have annual sales of no more than S\$100 million.<sup>49</sup> Despite that the government bears 50 percent of the default risks, commercial banks are still reluctant to lend to young companies. Most banks would require corporate borrowers to have at least two or three years of operating experience.<sup>50</sup> For example, DBS, one of the most popular banks for SMEs in Singapore, requires companies applying for government-assisted micro loans to provide financial statements for the past two years.<sup>51</sup> As a result, an enhanced MLP was introduced in 2014 to further encourage lending to younger SMEs with less than three years of operating history. Under the enhanced MLP, the government shares 70 percent of default risks in respect of micro loans of up to S\$100,000 to companies which are less than three years old.<sup>52</sup> Since banks have the ultimate power to decide whether and under what terms a loan should be granted, it is doubtful whether the enhanced MLP can significantly boost lending to start-ups. For instance, although the OCBC bank has recently introduced a programme under the enhanced MLP, it is only available to borrowers who are able to provide guarantor(s) for their loan.<sup>53</sup> Finding a guarantor is likely to be difficult for start-ups since they are considered highly risky businesses and have an estimated failing rate of 70 percent in the first year.<sup>54</sup>

Further, the existence of programmes such as MLP and enhanced MLP implies that, in the absence of government assistance, commercial banks would be reluctant to lend to SMEs and to start-ups in particular. Therefore, it is likely to be difficult for start-ups which do not qualify for MLP or enhanced MLP (e.g., if it requires a loan of a longer tenure) to secure funding from the banks. In any event, bank loans may not be

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<sup>49</sup> Spring Singapore's website, Micro Loan Programme <http://www.spring.gov.sg/Growing-Business/Loan/Pages/micro-loan-programme.aspx> (accessed 9 March 2015).

<sup>50</sup> Zhang Zhi Yang, "IPS Closed Door Discussion: Financing for SME Development in Singapore", August 2014 [http://lkyspp.nus.edu.sg/ips/wp-content/uploads/sites/2/2014/08/4-IPS-Closed-Door-Discussion-Financing-for-SME-Development-in-Singapore\\_4.pdf](http://lkyspp.nus.edu.sg/ips/wp-content/uploads/sites/2/2014/08/4-IPS-Closed-Door-Discussion-Financing-for-SME-Development-in-Singapore_4.pdf) (accessed 9 March 2015).

<sup>51</sup> DBS website <https://www.dbs.com.sg/sme/financing/working-capital/micro-loan.page> (accessed 9 March 2015).

<sup>52</sup> Spring Singapore's website, Micro Loan Programme <http://www.spring.gov.sg/Growing-Business/Loan/Pages/micro-loan-programme.aspx> (accessed 9 March 2015).

<sup>53</sup> OCBC website <http://www.ocbc.com.sg/business-banking/loans/micro-loan.html> (accessed 9 March 2015).

<sup>54</sup> Minister Lim Hng Kiang's Written Reply to Parliament Question on Business Failure Rates amongst Singapore SMEs 14 Aug 2012 <http://www.mti.gov.sg/NewsRoom/Pages/Minister-Lim-Hng-Kiang's-Written-Reply-to-Parliament-Question-on-Business-Failure-Rates-amongst-Singapore-SMEs.aspx> (accessed 9 March 2015).

suitable for start-ups. It can take a few months or years for some start-ups to generate profits to meet the periodic repayment requirements under bank loans. Even after they do, their cash flow may be volatile, making it harder for them to meet repayments.<sup>55</sup>

(b) VCs and Angel Investors

As noted earlier, VCs’ selectivity, narrow focus and minimum investment thresholds make them inaccessible to most start-ups. Angel investors are more active in investing in start-ups. They are typically high net worth individuals or successful businessmen with an appetite for young companies with higher risks.<sup>56</sup> Nevertheless, angel investment remains a limited funding source for start-ups in Singapore. Like VCs, angel investors are interested in limited types of companies, i.e., companies with high growth potential within a few years.<sup>57</sup> Moreover, angel investment is still relatively new in Singapore.<sup>58</sup> The most well-known Singapore-based angel investment group, Business Angel Network (Southeast Asia) (BANSEA), only introduces up to three proposals to its members every month.<sup>59</sup> Since 2007, its members have only invested in a total of 44 projects (or an average of 6 projects each year) in Singapore.<sup>60</sup>

The government has introduced a number of incubation and co-investment programmes to encourage VC and angel investment. The table below summarises the main programmes which have been introduced to date.

Programme	Stated Purpose	Industry Focus	Funding Cap	Professional Investor Involvement	Other Notes
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<sup>55</sup> Australian Government, *Crowd-sourced Equity Funding* (Discussion Paper December 2014), para. 1.2.

<sup>56</sup> Business Angel Network Southeast Asia (BANSEA) website [http://www.bansea.org/index.php?option=com\\_content&view=article&id=89&Itemid=196](http://www.bansea.org/index.php?option=com_content&view=article&id=89&Itemid=196) (accessed 9 March 2015).

<sup>57</sup> For example, members of the BANSEA are generally interested in “companies that they believe have the potential to grow to more than \$50 million in annual revenue within five years.” [http://www.bansea.org/index.php?option=com\\_content&view=article&id=89&Itemid=196](http://www.bansea.org/index.php?option=com_content&view=article&id=89&Itemid=196) (accessed 9 March 2015).

<sup>58</sup> Wong Poh Kam, “Overview of Angel Investing in Singapore” <https://www.techinasia.com/overview-of-angel-investing-in-singapore/> (accessed 20 February 2015).

<sup>59</sup> Business Angel Network Southeast Asia (BANSEA) website [http://www.bansea.org/index.php?option=com\\_content&view=article&id=89&Itemid=196](http://www.bansea.org/index.php?option=com_content&view=article&id=89&Itemid=196) (accessed 9 March 2015).

<sup>60</sup> Business Angel Network Southeast Asia (BANSEA) website [http://www.bansea.org/index.php?option=com\\_content&view=article&id=85&Itemid=190](http://www.bansea.org/index.php?option=com_content&view=article&id=85&Itemid=190) (accessed 9 March 2015).

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<p>IDM Jump-start and Mentor (i.JAM)<sup>61</sup></p>	<p>To support start-ups and individuals with breakthrough ideas that can be developed into innovative products/ services</p>	<p>Interactive Digital Media</p>	<p>Tier 1 Funding: up to \$50,000;  Tier 2 Funding: up to S\$100,000</p>	<p>Tier 1 Funding: grants are provided through appointed incubators;  Tier 2 Funding: the start-up must secure matching funds from the incubator/independent third party</p>	<p>Requirements for:</p> <ul style="list-style-type: none"> <li>- the start-up;<sup>62</sup></li> <li>- founders of the start-up;<sup>63</sup></li> <li>- the incubator /third party investor;<sup>64</sup></li> <li>- use of the government grant.<sup>65</sup></li> </ul>
<p>Technology Incubation Scheme (TIS)<sup>66</sup></p>	<p>To commercialise cutting-edge technologies through the formation of start-ups; and  To encourage universities and</p>	<p>Unspecified. However, the funded companies generally fall within four sectors: Biotech and</p>	<p>Up to S\$500,000</p>	<p>The start-up must be recommended by one of the 14 appointed technology incubators;  A technology incubator must invest at least 15 percent of</p>	<p>The relevant start-up must be based in Singapore.</p>

<sup>61</sup> i.JAM webpage <http://www.idm.sg/guidelines/> (accessed 9 March 2015).

<sup>62</sup> Eligible start-ups must (1) have an asset value of not more than S\$200,000; (2) have an operational period of not more than five years; (3) not have received government grants; (4) not have received more than S\$200,000 in external investment.

<sup>63</sup> There must be at least (1) one local full time founder, who shall constitute at least 20 percent of the project members or hold at least 20 percent equity stake; and (2) one competent technical founder.

<sup>64</sup> Total participation by the incubator and/or the third party investor is capped at 30 percent.

<sup>65</sup> The project funding monies disbursed by the government must be spent for work done in Singapore.

<sup>66</sup> TIS webpage <http://www.nrf.gov.sg/innovation-enterprise/national-framework-for-research-innovation-and-enterprise/technology-incubation-scheme> (accessed 9 March 2015).

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	polytechnics to pursue academic entrepreneurship	Pharmaceutical; Information communication technology; Medical Device; and Engineering. <sup>67</sup>		the equity in and provide guidance to the start-up;  The technology incubator will be given an option to buy out the government's stake in the start-up.	
Early Stage Venture Fund (ESVF) <sup>68</sup>	Same as above.	High-tech industry	Up to S\$10 million on each eligible VC fund.	The VC fund must co-invest with the government on a 1:1 matching basis;  The VC fund will be given an option to buy out the government's stake in the fund.	The VC fund must invest in Singapore-based early stage high-tech companies.
Sector Specific Accelerators (SSA) <sup>69</sup>	To encourage the formation and growth of start-ups in strategic but nascent sectors, such as medical and clean technology	Medical and clean technology	Unclear (S\$70 million total has been committed under this programme)	Appointed accelerators will identify, provide guidance to and co-invest (with the government on a 1:1 basis) in eligible start-ups.	The SSA was established in 2015;  Only four accelerators have been appointed so

<sup>67</sup> See the list of companies funded by the National Research Foundation (NRF) (divided by sector) <http://www.nrf.gov.sg/innovation-enterprise/nrf-seeded-companies> (accessed 9 March 2015).

<sup>68</sup> ESVF webpage <http://www.nrf.gov.sg/innovation-enterprise/national-framework-for-research-innovation-and-enterprise/early-stage-venture-fund> (accessed 9 March 2015).

<sup>69</sup> SSA webpage <http://www.spring.gov.sg/Nurturing-Startups/Pages/sector-specific-accelerator.aspx> (accessed 9 March 2015).

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					far.
SPRING Startup Enterprise Development Scheme (SPRING SEEDS) <sup>70</sup>	To invest in Singapore-based start-ups with innovative products/processes with intellectual content and strong growth potential across international markets	Unspecified.	Up to S\$1 million;  The first round of investment is usually limited to S\$300,000.	The start-up must have a ready, independent third-party investor.	Requirements for:  - The start-up; <sup>71</sup> and  - The third party investor.  <sup>72</sup>
Business Angel Scheme (BAS) <sup>73</sup>	To invest in growth-oriented, innovative start-ups.	Unspecified.	Up to S\$1.5 million.	The start-up must secure investment from a participating business angel investor which co-invests with the government on a 1:1 basis.	Requirements for the start-up. <sup>74</sup>

<sup>70</sup> Spring Singapore website <http://www.spring.gov.sg/Nurturing-Startups/SEEDS/Pages/spring-start-up-enterprise-development-scheme.aspx> (accessed 9 March 2015).

<sup>71</sup> The start-up must (1) be a Singapore-based company with core activities carried out in Singapore; (2) be incorporated as a private limited company for less than five years; and (3) have paid-up capital between S\$50,000 and S\$1 million.

<sup>72</sup> The third party investor must (1) be independent and objective, and not have prior interest in the company; (2) (if a corporate investor) have a minimum paid-up capital of S\$500,000; (3) be able to contribute to the startup's growth and should possess the management experience, relevant business contacts and/or necessary technical expertise that can add value to the startup; (4) take up a board seat in the startup; (5) invest at least S\$75,000 into the start-up and conduct due diligence on the company.

<sup>73</sup> BAS website <http://www.spring.gov.sg/Nurturing-Startups/Pages/business-angel-scheme.aspx> (accessed 9 March 2015).

<sup>74</sup> The start-up must (1) be Singapore-based with core activities carried out in Singapore; (2) be incorporated as a private limited company and for less than 5 years; and (3) have paid-up capital of between S\$50,000 and S\$1 million.

The above-mentioned governmental programmes have played a critical role in boosting Singapore's entrepreneurial ecosystem. However, they have a number of limits.

First, these programmes generally provide funding for innovative and/or high-tech companies and hence are more tailored for companies in certain industries. Although the TIS and ESVF are not expressly limited to companies in specific sectors, the companies which have been funded under these programmes generally fall within four sectors: biotech and pharmaceutical, information communication technology, medical device, and engineering.<sup>75</sup> Other programmes, such as i.JAM and SSA, target companies in particular industries. This means that start-ups in low-tech industries, e.g., design firms and catering companies, usually would not benefit from these government programmes.

Second, some programmes have requirements which a significant number of start-ups may not be able to satisfy. For example, i.JAM requires that the start-up must have at least (1) one local full time founder, who shall constitute at least 20 percent of the project members or hold at least 20 percent equity stake; and (2) one competent technical founder. Both SPRIND SEEDS and BAS require that the start-up must (1) be Singapore-based with core activities carried out in Singapore; and (2) have paid-up capital of at least S\$50,000. More significantly, all programmes require that the start-up has found an independent third party that is not only willing to invest in the start-up, but also to nurture and guide it (or in case of SPRING SEEDS, directly manage it). Except for SPRING SEEDS, the third party must be from a list of persons which have been approved by the government for the relevant programme. Given the limited number of approved persons and the degree of financial and other commitment required to support a start-up, the number of start-ups that can benefit from each programme is necessarily limited. SPRING SEEDS, for example, funded about 27 companies in 2009 and 15 in 2010.<sup>76</sup>

Third, the application process for certain programmes can take a long time. The estimated processing time for i.JAM is six to nine weeks. However, some applicants

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<sup>75</sup> See the list of companies funded by the National Research Foundation (NRF) (divided by sector) <http://www.nrf.gov.sg/innovation-enterprise/nrf-seeded-companies> (accessed 9 March 2015).

<sup>76</sup> SPRING SEEDS Capital Investment Profile Publication 2010, p3; SPRING SEEDS Capital Investment Profile Publication 2011, p.2.

have allegedly waited up to 12 months for the funding conditions to be finalised and for the completion of the relevant paperwork.<sup>77</sup> This can be frustrating for entrepreneurs who are eager to test their ideas in the market, especially where timing is of critical importance for the proposed project.

### (c) Government Grants

Apart from incubation/co-investment programmes, start-ups can also apply for cash grants from the government. Grants are typically one-off cash payments to help individuals start their businesses, the most important of which are listed in the table below.

Programme	Stated Purpose	Industry Focus	Funding Cap	Requirements on the Applicant	Other Notes
Technology Enterprise Commercialisation Scheme (TECS) <sup>78</sup>	To catalyse the formation and growth of start-ups based on strong technology intellectual property (IP) and a scalable business model	Electronics, Photonics & Device Technologies; Chemicals, Advanced Materials & Micro/Nanotechnologies ; Information & Communications Technologies; Biomedical Sciences (excluding drug	Up to S\$250,000 for proof-of-concept projects; Up to S\$500,000 for proof-of-value projects.	Requirements for the start-up <sup>79</sup>	The eligible project must be of a breakthrough level of innovation and lead to or build on proprietary know-how/IP

<sup>77</sup> i.JAM revamp? Entrepreneurs, investors weigh in on what it needs to do to stay relevant <https://www.techinasia.com/i-jam-revamp-entrepreneurs-investors-weigh-in-on-what-it-needs-to-do-to-stay-relevant/> (accessed 20 February 2015).

<sup>78</sup> TECS webpage <http://www.spring.gov.sg/Nurturing-Startups/Pages/technology-enterprise-commercialisation-scheme.aspx> (accessed 9 March 2015).

<sup>79</sup> The start-up must (1) be registered for less than five years; (2) have at least 30 percent local shareholding; (3) have an annual sales turnover of not more than S\$100 million or employs not more than 200 workers; and (4) carry out its core activities in Singapore.

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		discovery)			
Proof-of-concept grant (POC)	To commercialise cutting-edge technologies through the formation of start-ups; and  To encourage universities and polytechnics to pursue academic entrepreneurship	All areas of science and technology.  However, the funded companies generally fall within four sectors:  Biotech and Pharmaceutical;  Information communication technology;  Medical Device; and  Engineering. <sup>80</sup>	Up to S\$250,000 per project	Staff, researchers and students linked to institutes of higher learning; and  Researchers in public sector research institutes.	Calls for proposals are issued half-yearly
The ACE Start-ups Grant (ACE) <sup>81</sup>	To support entrepreneurial Singaporeans to take their first step in starting differentiated businesses	The following business ideas are excluded:  nightclubs, lounges, bars;  foot reflexology, massage parlours;  gambling;  prostitution, social	ACE will match S\$7 to every S\$3 raised by the entrepreneur for up to S\$50,000; start-ups in a capital	Requirements for:  the applicant; <sup>82</sup>  and  the start-up. <sup>83</sup>	Calls for proposals are issued bi-monthly.

<sup>80</sup> See the list of companies funded by the National Research Foundation (NRF) (divided by sector) <http://www.nrf.gov.sg/innovation-enterprise/nrf-seeded-companies> (accessed 9 March 2015).

<sup>81</sup> ACE webpage [https://www.enterpriseone.gov.sg/en/Government%20Assistance/Grants/Start-Ups/~/\\_media/8FB95C3A7CCB45B7AC6618FE25F19A18.ashx](https://www.enterpriseone.gov.sg/en/Government%20Assistance/Grants/Start-Ups/~/_media/8FB95C3A7CCB45B7AC6618FE25F19A18.ashx) (accessed 9 March 2015).

<sup>82</sup> The applicant must be a Singapore citizen or permanent resident who (1) is a first-time entrepreneur; (2) holds at least 51 percent equity in the company; (3) is the key decision maker and committed to the company on a full-time basis; and (4) has parental consent if s/he is below 18 years old.

<sup>83</sup> The start-up must not (1) be registered or incorporated for more than 6 months at the date of submission; or (2) have received any funding for the proposed business idea from another government agency.

		escort services;  employment agencies;  geomancy.	intensive industry may apply for an additional S\$50,000.		
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Existing government grants suffer from similar limitations as those outlined in respect of the incubation/co-investment programmes discussed above.

To begin with, except for ACE, the grants are clearly tailored for high-tech and innovative companies in specified sectors.

Additionally, each programme has requirements that many applicants would find difficult to satisfy. For example, TECS requires that the eligible project be of a breakthrough level of innovation and lead to or build on proprietary know-how/IP. POC is only eligible for application by staff, researchers and students linked to institutes of higher learning and researchers in public sector research institutes. ACE, on the other hand, is only available to applicants who (1) are Singapore citizens or permanent residents; (2) are first-time entrepreneurs; (3) hold at least 51 percent equity in the company; and (4) are the key decision makers and committed to the company on a full-time basis. Moreover, the applicant is required to raise 3/7 of the funds he needs before ACE would provide the remaining 4/7.

Further, applications for grants are open only periodically, which adds a few more months to the funding process. For example, calls for proposals are issued half yearly for POC and bi-monthly for ACE.

## (2) Adequacy of Existing Funding for Startups and Small Businesses – Equity Crowdfunding to Fill the Gap

Despite the government’s commendable efforts to promote entrepreneurship, there is still likely to be a funding gap for start-ups, especially for those that do not qualify for

the various government-assisted programmes outlined above. The presence of multiple government schemes to encourage VC and angel investment in specific sectors might also reduce the amount of funding which otherwise would have been directed to other sectors. The Deputy Prime Minister Teo Chee Hean noted in his speech at the Techventure conference on 25 September 2013 that “there is still a lack of early-stage financing in Singapore” (the government’s response was to commit another S\$50 million to the ESVF programme).<sup>84</sup> In 2014, OCBC Bank also claimed to have found in a survey with young businesses that “50 percent of young businesses in Singapore require funding to kickstart their business”.<sup>85</sup>

It is submitted that equity crowdfunding has a meaningful and significant role to play in Singapore by filling the capital gap to support some of the 50,000 new businesses being set up every year.<sup>86</sup> Experience in the United Kingdom has shown that equity crowdfunding can be used to support start-ups in industries that do not involve high technology. According to Crowdcube, one of the biggest UK equity crowdfunding platforms, traditional industries such as food & drink, sports and leisure, and the retail industry are among the sectors which were most funded on Crowdcube in 2013.<sup>87</sup>

More fundamentally, crowdfunding may be a better means for financing startups and small businesses selling consumer products and/or services than through government grants and/or co-investment programmes.

To begin with, it is arguable that the public (as a collective body) would be at least as good (if not better) than the government in spotting marketable consumer products and/or services. The reason for this is obvious: the crowd is likely, to a significant extent, to be representative of the consumers which the products and services will eventually be marketed to. Consequently, the crowd’s determination of the marketability of the product or service is likely to be a good indicator of how the market will eventually view the product or service being offered. There is a limited

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<sup>84</sup>Speech By Mr Teo Chee Hean, Deputy Prime Minister, Coordinating Minister For National Security and Minister for Home Affairs, at Techventure 2013, 25 September 2013, para. 13. [http://www.news.gov.sg/public/sgpc/en/media\\_releases/agencies/pmo-nrf/speech/S-20130925-1.html](http://www.news.gov.sg/public/sgpc/en/media_releases/agencies/pmo-nrf/speech/S-20130925-1.html) (accessed 9 March 2015).

<sup>85</sup> OCBC Bank Introduces Business Loan for Start-ups as Young as Six Months Old, April 2014 <https://www.ocbc.com/assets/pdf/Media/2014/April/OCBC%20Business%20First%20Loan%2030%20Apr%202014.pdf> (accessed 9 March 2015).

<sup>86</sup> Based on the Singapore Business Formation Statistics Report, the number of new businesses set up are 60,140 (2013), 56,681 (2012) and 55,699 (2011).

<sup>87</sup> Crowdcube Infographic <https://www.crowdcube.com/infographic> (accessed 9 March 2015).

body of empirical studies that have sought to test the collective wisdom of the crowd: Mollick & Nanda (2014) compared the decisions of the crowd and that of the expert in funding theatre projects. They randomly assigned sets of theatre projects featured on Kickstarter to experts (i.e., people who have expertise judging theater applications for various art institutions) to evaluate. Each set consists of both projects which failed and succeeded in obtaining funding from the crowd through Kickstarter; and the projects were presented in the same way as they were on Kickstarter. They reached two interesting conclusions: first, the expert and the crowd agreed on which projects to fund in the majority of the cases; second, the long-term outcome of the projects which were funded by both the crowd and the expert and those funded by the crowd alone were largely similar.<sup>88</sup>

Secondly, equity crowdfunding is a more transparent means of funding private businesses. At the moment, there is little public information on which companies receive government funding through government programmes (such as BAS or SPRING SEEDS<sup>89</sup>) or on how well those companies perform over the years. In contrast, such information would be publicly available if such financing took place through equity crowdfunding.

Equity crowdfunding is also likely to be a fairer means of financing as it allows the investing public to reap some of the benefits of the business in the event it succeeds. This must be contrasted with the present situation where taxpayers are effectively forced, through government grants or co-investment programmes, to bear the costs of private risk-taking with little chance to enjoy the benefits in the event the risk pays off. For example, whereas the government bears 70 percent of the default risks under the enhanced MLP programme, the commercial banks enjoy 100 percent of the benefits if the borrower pays off his debt. Moreover, a number of government co-investment programmes, such as TIS and ESVF, give an option to the government's co-investors to buy out the government's stake in the event that the start-up they invest in turn out to be successful. This essentially limits the amount of benefits the government can receive from investing in start-ups. With equity crowdfunding, the

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<sup>88</sup> Ethan Mollick & Ramana Nanda, "Wisdom or Madness? Comparing Crowds with Expert Evaluation in Funding the Arts" Working Paper 14-116 June 20, 2014 <http://ssrn.com/abstract=2443114> (accessed 9 March 2015).

<sup>89</sup> Indeed, such information is considered confidential by Spring Singapore, which administers these two programmes.

profits of the business which has been financed by the public would be distributed to a wider cross-section of society instead of simply being put into the pocket of the bank, VC/angel investor or the business owner.

On another level, allowing equity crowdfunding to fill the capital gap would free up government funds to be put to better use. For example, tax-dollars presently used to fund SMEs and startups through grants and co-investment programmes could instead be used to support fundamental or basic research. Government funding of such research is important because, while such research is extremely important, commercial returns on such research are speculative and would take so long that it would be very difficult to find any commercial investors willing to invest in such research.<sup>90</sup>

### PART III: PROVISIONS UNDER SINGAPORE LAW WHICH PROHIBIT EQUITY CROWDFUNDING

A number of provisions under Singapore law make it costly for small businesses in Singapore to engage in equity crowdfunding. This article focuses on the following restrictions in particular: first, the requirement that an offer of securities must be accompanied by a prospectus (the “prospectus requirement”); secondly, restrictions against advertising an offer of securities which is exempt from the prospectus requirement; and, thirdly, the shareholder cap for private companies.

#### A. Prospectus Requirement

As equity crowdfunding involves an offer of securities, it is subject to the prospectus requirement set out in the Securities and Futures Act (Cap. 289) (the “SFA”). Section 240 of the SFA would require a start-up company seeking to make offerings of its shares (the “issuer”)<sup>91</sup> to prepare and register with the Monetary Authority of Singapore (“MAS”) a prospectus complying with Section 243 of the SFA. Section 243 of the SFA in turn would require the prospectus to contain all the information that

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<sup>90</sup> Mariana Mazzucato, *The Entrepreneurial State: Debunking Public vs. Private Sector Myths* (London : Anthem Press, 2013), pp60-61.

<sup>91</sup> For simplicity, it will be assumed that the person making an offer of securities is the company whose shares underlie the offer. The company will be referred to as the issuer throughout the paper.

investors and their professional advisers would reasonably require to make an informed assessment of (a) the rights and liabilities attaching to the shares; (b) the assets and liabilities, profits and losses, financial position and performance, and prospects of the issuer; and (c) any additional requirements specified by the MAS.<sup>92</sup> For offers of unlisted shares, the additional particulars that a prospectus must contain can be found in the Sixth Schedule to the Securities and Futures (Offers of Investments) (Shares and Debentures) Regulations 2005. The Sixth Schedule is fairly extensive and contains over two hundred paragraphs and sub-paragraphs. The costs of complying with the prospectus requirement are likely to be disproportionately high for startups or small companies intending to raise the relatively modest sums they need. The legal costs of conducting due diligence on the company and its officers, drafting and reviewing a prospectus, as well as liaising with the MAS and the company's other professional advisers (e.g., accountants) can easily run into tens of thousands of dollars; even assuming a conservative hourly charge out rate of S\$ 300 per hour and a similarly conservative 100 hours of work to prepare and register the prospectus, that would mean S\$ 30,000 in legal costs. This does not include auditing fees, which can easily come up to several thousand more Singapore dollars. Companies that engage in crowdfunding often provide profit forecasts to attract investors and justify their offer price; if such forecasts are provided in the prospectus, an auditor's opinion is required.<sup>93</sup> Other fees and expenses can add another few thousand. For example, the fee for lodging a prospectus with the MAS is S\$ 2,000.

This means that a company seeking to raise modest financing in the sum of S\$ 100,000 can easily end up spending more than 30 percent of this sum up-front in complying with the prospectus requirement. Critically, there is no guarantee that the company will get any funding even after incurring these up-front costs. Many crowdfunding platforms have an all-or-nothing policy, that is, if a company does not meet its funding target within the specified funding period, it is not entitled to keep any of the funds it has raised during that period. According to Crowdcube, only about 24 percent of the offers on its website eventually reach their funding targets.<sup>94</sup>

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<sup>92</sup> Sections 243 (1) and (3) of the Securities and Futures Act (SFA).

<sup>93</sup> Para.10 of Part IV of the Sixth Schedule to the Securities and Futures (Offers of Investments) (Shares and Debentures) Regulations 2005.

<sup>94</sup> Crowdcube Infographic <https://www.crowdcube.com/infographic> (accessed 9 March 2015).

What this means is that, the prospectus requirement, if applied to equity crowdfunding, are likely to render equity crowdfunding impractical for the businesses that need it the most.

## B. Exemptions from the Prospectus Requirement

The SFA does contain a number of exemptions from the prospectus requirement. However, as will be discussed below, equity crowdfunding is unlikely to fall within the ambit of these exemptions.

### (1) Exemption for Small offers

Section 272A of the SFA exempts certain small offers in Singapore from the prospectus requirement. To qualify for the exemption, a small offer must meet, amongst others, the following requirements:

- (a) The offer must be a personal offer; and
- (b) The total amount of the offer within any 12 months must not exceed S\$ 5 million.

However, for the reasons set out below, it is unlikely that companies undertaking equity crowdfunding will be able to bring themselves within the scope of this exemption.

To begin with, offers made through a crowdfunding platform arguably do not fall within the type of offers that would be considered “personal” by the MAS. Section 272A(3) of the SFA provides that a personal offer is one that:

- (a) may be accepted only by the person to whom it is made; and
- (b) made to a person who is likely to be interested in that offer, having regard to
  - (i) any previous contact or connection between the offeror and that person; or
  - (ii) any previous indication by that person to

- A. the offeror; or
- B. a specified person

that he is interested in offers of that kind.<sup>95</sup>

Specified persons are (broadly speaking) persons who are authorised to deal in securities or to provide financial advisory services concerning investment products in Singapore or a foreign jurisdiction.<sup>96</sup>

The MAS guidelines on the small offers exemption explain that this exemption was introduced to make fundraising less costly for SMEs.<sup>97</sup> The MAS noted that SMEs were most likely to raise funds from VCs, angel investors, associates as well as family and friends, who “would have access to alternative sources of information and would not need to rely on a prospectus as a basis for assessing the business and its viability and commerciality.”<sup>98</sup> Therefore, the first limb of the exemption, i.e., offers made to persons with previous contact or connection with the offeror, are meant to cover persons who already have access to the information that would have been included in a prospectus, including for example the offeror’s family members and controlling shareholders.<sup>99</sup> The second limb of the exemption, i.e., offers made to persons that have indicated its interest to the offeror or a specified person, are meant to facilitate offers of securities to VCs and angel investors, which are likely to have the relevant professional experience and expertise to evaluate the securities being offered without requiring a prospectus.<sup>100</sup> Since SMEs may have limited contacts, they are allowed to enlist help from specified persons to make offers to VCs and angel investors with whom they have no previous connection. However, the MAS guidelines specifically require SMEs to ensure that such specified persons have proper “know your client” (KYC) and pre-qualification procedures to ensure that offers are made only to

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<sup>95</sup> Section 273(3) of SFA.

<sup>96</sup> *ibid.*

<sup>97</sup> Monetary Authority of Singapore, “Guidelines on Personal Offers Made pursuant to the exemption for Small Offers” 15 October 2005 (the “Guidelines”), para. 4.1.

<sup>98</sup> Para. 4.1 of the Guidelines.

<sup>99</sup> Paras. 6.3 to 6.5 the Guidelines.

<sup>100</sup> Paras. 6.6 and 6.7 the Guidelines.

investors who “fully understand the risks involved and still view such investments as suitable in light of their investment objectives, financial means and risk profiles.”<sup>101</sup>

Neither limb of the exemption seems wide enough to facilitate an offer of shares on equity crowdfunding platforms. In such cases, the issuer is essentially making an offer to any investor who can see and accept its offer, i.e., anyone who has registered with the relevant platform. The first limb of the exemption would not apply to a majority of these investors since they do not have a prior connection with the company. The second limb of the exemption would apply only if the following conditions are satisfied, i.e., the crowdfunding platform must (1) be a specified person; and (2) conduct sufficient due diligence on each registered user to ensure that each user can only receive offers that match his risk profile. The considerable costs involved in satisfying both conditions (outlined below) are likely to discourage entities from becoming an equity crowdfunding platform in the first place.

First, to become a specified person, a crowdfunding platform would need to obtain a capital market licence for dealing in securities or a financial adviser licence (unless it is exempt from the requirement to hold such licence<sup>102</sup>). Obtaining and maintaining such licence is costly. This is evidenced by the fact that between 2005 and 2014, there are on average only about 91 capital market licencees (dealing in securities) and about 54 financial advisers licencees each year in Singapore.<sup>103</sup>

Secondly, to ensure that each registered user receives only offers that match his risk profile, the crowdfunding platform would need to conduct extensive KYC for each user. The pre-qualification procedures recommended by the MAS would involve “a comprehensive analysis of the investment needs and risk profile” for each registered user, and having done so, the crowdfunding platform should reasonably believe that:

- (a) the user has sufficient expertise to evaluate the risks and merits of the equity crowdfunding projects to be sent to him;
- (b) the user is fully aware of the risks of investing in that type of projects;

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<sup>101</sup> Para. 6.9 of the Guidelines.

<sup>102</sup> See, e.g., section 99 of the SFA and section 23 of the Financial Advisers Act for a list of the exempted persons.

<sup>103</sup> Monetary Authority of Singapore, Annual Report, 2013/2014, p.17.

- (c) the user considers investing in such projects appropriate in light of his investment objectives, financial means and risk profile; and
- (d) such investment is suitable for the user.<sup>104</sup>

Conducting such a comprehensive assessment is likely to require a significant amount of personal information from each registered user, including, for example, his age, occupation, income, net worth, investment experience, investment goals, and so on. Requiring a crowdfunding platform to conduct such extensive background checks on each registered user is both costly and inefficient since only a small proportion of the registered users are likely to eventually make an investment. Crowdcube, for example, has over 135,671 registered users, but only a little over 10 percent has ever made an investment and about 76 percent of these users have only made one investment.<sup>105</sup> Requesting extensive personal information from registered users might also discourage investors that are only minded to invest a small amount and therefore find the pre-qualification process disproportionately cumbersome. Furthermore, if crowdfunding platforms are required to keep such extensive personal information of its registered users, the platforms would have to spend significant resources to comply with the requirements of the Singapore Personal Data Protection Act 2012.

## (2) Exemption for Offers to Accredited Investors

Offers of securities to accredited investors as well as companies and trusts which are wholly owned by accredited investors are also exempt from the prospectus requirements if certain conditions are satisfied, including, e.g., restrictions against advertisement.<sup>106</sup> Accredited investors include:

- a. an individual whose net personal assets exceed S\$2 million or whose income in the preceding 12 months is not less than S\$300,000;
- b. a corporation with net assets exceeding S\$ 10 million; and

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<sup>104</sup> Para. 6.10 of the Guidelines.

<sup>105</sup> Crowdcube is estimated to have 104 supporters per pitch and has funded 194 pitches so far. Among the crowd investors, about 76 percent invest in only one project. Accordingly, the number of registered users that have made an investment is about 15,334.

<sup>106</sup> Section 275 of the SFA.

- c. other persons prescribed by the MAS.<sup>107</sup>

Unfortunately, the exemption for offers to accredited investors is arguably both under-inclusive and over-inclusive. On one hand, this exemption is under-inclusive because restricting crowdfunding to accredited investors would take the crowd out of crowdfunding. The average monthly household income from work per household member for the wealthiest ten percent of the population in Singapore is S\$ 11,198 in 2013 and S\$ 12,032 in 2014.<sup>108</sup> Assuming that each household has one child (which roughly represents Singapore residents' fertility rate in 2010),<sup>109</sup> the adjusted monthly household income per adult would be S\$ 16,797 in 2013 and S\$ 18,048 in 2014, which is still considerably lower than the amount required to qualify as an accredited investor, i.e., S\$ 25,000 per month. Therefore, only less than ten percent of the Singaporeans would be able to avail themselves of this exemption.

On the other hand, the exemption is over-inclusive because the mere fact that a person's net personal asset exceeds S\$2 million does not entail that he has the necessary experience or expertise to assess the risks and merits of investing in start-up companies.<sup>110</sup> For example, someone who has won a lottery or inherited a large sum of money may not be better at assessing the prospects of a start-up company than a finance lecturer whose income and net assets may fall below the threshold for accredited investors.

### (3) Other Exemptions

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<sup>107</sup> Section 4A of the SFA.

<sup>108</sup> Department of Statistics, *Key Household Income Trends 2014*, p6 [http://www.singstat.gov.sg/docs/default-source/default-document-library/publications/publications\\_and\\_papers/household\\_income\\_and\\_expenditure/pp-s21.pdf](http://www.singstat.gov.sg/docs/default-source/default-document-library/publications/publications_and_papers/household_income_and_expenditure/pp-s21.pdf) (accessed 9 March 2015).

<sup>109</sup> The fertility rate in 2010 is 1.15. See, Ministry of Social and Family Development, *Population in Brief 2011* <http://app.msf.gov.sg/Portals/0/Files/SPRD/Population%20in%20Brief%202011.pdf> (accessed 9 March 2015).

<sup>110</sup> The MAS has indeed recognised that accredited investors, as currently defined, are not "necessarily better informed or require less regulatory protection than retail investor[s]." Therefore, the MAS has proposed to provide accredited investors with a choice to benefit from the full range of regulatory safeguards which apply to retail investors. See Monetary Authority of Singapore, *Consultation Paper on Proposals to Enhance Regulatory Safeguards for Investors in the Capital Markets* (Consultation paper July 2014).

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Other exemptions under the SFA from the prospectus requirement all contain restrictions which render them of limited use in facilitating equity crowdfunding.

These exemptions include:

Exemption	Main condition of the Exemption	Restriction against advertisement
Private placement (S272B of the SFA)	Offers of securities to no more than 50 persons within any period of 12 months	Yes
Large offers (S275(1A) of the SFA)	Offers of securities in which the consideration for each transaction exceed S\$ 200,000	Yes
Offers to Institutional investors (S274 of the SFA)	Offers of securities made to institutional investors, which include, amongst others, sophisticated financial institutions like banks, finance companies, as well as holders of a capital markets services licence for selected regulated activities. <sup>111</sup>	No

Since the essence of crowdfunding is to raise many small amounts of money from a large number of people, the exemptions for private placement and large offers are unlikely to be of much use. The exemption for offers made to institutional investors is equally unhelpful. As noted earlier, the very reason why many start-ups and small businesses resort to equity crowdfunding is because they have difficulty obtaining funds from traditional sources, i.e., institutional investors. Therefore, this exemption would be of little practical use to the type of companies that need equity crowdfunding the most.

<sup>111</sup> These regulated activities include: (a) dealing in securities; (b) fund management; (c) providing custodial services for securities; (ca) real estate investment trust management; (d) securities financing; and (e) trading in futures contracts. See section 4A(1)(c) of the SFA.

### C. Restrictions against Advertisement

Furthermore, even if equity crowdfunding falls within the small offers or accredited investor exemption, it would still be subject to restrictions against advertisement, i.e., the offer must not be accompanied by an advertisement making or calling attention to that offer/intended offer.<sup>112</sup>

An advertisement is widely defined to mean (1) a written or printed communication; (2) a communication by radio, television or other medium of communication; or (3) a communication by means of a recorded telephone message, that is published in connection with an offer of securities.<sup>113</sup> However, it does not include:

- (a) an information memorandum;
- (b) a disclosure, notice or report required under the SFA, or rules and requirements of an exchange; or
- (c) a notice or report of about the issuer's general meeting.<sup>114</sup>

An information memorandum is a document:

- (a) purporting to describe the securities being offered, or the business and affairs of the issuer; and
- (b) purporting to have been prepared for delivery to and review by persons to whom the offer is made so as to assist them in making an investment decision in respect of the securities being offered.<sup>115</sup>

Actual information provided by issuers on crowdfunding platforms about the issuer and its shares should not be considered advertisement. The reason for this is that, as such information has been prepared for delivery to and review by persons to whom the offer is made and to assist them in making an investment decision, it arguably amounts to "information memoranda". However, the definition of advertisement is probably wide enough to cover:

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<sup>112</sup> See sections 272A(c) and 275(1)(a) of the SFA.

<sup>113</sup> See, e.g., section 275(2) of the SFA.

<sup>114</sup> *ibid.*

<sup>115</sup> *ibid.*

- (a) any emails or messages sent by a crowdfunding platform to notify its registered users of any new crowdfunding projects;
- (b) any posts or comments made on any social network website (such as Facebook or Twitter) to inform potential investors of any new projects on a crowdfunding platform; and/or
- (c) indeed any unsolicited promotional materials.<sup>116</sup>.

The width of the advertisement restrictions would pose a significant challenge to effective crowdfunding. Crowdfunding relies on the ability of companies and crowdfunding platforms to attract support from the crowd. The restrictions against advertisement would make it extremely difficult for them to introduce new offers to investors or to keep investors informed of updates. They would be at a distinct disadvantage when fighting for investor attention against competitors which are allowed to highlight the key information about the products they offer. Such restrictions also inconvenience investors who are genuinely interested in learning more about equity crowdfunding; such investors would be deprived of information which can help them identify more quickly the projects they interest in without having to regularly visit various crowdfunding platforms. While there is certainly a need to protect investors from misleading advertisements, the current restrictions against advertisement are arguably too extensive.

#### D. Shareholder Cap

Most small businesses in Singapore are incorporated as private companies. Section 18(1)(b) of the Companies Act provides that the maximum number of members for private companies is 50. Since the essence of crowdfunding is to raise money from a large number of people, the number of crowd investors at any successful funding round is like to exceed 50. According to a report into the UK alternative finance industry in 2014 (the “Alternative Finance Industry Report”), the average number of

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<sup>116</sup> The MAS has recently confirmed that the advertising restrictions would prevent crowdfunding platforms from advertising any specific crowdfunding projects that may be available on the platforms to the general public. Monetary Authority of Singapore, *Facilitating Securities-based Crowdfunding* (Consultation paper February 2015) at para.3.6.

investors per equity crowdfunding project is 125.<sup>117</sup> If each investor becomes a member of the company that he invests in, it would cause the company to breach section 18(1)(b). A breach of section 18(1)(b) would result in the company and every officer of the company be guilty of an offence and be liable on conviction to a fine not exceeding S\$5,000 or to imprisonment for a term not exceeding 12 months.<sup>118</sup>

Converting a private company to a public company for the purpose of avoiding the shareholder cap would not be cost-effective for start-ups and small businesses because doing so would significantly increase their costs of doing business. A public company is more costly to maintain. For example, it cannot dispense with the holding of annual general meetings<sup>119</sup> or utilise exemptions from having their financial reports audited.<sup>120</sup> Moreover, a public company does not qualify for the tax-exemption scheme for start-up companies since it has more than 20 shareholders.<sup>121</sup> It would also be subject to additional legal requirements, e.g., those under the Singapore Code on Take-overs and Mergers,<sup>122</sup> which would result in higher regulatory/compliance costs. Further, the conversion itself would involve considerable legal and administrative expenses.<sup>123</sup>

Apart from the costly option of converting to a public company, a more plausible way<sup>124</sup> to avoid a breach of the shareholder cap is for the crowd investors to appoint a nominee, who holds shares of the private company on their behalf. Either the crowdfunding platform or a third party service provider can serve as a nominee. The nominee structure has perceivable benefits. It is desirable for the company since it

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<sup>117</sup> Peter Baeck, Liam Collins & Bryan Zhang, *Understanding Alternative Finance, the UK Alternative Finance Industry Report*, November 2014, p.57

<http://www.nesta.org.uk/sites/default/files/understanding-alternative-finance-2014.pdf> (accessed 9 March 2015).

<sup>118</sup> Section 32(8) of the Companies Act (CA).

<sup>119</sup> Section 175A(7) of the CA.

<sup>120</sup> Section 205C of the CA.

<sup>121</sup> Tax Exemption Scheme for New Start-up companies  
<http://www.iras.gov.sg/irashome/page04.aspx?id=414> (accessed 9 March 2015).

<sup>122</sup> Section 213(17) of the CA. Unlisted public companies are expected to observe the letter and spirit of the General Principles and Rules, wherever this is possible and appropriate.

<sup>123</sup> The conversion procedure requires a company to submit to the Registrar of Companies a series of documents, including: (a) a special resolution determining to convert to a public company; (b) a statement in lieu of prospectus; and (c) a declaration in the prescribed form verifying that section 61(2)(b) has been complied with. See sections 31(2) and 60(1)(b) of the CA.

<sup>124</sup> Commentators have also suggested implementing a collective investment scheme or making each crowdfunded company a subsidiary of a public company. See O Stacey, S Lovegrove, and D Murphy, "Crowdfunding: Possibilities and Prohibitions" (2012) 23(1) PLC 18. The former is likely to be too costly while the latter is not practical in many circumstances.

only has to deal with the nominee rather than hundreds of shareholders. It may also be desirable for passive investors who do not want to be burdened with the administrative work involved in being a shareholder. However, the nominee structure also has its drawbacks. It renders investors more vulnerable in certain circumstances as they cannot directly exercise rights which are reserved for members of the company, but must act through the nominee. For example, since they are not registered members of the company, they cannot bring proceedings under section 216 of the Companies Act against unfair or oppressive conduct by the directors or majority shareholders. Hence, a minority shareholder is exposed to the additional risk that the nominee might not act in its best interests. Moreover, the nominee structure would make equity crowdfunding more expensive since the nominee will have to be paid for its services.

Investors who want to actively exercise their voting rights may not be able to do so under the nominee structure. Firstly, the nominee as one member is only entitled to one vote in a general meeting (when the vote is on a show of hands).<sup>125</sup> Therefore, the nominee's vote may not reflect the views of all investors. Secondly, the default position is that a nominee cannot appoint more than two proxies to attend and vote at the same meeting unless the company's articles of association provide otherwise.<sup>126</sup> This means that most crowd investors would be prevented from voting as proxy unless the company's articles allow the nominee to appoint as many proxies as it desires. The situation is partially remedied by the Companies (Amendment) Bill 2014, which will introduce a new multiple proxies regime. In particular, it will allow specified intermediaries, such as banks or persons holding a capital markets services licence to provide custodial services, to appoint more than two proxies.<sup>127</sup> However, the multiple-proxy regime only applies to specified intermediaries and it is unclear whether engaging a specified intermediary would be cost-efficient in the context of equity crowdfunding.

In summary, the shareholder cap, while affording little benefit to investors, is likely to significantly increase the costs of equity crowdfunding and limit the way in which equity crowdfunding may be conducted.

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<sup>125</sup> Section 179(1)(c)(i) of the CA.

<sup>126</sup> Section 181(1)(b) of the CA.

<sup>127</sup> Such proxies will also be able to vote on a show of hands.

## PART IV: RISKS OF EQUITY CROWDFUNDING

This paper will argue that a more tailor-made approach should be employed to regulate equity crowdfunding. This section will first set out the key risks before outlining potential measures to address each risk. The key risks fall into three types: issuer-related risks, platform-related risks and investor-related risks.

### A. Issuer-related Risks

With regard to issuer-related risks, there is, to begin with, the inherent risk involved in investing in start-up companies. Investing in early stage companies is riskier than investing in more established companies. There is a much greater degree of uncertainty surrounding the key factors which determine the success of a company, ranging from the viability of the business plan, quality of the management team, demand from the market for the company's product/service, level of competition from similar companies, to name just a few. Experience has shown that most start-ups fail;<sup>128</sup> significantly, it has been said that seven to eight out of ten newly established companies in Singapore fail within the same year.<sup>129</sup>

The risk of investing in startups is further exacerbated by the highly illiquid nature of such investments. In contrast to shares in well-known public or listed companies, it is unlikely that there will be a meaningful secondary market for shares in a small start-up company. This means that, once they have made their investment, equity crowdfunding investors are likely to have very limited exit options. Furthermore, as start-ups are focused on growing their business, there is unlikely to be any return by way of dividend in the short or medium term. Taken together, this means investors may not see the fruits of their investments unless and until the company is bought by a third

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<sup>128</sup> "The UK Office of National Statistics, Business Demography 2011, 13 December 2012, indicated that around 50 percent to 70 percent of business start-ups fail completely over five years. According to the US Bureau of Labor Statistics, 65 percent of new business establishments fail completely over ten years." See Monetary Authority of Singapore, *Facilitating Securities-based Crowdfunding* (Consultation paper February 2015) at para.1.4.

<sup>129</sup> Minister Lim Hng Kiang's Written Reply to Parliament Question on Business Failure Rates amongst Singapore SMEs 14 August 2012 <http://www.mti.gov.sg/NewsRoom/Pages/Minister-Lim-Hng-Kiang's-Written-Reply-to-Parliament-Question-on-Business-Failure-Rates-amongst-Singapore-SMEs.aspx> (accessed 9 March 2015).

party or goes public. For better or worse, equity crowd-funding investors' funds are locked in until the start-up company eventually succeeds or fails.

Information asymmetry, i.e., the fact that the issuer knows the condition of its business better than crowd investors, also forms an important part of the issuer-related risks. Information asymmetry presents an opportunity for issuers to take advantage of investors in two ways:

- a. provide crowd investors with misleading information which paints an overly optimistic picture of its business or omits material adverse information, or in extreme cases, conduct fraudulent campaigns solely for the purpose of cheating investors' money; and
- b. moral hazard problems, e.g., issuers might misuse funds obtained from crowd investors, or act in a way to further their own interests at the expense of the investors'.

While there are, to some extent, existing laws and regulations which offer limited protection in respect of the this sort of advantage-taking conduct (for example, the tort of misrepresentation and deceit, legislation regarding minority shareholder rights, and laws preventing misuse of funds) the existing laws are likely to be insufficient to protect equity crowdfunding investors for reasons such as the collective action problem which are further discussed below.

## B. Investor-related Risks

As for investor-related risks, there are several concerns.

First, some members of the crowd may lack sufficient financial literacy to accurately understand the business or financial information presented by the issuer or the rights attached to the type of shares that they intend to purchase. For example, they might not understand the accounting treatment for goodwill or the implications of being a non-voting minority shareholder in a private company. As a result, these investors may not be able to fully appreciate the risks involved in their investment to make an informed decision. They are more susceptible to be adversely influenced by

misleading statements, whether intentionally or honestly made. And they are less able to properly evaluate the company's current value and future performance. For these members of the crowd, the argument for investor protection is arguably sufficiently strong to justify preventing them from investing in equity crowdfunding projects. This is especially true when one takes into account the inherently high risk nature of the investment.

While it is true that certain investors of an initial public offering (IPO) might be equally ignorant of the companies they invest in, there are crucial differences between investment in the context of a public offering and equity crowdfunding in start-ups. Critically, there are a number of built-in protective mechanisms in an IPO. These investor protection measures include, for example, the prospectus and listing rules, which set out detailed disclosure requirements and procedures to ensure compliance with these requirements, and the presence of multiple gatekeepers, such as underwriters, lawyers and accountants, who help police the issuers' conduct and, to a considerable extent, ensure that the issue price for the share is reasonable. These measures cannot be easily replicated in equity crowdfunding because the associated costs would be prohibitively high for entrepreneurs who seek to raise a modest sum. Without such protective measures, investors of equity crowdfunding are placed at greater risk than that of IPOs. In addition, IPO shares are likely to carry lower risk since the issuer of an IPO is likely to be a fairly mature company with an established track record.

Secondly, unlike an angel investor or a VC firm, a crowd investor does not have the bargaining power to negotiate extensive shareholder protective provisions to safeguard his interests. The terms of the investment are often set by the entrepreneur on a take it or leave it basis. Without adequate shareholder protection, a crowd investor may not be able to fully enjoy the benefits of a successful investment. There is risk that his shareholding may be unfairly diluted. Start-ups are likely to need several rounds of additional funding to keep them afloat or take them to the next level. Each round may involve issuance of additional shares. Issuance of new shares to new investors can result in dilution of shares held by existing shareholders. It will increase the total number of outstanding shares, which in turn decrease the percentage of shares owned by crowd investors. In the absence of proper anti-dilution protection,

crowd investors could find themselves in the position of Eduardo Saverin, a Facebook co-founder, whose original 30 percent shareholding in Facebook was diluted to 0.3 percent when new investors came along.<sup>130</sup> The dilution problem is more prominent in a down-round, i.e., where the new shares are issued at a lower price than that paid by existing investors. The issuance of new shares would cause each crowd investor to hold a smaller percentage of shares in a less valuable company. Further, there is risk that a crowd investor may be excluded from a subsequent buy-out.

Thirdly, crowd investors are likely to lack incentive, skills or resources to adequately maintain up-to-date knowledge of the company's performance and to prevent, detect or remedy misconduct, which in turn is likely to increase the likelihood of moral hazard problems. There are two reasons why a crowd investor may be less incentivised to engage with the companies they fund. The first reason is that, if a crowd investor invests a modest sum in the project, it is rational for that investor not to spend significant amounts of time and effort in monitoring the project because he has to bear all the monitoring costs but only receives a small percentage of the benefit. It is unlikely, for example, for a crowd investor to take the more drastic measure of bringing an unfair prejudice proceeding against the directors or majority shareholders, the cost of which would be disproportionate to his investment. This can lead to a collective action problem where investment in the project is so dispersed that none of the investors has sufficient "skin in the game" to act on behalf of the crowd.<sup>131</sup> The second reason is that there is little that a crowd investor can do if he suspects or detects any misconduct on the part of the company that he has invested in. Unlike shareholders of a publicly traded company or a mutual fund, he cannot sell his shares or redeem his units in the fund. Unlike VCs, crowd investors are generally unable to negotiate for significant control over the companies they invest in. Even as a group, crowd investors very often only hold minority shareholding in a company, which may not be sufficient to entitle them to appoint a director. It is also not uncommon for crowd investors who invest relatively small sums to hold non-voting shares.<sup>132</sup>

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<sup>130</sup> Shibani Mahtani, "The Other Facebook Founder" *The Wall Street Journal*, May 17, 2012 <http://www.wsj.com/articles/SB10001424052702303877604577380131964661806> (accessed 9 March 2015).

<sup>131</sup> Jason Parsont, "Crowdfunding, the Real and the Illusotry Exemption" 4 *Harv. Bus. L. Rev.* 281.

<sup>132</sup> See, e.g., crowdfunding offers on Crowdcube.

More critically, even if crowd investors are motivated to maintain oversight of the company, they lack the resources, sophistication and time to effectively take the company's management to task for misconduct. As minority shareholders in an unlisted company, crowd investors would not have access to sufficient information to keep themselves informed of the performance of the company. Their main source of information appears to be the AGM. Information to be disclosed at AGMs includes, amongst others, (a) particulars of the company's shares; (b) the company's payments and receipts; (c) particulars of the company's directors and secretaries and, if any, trustees, auditors, and managers; (d) particulars of any contract the modification of which is to be submitted to the meeting for its approval, and (e) particulars of the company's shareholder.<sup>133</sup> While AGMs must be held every year, an interval of 15 months is allowed between two meetings.<sup>134</sup> This means that a crowd investor may not be able to get much information about the company he invests in for as long as 15 months. It is plausible that a significant percentage of the start-ups would have stopped trading in the interim. Furthermore, despite good intentions, crowd investors are likely to lack experience monitoring early stage companies. According to a recent survey in the United Kingdom by Nesta and the University of Cambridge, 62 percent of the investors surveyed described themselves as "retail investors with no previous investment experience of early stage or venture capital investment."<sup>135</sup> The growth of a community of experienced crowd investors will take time.

### C. Platform-related Risks

Equity crowdfunding platforms' business model suggests that their interests are not always aligned with that of the crowd investor. All crowdfunding platforms receive a fee in the form of a percentage of the funds raised after each crowdfunding project is funded. But many platforms do not receive any monetary benefit if investors receive profits from their investment (although they do indirectly benefit through enhanced reputation, which may lead to more investors and potentially more deals). Therefore,

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<sup>133</sup> Section 174(3) of the CA.

<sup>134</sup> Section 175(1) of the CA.

<sup>135</sup> Financial Conduct Authority, *A Review of the Regulatory Regime for Crowdfunding and the Promotion of Non-readily Realisable Securities by Other Media* February 2015 <http://www.fca.org.uk/static/documents/crowdfunding-review.pdf> (accessed 9 March 2015).

for many crowdfunding platforms, the benefits of ensuring that a project gets funded appear to be more direct and certain than the benefits of ensuring that a good quality project gets funded. In addition, the difference between a good and a bad crowdfunding project may not be obvious to investors until many years later and the failure of a project would not be easily attributable to the platform. Accordingly, it is plausible that some equity crowdfunding platforms might have less incentive to vigorously screen the companies featured on their platforms and have more incentive to introduce a greater number of projects of lesser quality to attract investors.

## PART V: AN EXEMPTION FOR EQUITY CROWDFUNDING

Although the risks associated with equity crowdfunding cannot be completely eliminated, proper safeguards can adequately mitigate such risks while exemptions from the prospectus requirement, shareholder cap and prohibition against advertisement are created to facilitate equity crowdfunding (the “crowdfunding exemption”). While a full discussion of the law reforms necessary to properly balance the rights of the various stakeholders involved in equity crowdfunding is outside the scope of this paper, the following section briefly explores a few key safeguard measures. The various measures proposed below seek to provide adequate protection to equity crowdfunding investors through (1) appropriate restrictions on who is eligible to participate in equity crowdfunding; (2) mandatory minimum protection for crowdfunding investors; (3) enhancing the crowdfunding platform’s role as a gatekeeper; and (4) to the extent possible, enabling crowd investors to pool their resources to advance their interests.

### A. Restrictions on Crowdfunding Issuers, Platforms and Investors

#### (1) Issuer Restrictions

For a start-up to be eligible for the crowdfunding exemption, it should satisfy two residency requirements: first, it must be registered as a company in Singapore; second, a majority of the company’s directors and/or shareholders must be Singapore residents. Having the company registered in Singapore ensures that Singaporeans benefit from the eventual growth and success of the company, either directly as an

investor or indirectly from the company's tax payments or the jobs it creates. Moreover, the residency requirements make it easier for the relevant stakeholders (i.e. the regulatory authorities and investors) to effectively oversee the issuer, its directors and shareholders and to hold them accountable for their actions.

## (2) Platform Restrictions

Each equity crowdfunding platform should be licensed by the MAS to ensure that it is fit and proper to carry on the business of operating an equity crowdfunding platform. In particular, the regulator should be satisfied that each prospective platform has the financial resources, experience and expertise to perform the various investor protection obligations it needs to fulfill (which are discussed further below).

## (3) Investor Restrictions

Only investors with a certain level of financial literacy and legal knowledge should be allowed to participate in equity crowdfunding. This ensures that investors have the ability to:

- understand the information presented by the issuer and to ask sensible questions to assist themselves and other investors in making an informed investment decision;
- appreciate the risks involved in investing in start-up companies and the implications of being a minority shareholder; and
- contribute to the growth of the start-up by providing advice, feedback, evaluation or even participation in its management.

Dealing with relatively sophisticated investors also reduces the need for entrepreneurs to explain basic financial and legal concepts and might result in lower costs for raising funds.

It is submitted that each interested investor (except entrepreneurs and persons with experience investing in start-ups, e.g., angel investors and VCs) should be required to attend an online course explaining the risks of investing in start-ups, the ways to evaluate and value start-ups, the differences between various means of financing a

start-up, and the common statutory and contractual rights of minority shareholders. Following the course, investors should be required to pass a written test before being allowed to participate in equity crowdfunding investment. To ensure its quality, the course should be prepared and approved by the MAS. Each crowdfunding platform should be under a duty to direct investors to the course and to ensure that all investors have attended and passed the course.

## B. Funding Caps

### (1) Issuer Caps

Since the main rationale for an exemption from the prospectus requirement is that the costs of complying with such requirement would be disproportionately high for start-ups that only need to raise a relatively small sum, there should be a cap on the amount that each issuer can raise in a given period. In a recent survey conducted by OCBC bank with young businesses, about 70 percent of the businesses indicated they required less than S\$ 100,000 for their first loan to kickstart their businesses.<sup>136</sup> Moreover, the maximum amount that a start-up can receive from existing government programmes is generally no more than S\$ 1 million. While the financial needs of start-ups vary from industry to industry, an offering cap of S\$ 1 million during a 12-month period is likely to be sufficient to satisfy the needs of most start-ups.

### (2) Investment Caps

In light of the high risk of investing in start-ups, there should be a cap on the amount each retail investor can invest in equity crowdfunding projects to prevent investors from investing more than they can afford to lose. One of the key insights of the behavioral finance literature is that people have bounded rationality and tend to be overly optimistic of the consequences of their conduct.<sup>137</sup> An investment cap is a useful tool to counteract investors' tendency to over-estimate the prospects of their

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<sup>136</sup> OCBC Bank Introduces Business Loan for Start-ups as Young as Six Months Old, April 2014 <https://www.ocbc.com/assets/pdf/Media/2014/April/OCBC%20Business%20First%20Loan%2030%20Apr%202014.pdf> (accessed 9 March 2015).

<sup>137</sup> Cass Sunstein (eds), *Behavioral Law and Economics* (Cambridge University Press 2000), Chap 1.

investment. It serves both as a risk warning and a safeguard against significant exposure to risky projects.

Many jurisdictions have imposed caps on the amount each retail investor can invest in crowdfunding projects within a certain period. The cap varies from jurisdiction to jurisdiction. In the United States, the investment cap within a 12-month period for investors whose annual income or net worth is less than US\$ 100,000 is the greater of US\$ 2,000 or five percent of that investor's annual income or net worth.<sup>138</sup> In the United Kingdom, the investment cap for a retail investor is ten percent of his net assets. It is submitted that an investment cap of five to ten percent of a crowd investor's annual income seems reasonable.<sup>139</sup>

Each crowdfunding platform should have a duty to provide investors with details of the investments they have made through that platform and to remind investors of the cap before each investment.

### C. Investor Protection prior to the Completion of a Funding Round

#### (1) Access to Information about the Start-up

Before investing in a start-up, crowd investors should have a reasonable opportunity to gather information from the issuer in order to understand its business and to assess the reasonableness of the offer price. To enable crowd investors to make an informed decision, the information provided about the relevant start-up must be clear, accurate and comprehensive. As noted above, applying the existing prospectus requirement to equity crowdfunding is problematic as the up-front costs of preparing and registering a prospectus are disproportionately high. The proposal below seeks to reduce the issuer's costs while ensuring adequate and accurate disclosure by (1) imposing less stringent disclosure requirements on the entrepreneur and (2) dividing the responsibilities and costs of conducting due diligence on the start-up between the crowdfunding platform and the crowd investors.

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<sup>138</sup> Section 302(a) of the JOBS Act.

<sup>139</sup> Financial Conduct Authority, *The FCA's Regulatory Approach to Crowdfunding over the Internet, and the Promotion of Non-readily Realisable Securities by Other Media* (PS14/4 March 2014).

## DRAFT PAPER

### (a) Background Check by the Platform

Before an issuer is allowed to pitch his project on a crowdfunding platform, the platform should be required to conduct limited due diligence on the company. The aim is to reduce the risk of fraud and to verify some of the information provided by the issuer. Such due diligence should include at least:

- Company searches to verify the issuer's existence as well as the identity of its directors;
- A review of the issuer's constitutional documents and subsequent filings; and
- Bankruptcy/insolvency and criminal record checks on the issuer, its directors, officers and substantial shareholders.

The platforms are free and should be encouraged to conduct additional due diligence checks as long as they clearly disclose the scope of their due diligence to crowd investors.

### (b) Mandatory Disclosure by the Issuer

The issuer should be subject to more streamlined disclosure requirements. This has the dual benefit of reducing the up-front costs that issuers need to incur for equity crowdfunding and reducing the amount of time and effort that crowd investors need to invest for deciding which projects they want to explore further. The list of information which issuers are required to provide under the JOBS Act serves a good starting point. This includes particulars of (further details are set out in Annex I):

- The issuer;
- Key persons associated with the issuer;
- The issuer's business;
- The issuer's financial condition;
- The purpose for which the funds will be used;
- The amount of the securities to be offered;

- The price of the securities to be offered; and
- The issuer's ownership and capital structure.

In addition, the MAS should work with crowdfunding platforms to establish a standard disclosure template for issuers. Having a standard disclosure template helps guide issuers in making disclosure and assists investors in understanding and comparing different crowdfunding projects.

(c) Wisdom of the crowd

The information asymmetry between the issuer and crowd investors can be partially bridged by the wisdom of the crowd. The phrase “wisdom of the crowd” is commonly used to describe the phenomenon that decisions made by a crowd collectively can be better than decisions made by experts. In his book, *Wisdom of the Crowd*, Surowiecki has given many examples where decisions of the crowds proved to be more accurate than the experts in predicting a range of matters: weight of a cow, whereabouts of a lost ship, best performing movies, and so on.<sup>140</sup> It is believed that the wisdom of the crowd can be utilized in the crowdfunding industry. There is evidence that the wisdom of the crowd has helped reduce incidences of fraud. A number of fake campaigns on Kickstarter, one of the biggest reward crowdfunding platforms, have been brought to an end thanks to reports by prospective investors. Wisdom of the crowd can also help identify additional relevant information and to seek clarification from the issuer. Examples of questions commonly raised by crowd investors through the Q&A function provided by crowdfunding platforms relate to (a) justifications for the issuers' valuation of their shares or the financial forecasts; (b) market competitors which offer similar services/products; and (c) inconsistencies in the information provided, e.g., where the issuer has provided a different financial forecast in a previous funding round.

To utilise the wisdom of the crowd, the crowdfunding platform should be required to provide a forum on the platform through which crowd investors can ask questions and communicate with each other.

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<sup>140</sup> J Surowiecki, *The Wisdom of Crowds: Why the Many Are Smarter than the Few and How Collective Wisdom Shapes Business, Economies, Societies, and Nations* (New York: Doubleday: 2004).

(d) Due diligence by Third Party Service Provider

After a sufficient number of crowd investors have indicated an intention to invest in the issuer to meet the funding target, crowd investors should be provided with an opportunity to decide as a group whether to conduct more comprehensive due diligence on the issuer. Although the amount invested by each crowd investor is relatively small, the group as a whole would likely be investing a substantial sum. This justifies spending a few thousand to engage a third party to conduct more extensive due diligence. The third party may be the crowdfunding platform itself or a service provider (e.g., an accounting or law firm) appointed or recommended by the platform. If crowd investors decide to conduct additional due diligence, they should not be required to transfer funds to the issuer until the completion of a satisfactory due diligence report.

Under certain circumstances, crowd investors might not consider it necessary to conduct their own due diligence, e.g., where they (1) co-invest with a reputable professional investor who has financial resources and industry experience to conduct its own due diligence; and (2) have access to the due diligence report prepared by the professional investor. In this case, crowd investors might consider it more cost-efficient to piggyback the professional investor's efforts. As noted earlier, Singapore has a number of co-investment programs through which the government co-invests with an angel investor or incubator. Some of these programs, such as SPRING SEEDS and BAS, may be adapted to allow the crowd to co-invest with professional investors.

C. Mandatory and Optional Shareholder Protection

(1) Mandatory Risk Warnings by the Platform

Although each crowd investor should have completed a course that outlines the risks involved in investing in start-ups before making an investment, an investor would be more likely to take into account these risks if he is reminded of them immediately prior to making an investment. Accordingly, it is submitted that the crowdfunding platform should have a duty to remind investors of the risks of investing in start-ups.

This may be achieved through an automatic pop up message that contains standardised risk warnings in an accessible font and size once an investor indicates his interest to invest in a crowdfunding project.

## (2) Mandatory Advertising and Selling Restrictions

To ensure that investors benefit from various investor protection measures (e.g., information disclosure and risk warnings) provided through crowdfunding platforms, there should be a requirement that an offer of securities using the crowdfunding exemption must take place through licensed crowdfunding platforms.

Additionally, while the issuer and the crowdfunding platform should be allowed to advertise crowdfunding projects to the general public, such advertisement should (1) only include information which is presented at the crowdfunding platform; (2) contains a link to the relevant crowdfunding platform; and (3) contains a warning that the investor must read all the relevant information on the platform before investing in any project.

## (3) Mandatory Shareholder Protection Provisions

As a minority shareholder, a crowd investor would find it difficult to negotiate with the issuer for specific shareholder rights and protections before he decides to invest in the company. Without such rights and protections, crowd investors may be excluded from the benefits of a successful investment, e.g., where majority shareholders are able to liquidate their investment in a sale to the exclusion of minority shareholders. Therefore, it is submitted that crowd investors should be entitled to some minimal rights that minority shareholders commonly enjoy. These should include:

1. **Withdrawal right:** A crowd investor should have a contractual right to cancel an agreement to purchase shares from the issuer if (1) the investor gives the issuer a notice to withdraw his investment at least 96 hours before the deadline for meeting the funding target; (2) the issuer discloses any new material adverse information before the completion of the funding round; and (3) the due diligence report reveals any new material adverse information or renders any part of the issuer's proposal false or misleading.

2. Voting right: This would allow crowd investors to vote at a general or extraordinary meeting of the company during which important issues, such as appointment of directors, are decided. Although the voting power possessed by each crowd investor may be negligible, the crowd as a group may hold sufficient percentage of shares to influence the company's decision-making.
3. Tag-along right: This would allow crowd investors to participate under the same terms in a qualified sale of the company's shares initiated by other shareholders. This right is particularly useful for minority shareholders whose shareholding is less liquid than that of the majority.

#### (4) Optional Shareholder Protection Provisions

Crowdfunding platforms can and should step in to negotiate on behalf of crowd investors for additional shareholder rights. Stronger shareholder rights and protection can help crowdfunding platforms distinguish themselves from their competitors and attract more investors. When investing in early stage companies, VCs and angel investors often hold preferred shares, which can be converted to common shares under specific circumstances (e.g., a public offering or trade sale) and carry a bundle of rights which protect holders of preferred shares. Some or all of these rights may be included in the shareholder agreements to be entered into by crowd investors. These include:

1. Pre-emptive right: This allows crowd investors to purchase on a pro rata basis shares issued by the company on a future occasion. This is particularly important to enable crowd investors to keep the percentage of their shares in an up-round financing.
2. Anti-dilution protection from a down-round: This would protect crowd investors from the dilutive effects of a subsequent financing round in which the company is priced below the price at which the crowd investors invested in the company. For example, if crowd investors originally bought shares at S\$ 10, at a second financing round, the company received a lower valuation and a VC bought additional shares at S\$ 5. A full-ratchet anti-dilution provision would treat crowd investors as if they had bought the shares at S\$ 5 and re-adjust the percentage of their shareholding accordingly. This essentially forces

shareholders (e.g., the entrepreneurs) who are not protected by similar anti-dilution provisions to bear the loss caused by the lower valuation. Since crowd investors are not able to negotiate the price of their shares with the issuer, the possibility to re-adjust the price at which investors purchase their shares partially reduces the chance that issuers would price their shares at an unreasonable price in the first place.

3. Liquidation preference: This provision allows holders of preferred shares to be paid a specific amount before the company's funds are distributed among common shareholders when the company is liquidated, sold or wound up.
4. Right to dividend: Since early stage companies rarely declare dividends, some transactions provide that preferred shareholders are entitled to mandatory dividends irrespective of whether dividends are declared by the board in a given year. Such dividends may be cumulative and will be paid to preferred shareholders at the discretion of the board, upon redemption of the shares or dissolution of the company.
5. Right to redemption: This is a fairly contentious provision which allows shareholders to force the company to buy their shares at a specified time in the future. This is clearly advantageous to crowd investors who would be entitled to an additional chance to liquidate their investment. Issuers, on the other hand, would generally resist inclusion of such provisions.

#### (5) Liability of the Issuer and the Platform

The issuer should be liable for any false or misleading statements in his crowdfunding proposal or any advertisement it has published. If, before the issuer receives funding from the investors, it is aware of any new circumstances that would render any part of his proposal false or misleading, it should be under a duty to disclose that information to the investors and afford them an opportunity to withdraw their investment.

Similarly, if the crowdfunding platform becomes aware of any false or misleading statement in a crowdfunding proposal or advertisement it has published, it should be

liable for that statement unless it has immediately taken reasonable steps to remove that misstatement, to inform the relevant crowd investors of it, and to offer the investors an opportunity to withdraw their investment.

#### D. Investor Protection after the Completion of a Funding Round

##### (1) Detection of misconduct

As noted above, crowd investors have little access to the company's information or to participate in its management after the completion of the funding round. This makes it difficult for crowd investors to fend for themselves against potential abusive conduct by the company's directors or majority shareholders. Crowd investors' access to information may be improved in two ways.

##### (a) Periodic Disclosure of Financial Information by the Company

The company should be required to report to crowd investors on a more regular basis. The aim is to provide investors with sufficient information to detect improper behavior without overly burdening the company. In this respect, the company may be required to provide investors with unaudited profit and loss accounts on a quarterly basis; this would enable investors to understand the financial state of the company and, since the company needs to prepare such account in any event, producing such accounts should not be too burdensome.

At the same time, there should be a procedure for crowd investors to seek additional information from the company on a periodic basis, say on a quarterly basis. For example, investors can post their questions on an online forum similar to the one they have used when they participate in equity crowdfunding. The company can then respond to these questions in the same forum.

##### (b) Independent Director Appointed by the Crowd Investors

Crowdfunding investors should be entitled to appoint one independent director to the company they invest in to represent and safeguard their interests. The crowdfunding platform should facilitate the appointment by establishing a panel of independent

directors from which an independent director may be appointed. The independent director would owe fiduciary duties to the crowd investors as a whole and report to them on a periodic basis.

(2) Respond to Misconduct

(a) Dispute resolution scheme by the platform

The crowdfunding platform should be required to establish a dispute resolution scheme to resolve potential conflicts between the crowd investor and the issuer. The scheme should, for example, set up a complaint procedure for crowd investors to report misconduct and set out the basic steps that the platform may take to assist crowd investors in negotiating or otherwise dealing with the issuer.

(b) Legal proceedings

As shareholders of the crowdfunded company, crowd investors are entitled to apply to the court for an order if the affairs of the company are being conducted or the powers of the directors are being exercised in a manner which is oppressive or unfairly prejudicial to their interests (e.g., if crowd investors are excluded from an opportunity to sell their interests in breach of their tag-along rights). However, as noted earlier, each crowd investor has limited means and limited stake in the company, it is likely that crowd investors need to pool their resources to take actions against such misconduct. A forum for crowd investors to communicate with each other would facilitate crowd investors in taking collective actions.

(c) Rating and Reputation

In addition to formal enforcement measures, there should be a mechanism for crowd investors to use reputation as an informal means to police the company's conduct. Commentators have suggested three necessary conditions for reputation to act as a constraint on misbehaviour: (1) the relevant party whose conduct is policed by the reputation market must anticipate repeated future transactions; (2) market participants must have shared expectations of what constitutes appropriate behaviour; and (3) those who deal with the party whose conduct is policed by the reputation market must

be able to determine whether that party's conduct conforms to the shared expectations.<sup>141</sup>

It is likely that reputation has played a crucial role in reducing the rate of fraud in reward equity crowdfunding. A recent study has shown that, despite absence of significant outside vetting of the projects on Kickstarter, the rate of fraud is relatively low. Mollick (2014) examined 471 successful Kickstarter projects in the categories of design and technology that have promised delivery dates for distributing rewards to crowd investors. He found that only 14 projects failed to deliver, that is, 3.6 percent of the projects surveyed.<sup>142</sup> The three pre-conditions for a successful reputation market are arguably present in the case of Kickstarter projects. Entrepreneurs are likely to anticipate future transactions: they might come back to Kickstarter with new projects, or, for those that post their own pictures or videos on Kickstarter, they would anticipate interactions with their friends and families who can see their projects on Kickstarter. Whether the entrepreneurs have conformed to the expected behavior, i.e., deliver products/services they promise in their Kickstarter campaign to crowd investors, is also easy to determine.

In the case of equity crowdfunding, issuers are likely to anticipate repeated contact with future investors since start-ups usually need several rounds of financing. The difficulty lies in ensuring that future investors are able to easily determine whether the issuer has conformed to "shared expectations" in a previous financing round. One possible way is to provide a mechanism for crowd investors to rate and comment on various aspects of the issuers' (and the relevant entrepreneurs') performance, including, for example, their ability to achieve milestones in their business plans, to keep investors informed of the company's development, and to fairly distribute the company's assets. The rating and comments from investors of major crowdfunding platforms can be consolidated to produce a useful database for future investors. Entrepreneurs would have strong incentive to keep a decent rating since such information would be available to their prospective investors, future employers and even social connections.

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<sup>141</sup> Ronald Gilson, "Engineering a Venture Capital Market: Lessons from the American Experience" *Stanford Law Review* Vol. 55, No. 4 (Apr., 2003) 1067.

<sup>142</sup> Ethan Mollick, "The dynamics of crowdfunding: An exploratory study" *Business Venturing* 29 (2014) 1-16, p.11.

CONCLUSION

Equity crowdfunding should be facilitated in Singapore to supplement and, where appropriate, replace government initiatives to assist and finance start-ups and small businesses. Apart from removing existing legal barriers to equity crowdfunding, additional investor protection measures tailored to mitigate various types of risks involved in equity crowdfunding should be put in place.

Annex I: Disclosure Requirements under Title III of the JOBS Act

Requirement	Particulars and Supporting Documents
The issuer	Issuer’s name, legal status, physical address, and website address
Key persons associated with the issuer	Names of the directors and officers, and each person holding more than 20 percent of the shares of the issuer
Issuer’s business	A description of the issuer’s business and the anticipated business plan
Issuer’s financial condition	<p>A description of the issuer’s financial condition, and including, for offerings that, together with all other equity crowdfunding offerings of the issuer within the preceding 12-month period, have, in the aggregate, target offering amounts of—</p> <p>(i) \$100,000 or less—</p> <p>(I) the income tax returns filed by the issuer for the most recently completed year (if any); and “(II) financial statements of the issuer, which shall be certified by the principal executive officer of the issuer to be true and complete in all material respects;</p> <p>(ii) more than \$100,000, but not more than \$500,000, financial statements reviewed by a public accountant who is independent of the issuer; and</p> <p>(iii) more than \$500,000, audited financial statements;</p>
Proposed use of funds to be raised	A description of the stated purpose and intended use of the proceeds of the offering sought by the issuer with respect to

	the target offering amount
Offering amount	The target offering amount, the deadline to reach the target offering amount, and regular updates regarding the progress of the issuer in meeting the target offering amount
Price of the securities	The price to the public of the securities or the method for determining the price, provided that, prior to sale, each investor shall be provided in writing the final price and all required disclosures, with a reasonable opportunity to rescind the commitment to purchase the securities
Issuer's ownership and capital structure	<ul style="list-style-type: none"> <li>• Terms of the securities of the issuer being offered and each other class of security of the issuer, including how such terms may be modified, and a summary of the differences between such securities, including how the rights of the securities being offered may be materially limited, diluted, or qualified by the rights of any other class of security of the issuer;</li> <li>• A description of how the exercise of the rights held by the principal shareholders of the issuer could negatively impact the purchasers of the securities being offered;</li> <li>• The name and ownership level of each existing shareholder who owns more than 20 percent of any class of the securities of the issuer;</li> <li>• How the securities being offered are being valued, and examples of methods for how such securities may be valued by the issuer in the future, including during subsequent corporate actions; and</li> <li>• The risks to purchasers of the securities relating to minority ownership in the issuer, the risks associated with corporate actions, including additional issuances of</li> </ul>

	shares, a sale of the issuer or of assets of the issuer, or transactions with related parties.
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