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THE SURPRISING LIBERALITY OF SECURITIES CROWDFUNDING REGULATION IN HONG KONG: INSIGHTS FROM A COMPARATIVE ANALYSIS

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Crowdfunding—the use of the internet and other social media by entrepreneurs to attract funding for their ideas and projects—holds forth the promise of mitigating the funding gap that entrepreneurs face. While regulators in the US, the UK and Singapore have made adjustments to the securities fundraising rules in response to the demand for a reconsideration on how the regulatory system should respond to the potential benefits proffered by crowdfunding, HK has not carried out such an exercise. This article examines whether the current fundraising rules are more restrictive than those found in the reference jurisdictions, and whether further reforms are necessary. The comparative study reveals the surprising liberality of the existing HK regulatory regime, the current regulatory strategies employed by reference jurisdictions to strike a better balance between access to funding and investor protection, and what lessons HK may derive from them.

I. INTRODUCTION

On 28 April 2019, the South China Morning Post reported that the Hong Kong Securities and Futures Commission had issued licences to Angelhub, which allowed it to operate as the first equity crowdfunding platform in Hong Kong ("HK").[1] Vincent Fong, a contributing editor for fintechnews.hk, found the development underwhelming.[2] He was disappointed that this did not represent true crowdfunding. According to Fong, true equity crowdfunding posits a start-up entrepreneur being able to pitch her ideas to the market, and corollary to that, an opportunity to participate that is open to all. The Angelhub development fell short of the mark first, because the platform was available only to professional investors; for individual investors, these would be persons each having an investment portfolio of not less than HK$8 million

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1 Enoch Yiu, "Hong Kong issues equity crowdfunding license to Angelhub in boost to fintech ambitions, start-ups" *South China Morning Post* (28 April 2019), online: SCMP <https://www.scmp.com/business/companies/article/3007897/hong-kong-issues-equity-crowdfunding-licence-angelhub-boost>.

2 Vincent Fong, "Hong Kong Gets Its First Equity Crowdfunding Platform, Well Kinda" *Fintech News Hong Kong* (30 April 2019), online: Fintechnews <http://fintechnews.hk/9260/crowdfunding/hong-kong-equity-crowdfunding-angelhub/>.

(approximately US$1 million). As such, it did not present investment opportunities to the "common folk". Second, the entrepreneur behind Angelhub had indicated in the interview with the South China Morning Post ("SCMP") her estimation that only about five percent of start-ups that apply to the platform will be exposed to investors. This means many start-ups continue to be denied access to funding.

The question which arises is whether the HK regulatory regime has failed to accommodate technological advances that serve to connect capital providers with entrepreneurs. Unlike other major financial centres, HK has not observably adjusted its fundraising rules to cater to crowdfunding. This is despite the HK Financial Services Development Council ("FSDC") issuing a paper in March 2016 entitled "Introducing a Regulatory Framework for Equity Crowdfunding in Hong Kong"[3] in which it explored a number of possible adjustments to the regulatory framework in order to accommodate crowdfunding. An underlying premise of the paper is that the limited activity based on the current exemptions to the prospectus requirement points to constraints which are insufficiently accommodating of crowdfunding.[4]

The present article takes the comparative regulatory analysis carried out in the FSDC Paper further by examining in detail how the present rules on securities offerings in HK[5] compare with the United States ("US"), the United Kingdom ("UK") and Singapore—three jurisdictions against which HK often compares itself. In particular, as crowdfunding is invariably associated with the funding of start-ups, the necessary query is whether the exemptions or safe-harbours from the requirement to prepare a statutory prospectus afford start-ups the room to raise funds without undue burden.[6] This issue impacts on the need to create a new exemption as proposed by the FSDC.[7] Through a detailed examination of the exemptions, this article demonstrates

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3 Hong Kong Financial Service Development Council, "Introducing a Regulatory Framework for Equity Crowdfunding in Hong Kong" (2016) FSDC Paper No 21, online: FSDC <http://www.fsdc.org.hk/sites/default/files/Final_Report.pdf>.

4 *Ibid* at para 93 ("If crowdfunding in Hong Kong were to remain confined to such a limited form or amounts, relying on such limited regulatory exemptions, its full economic benefits would likely not be realized.").

5 The focus of this article is on fundraising through an issue of shares or debentures. These are governed by *Companies (Winding Up and Miscellaneous Provisions) Ordinance* (Cap 32, Hong Kong) [*CWUMPO*] Pt II (Hong Kong companies) and Pt XII (companies incorporated outside of HK). Fundraising involving more complex products like structured deposits and participatory interests in a collective investment scheme are governed by *Securities and Futures Ordinance* (Cap 571, Hong Kong) [*SFO*] Pt IV, Div 2. Unless exempted, the advertisements and offerings must be authorised by the Securities and Futures Commission. *SFO*, *ibid*, s 103(1). The exemptions are more generous under *CWUMPO*; a common exemption relates to offerings to professional investors. *SFO*, *ibid*, s 103(3)(k) and *CWUMPO*, *ibid*, Seventeenth Schedule, Pt 1, s 1.

6 There are a few varieties of crowdfunding. Apart from equity and debt crowdfunding, an entrepreneur may also seek funds through donation and reward crowdfunding. In HK, fundraising through the issue of equity and debentures (debt) is covered by Pts II and XII of the *CWUMPO*, *ibid*. For the purposes of this article, they will be compendiously referred to as securities. It should be noted that the definition of "securities" for the purposes of *SFO, ibid*, s 103 goes beyond shares and debentures. See *SFO*, *ibid,* First Schedule, Pt 1, s 1. Those securities not regulated by the *CWUMPO* are regulated by *SFO, ibid*, Pt IV, Div 2. Donation and rewards crowdfunding do not typically involve the issue of securities and fall outside the scope of this article. It is noteworthy that there is no exhaustive statutory definition of "debenture". In *Levy v Abercorris Slate and Slab Co* (1887) 37 Ch D 260 at 263, Chitty J defined the term as "a document which either creates a debt or acknowledges it", which definition was more recently applied in *Fons Hf v Corporal Ltd* [2014] EWCA Civ 304 (CA) [*Fons Hf*].

7 *Supra* note 3 at paras 102-105.

the surprising liberality of the HK fundraising regime and suggests that the relative dearth of crowdfunding activity lies elsewhere.

The regulatory responses to crowdfunding in the US, the UK and Singapore vary in their intensity though the regulatory choices revolve around three parameters: the issuer, the intermediary and the investor. The most striking difference is that the US has, through the *Jumpstart Our Business Startups Act*[8] Title III, expressly provided for a crowdfunding regulatory exemption premised on general public solicitation, while the UK and Singapore have taken a different route. It will be a mistake to read the latter policy choice as a sign of timidity. The present author unpacks the parameters underlying the UK and Singapore approaches and uncovers their merits. Rather than offering modes of further liberalising access, the reference jurisdictions offer a toolkit on the strategies that can be adopted for investor protection.

II. The Regulatory Landscape Affecting Securities Crowdfunding in Hong Kong

Fundraising from the public through an issue of shares or debentures attracts the requirement to prepare a statutory prospectus.[9] The entrepreneur who desires to raise capital in HK through offering shares in or debentures of a company does not necessarily need to prepare a full prospectus.[10] There are a number of exemptions or safe-harbours providing for more limited fundraising which he might utilise in order to avoid the time and expense of preparing a full prospectus.[11] If the entrepreneur seeks to raise no more than HK$5 million, he might call in aid the small offering exemption found in section 3 of the Seventeenth Schedule to the *CWUMPO*.[12] Alternatively, by limiting the offer to no more than 50 persons, section 2 of the same might be employed (hereinafter referred to as "limited offerees exemption"). A third method is to structure the fundraising such that the minimum consideration payable by any person for the shares is HK$500,000.[13] A fourth method is to make the offer only to "professional investors"[14] which, amongst others, include individuals having a portfolio of not less than HK$8 million.[15] Indeed, an offer to professional

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8 Pub L No 112-106, 126 Stat 306 (2012) [*JOBS Act*].

9 *CWUMPO*, *supra* note 5, s 2 (definition of prospectus) read with s 38 (companies incorporated in Hong Kong), s 342 (companies incorporated outside Hong Kong). Debt securities that fall within the definition of "structured products" fall outside the regulatory regime of *CWUMPO*: *CWUMPO*, *ibid*, s 38AA, s 342AA. The regulatory regime applicable to them is that applied to collective investment schemes: *SFO*, *supra* note 5, Pt IV, Div 2, in particular ss 103, 104.

10 The requirement for a statutory prospectus can be found in *CWUMPO*, *ibid*, s 38D read with s 38 (for companies incorporated under HK company legislation / s 342C read with s 342 (for companies incorporated outside HK). In addition, *SFO*, *ibid*, s 103(1) requires that all non-exempted offers to acquire securities be authorised by the Securities and Futures Commission; significantly, the exempted offers include those covered by *CWUMPO*, *ibid*, Seventeenth Schedule, Pt 1: see *SFO*, *ibid*, s 103(2)(ga).

11 See *CWUMPO*, *ibid*, Seventeenth Schedule, Pt 1.

12 See *ibid*, Seventeenth Schedule, Pt 2 which sets out the maximum amount that can be raised under the small offering exemption.

13 See *ibid*, Seventeenth Schedule, Pt 1, s 4, read with Pt 2 of the same.

14 See *ibid*, Seventeenth Schedule, Pt 1, s 1 read with *SFO*, *supra* note 5, First Schedule, Pt 1, s 1 and the *Securities and Futures (Professional Investor) Rules* (Cap 571D).

15 See *Securities and Futures (Professional Investor) Rules* (Cap 571D), *ibid*, s 5 read with *CWUMPO*, *supra* note 5, Seventeenth Schedule, Pt 1, s 1 and *SFO*, *supra* note 5, First Schedule, Pt 1, s 1.

investors may be made together with an offer to limited offerees.[16] However, the offer to limited offerees by its terms precludes a general offer through the internet to the world-at-large.

To the extent that the offering is advertised through an online web portal which aggregates similar offerings—a funding portal—its activities would minimally amount to "dealing in securities", a Type 1 regulated activity under the *SFO*.[17] If a portal provides advice or issues analyses and reports relating to the securities on offer, it would amount to "advising on securities" and fall to be licensed as "advising on securities"—a Type 4 regulated activity.[18] And to the extent that the portal provides electronic facilities by which an investor puts through instructions leading to a binding transaction, the portal would be operating an automated trading service, a Type 7 regulated activity.[19] The carrying on of a business in any such regulated activity would, unless licensed or authorised, contravene section 114(1) of the *SFO*.

Beyond the usual avenues of bank finance, venture capital, private equity finance and government start-up grants, an entrepreneur might wish to reach out to the wider pool of investors to solicit their interest in his venture. Fundraising regulatory regimes have long required attempts at offering securities to the public to be accompanied by a statutory prospectus.[20] The statutorily prescribed disclosures provide the public with a standard list of comparators, which thereby facilitate the efficient pricing of the securities offered. Selective and uneven disclosure is avoided; similarly, the transaction costs that attend the bargaining for information. Apart from protecting the members of the investing public who would not be in a position to bargain for information, the mandatory disclosure contained in the statutory prospectus delivers a public good through savings on the multiple sets of bargaining costs that might otherwise have to be incurred and hence promotes efficient capital allocation.[21] The costs associated with preparing a statutory prospectus are not insignificant. Should the prospectus requirement extend too broad, its associated costs will present an obstacle to small and medium enterprises which have more modest funding needs. The disapplication of the prospectus regime for the small offer exemption found in section 3 of the Seventeenth Schedule to *CWUMPO* represents an acknowledgement that a

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16 See *CWUMPO*, *ibid*, Seventeenth Schedule, Pt 4, s 1.

17 Defined as "making or offering to make an agreement with another person, or inducing or attempting to induce another person to enter into or to offer to enter into an agreement—(a) for or with a view to acquiring, disposing of, subscribing for or underwriting securities . . .". *SFO*, *supra* note 5, Fifth Schedule, Pt 2. *SFO*, *ibid*, ss 114(1) and (2) prescribe that "no one shall. . . carry on a business in a regulated activity" without a licence. *Cf Financial Services and Markets Act 2000* (UK), c 8, s 21(1) [*FSMA*] where use of the phrase "in the course of business" connotes a wider ambit. "A person. . . must not, *in the course of business*, communicate an invitation or inducement to engage in investment activity." [emphasis added]. Clive M Schmitthoff, ed, *Palmer's Company Law*, 25th ed (London: Sweet & Maxwell, 1992) at para 11.030 suggests that this phrase is wider than "by way of business" found in, for *eg*, *FSMA*, *ibid*, s 22 which defines the meaning of "regulated activity" that is prohibited under *ibid*, s 19 unless carried out by an authorised person or an exempt person. "It seems clear that 'by way of business' requires the activities to be carried on by way of business in their own right rather than just carried on in the context of (perhaps another) business activity". Schmitthoff, *ibid* at para 11.026.

18 See *SFO*, *supra* note 5, Fifth Schedule, Pt 2, definition of "advising on securities".

19 See *ibid*, definition of "automated trading services".

20 See *Securities Act of 1933*, 15 USC § 77a (1933) [*Securities Act*]; *Companies Act*, *1948* (UK) 11 & 12 Geo VI, c 38.

21 John C Coffee Jr, "Market Failure and the Economic Case for a Mandatory Disclosure System" (1984) 70 Va L Rev 717 (arguing that mandatory disclosure is economically efficient as it avoids the multiple sets of cost incurred in searching for information on the part of diverse investors).

balance needs to be struck between the benefits of requiring a statutory prospectus and the obstacle that such a requirement might pose to fundraising by small and medium enterprises. On the other hand, the exemptions for offers to professional investors might be justified by their presumptive capacity to bargain for information and to engage in due analysis of the merits of the offer. In the alternative, they would have the means and the incentive to engage financial advisers who would advise them on the merits of the proposed offer. This would explain the inclusion of high net worth individuals within the definition of "professional investor" as well as the exemption for offers with considerable minimum consideration.

A claim that an entrepreneur seeking modest funding for his start-up is unduly burdened by the existing regulatory environment has thus to be assessed against the backdrop of the multiple exemptions to the requirement for a statutory prospectus. Moreover, the exemptions go further to disapply the regime for regulated solicitation of investor interest found in section 103 of the *SFO*; the dissemination of advertisements and other solicitation material relating to the exempted offerings do not require the prior approval of the Securities and Futures Commission.[22]

III. How do the Current HK Exemptions Compare with the Reference Jurisdictions Prior to Their Initiatives to Accommodate Crowdfunding?

A. *Small Offers Exemption*

The small offers exemption found in the Seventeenth Schedule of the *CWUMPO* sets the ceiling of HK$5 million within any 12-month period. By comparison to the reference jurisdictions, the HK ceiling is the lowest amongst the comparative jurisdictions:

US	UK	Singapore
$1 million in any 12-month period *Regulation D* section 230.504	€8 million in any 12-month period *Prospectus Regulation* 2017/1127, confirmed by the *Financial Services and Markets Act 2000 (Prospectus and Markets in Financial Instruments) Regulation 2018 (2018/786)* amending section 86(1)(e) of the *FSMA* (wef. 21 July 2018)	S$5 million in any 12-month period *Securities and Futures Act* s 272A(1)(a)

At first impression, section 230.504 of *Regulation D*[23] assists the entrepreneur who seeks modest amounts of funding not exceeding US$1 million. Rule 504 provides a

[22] See *SFO*, *supra* note 5, s 103(2)(ga).

[23] *Securities Act of 1933 General Rules and Regulations*, 17 CFR §§ 230.500-230.508 [*Regulation D*].

safe-harbour from the registration requirements levied by section 5 of the *Securities Act*. Materially, the safe-harbour prescribes no limitation on the kind of persons to whom the securities are offered or sold, and imposes no limitation on the number of persons to whom such offer or sale can be made. Its use for crowdfunding is, however, precluded by the condition that the offer or sale must not be accompanied by any form of general solicitation or general advertising; since the very premise of crowdfunding is the solicitation of funds from the general public through a publicly accessible portal, rule 504 does not aid an attempt at any kind of securities crowdfunding.

The small offer exemption provided in Singapore sets a ceiling about 5.7 times as high as that found in HK. However, the terms for use of the small offer exemption are significantly different. First, the small offer exemption is premised on the offers being in the nature of a "personal" offer *viz* one directed at a pre-identified individual or entity, which would include offers made to persons who have previous contact, professional or other connection with the offeror.[24] Secondly, the use of the small offers exemption is circumscribed by the advertising restriction—for a condition to be satisfied in order to rely upon the exemption is that:

> . . . none of the offers is accompanied by an advertisement making an offer or calling attention to the offer or intended offer.[25]

This precludes a portal set up by the issuer calling attention to the intended fundraising for "advertisement" is defined broadly and includes "a communication by radio, television or other medium of communication."[26] Additionally, advertising and promotional expenses are prohibited except for administrative and professional expenses paid to licensed intermediaries or an exempt person in respect of dealing in securities; the effect of this restriction is that the marketing of the securities has to be carried out by a licensed intermediary, or an exempt intermediary who has obtained an acknowledgement from the Monetary Authority of Singapore ("MAS").[27] The small offer exemption is designed such that the issuer does not solicit funds from the general public but rather, from a circle of existing contacts.[28]

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[24] *Securities and Futures Act* (Cap 289, 2006 Rev Ed Sing), s 272A(3) [*SFA*]. Materially, the connection includes a previous indication made by a person to the issuer or prescribed intermediaries that he is interested in offers of that kind: s 272A(3)(b)(iii).

[25] *Ibid*, s 272A(1)(c).

[26] *Ibid*, s 272A(10)(b).

[27] *Ibid*, s 272A(1)(d)(iii).

[28] However, the circle of potential offerees can be significantly widened through an intermediary who performs specified pre-qualification procedures so that offers to these pre-qualified persons would count as personal offers. In this regard, the revised MAS, *Guidelines on Personal Offers Made Pursuant to the Exemption for Small Offers* (Singapore: MAS, 8 June 2016), online: MAS <https://www.mas.gov.sg/regulation/guidelines/guidelines-on-personal-offers-made-pursuant-to-the-exemption-for-small-offers> liberalised the nature of the investor qualifications in order that they might be included as pre-qualified persons. Prior to the revision, intermediaries were required to ensure that: (a) the investor has the financial competence, and (b) the relevant product is suitable for the investor given her investment objectives, financial means and risk tolerance. With the revision on 8 June 2016, the intermediary need only check for either financial competence, or suitability to invest in securities crowdfunding. Moreover, the definition of financial competence has been relaxed. The previous requirement to ascertain financial competence by both the criteria of knowledge and experience has been relaxed so that satisfaction of either criterion would now suffice. See *ibid* at paras 3.1-3.7.

In the UK, the financial promotion restriction contained in section 21(1) of the *FSMA* channels the marketing efforts relating to "financial instruments"[29] through "authorised persons" who have obtained the permission of the regulator to carry on one or more regulated activities.[30] It does so by prescribing that:

> A person must not, in the course of business, communicate an invitation or inducement to engage in [an] investment activity.

"Engage in [an] investment activity" is defined in section 21(8) to mean "entering or offering to enter into an agreement the making or performance of which by either party constitutes a controlled activity." Under the First Schedule of the *Financial Services and Market Act 2000 (Financial Promotion) Order 2005*, the definition of "controlled activity" includes the "buying, selling, subscribing for . . . securities as principal or agent".[31] The prohibition in section 21(1) is disapplied if the activity is carried out by an "authorised person". A channelling effect is thereby created. Materially, the *FSMA Order* sets out multiple categories of defined circumstances where the financial promotion restriction does not apply. Amongst others, they include communication to certified high net worth individuals,[32] certified sophisticated investors,[33] self-certified sophisticated investors,[34] and associations of high net worth or sophisticated investors.[35] In theory at least, the issuer may promote its securities to these potential investors without falling foul of the financial promotion restrictions.

B. *Exemption for Limited Number of Offerees*

The HK exemption involving a limited number of offerees sets the ceiling at 50 persons. This ceiling is the same as that for Singapore under the equivalent exemption, but less than the figure of 150 for the UK.

US	UK	Singapore
(Closest equivalent is *Regulation D* rule 505 and 506(b), as to which, see below.)	150 persons *FSMA* section 86(1)(b), as amended by *Prospectus Regulations 2011* (SI 2011/1668), implementing *Directive 2010/73/EU*. This exemption continues under art 4(b) of the *EU Prospectus Regulation 2017/1127*.	50 persons *Securities and Futures Act* s 272B

[29] See EC, *Directive 2014/65/EU of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU*, [2014] OJ, L 173/349 at Annex I, s C [*MiFID2*] defines financial instruments to include transferable securities, which term is defined in art 4(1)(44) to include securities negotiable on the capital market.

[30] *FSMA*, *supra* note 17, s 31(1)(a).

[31] See *The Financial Services and Markets Act 2000 (Financial Promotion) Order 2005*, SI 2005/1529 at Schedule 1, para 3(1) [*FSMA Order*].

[32] *Ibid*, art 48.

[33] *Ibid*, art 50.

[34] *Ibid*, art 50A.

[35] *Ibid*, art 51.

The restriction against general advertising that obtains for the small offers exemption applies in equal measure to the limited offerees exemption in the UK and in Singapore.[36] As discussed below,[37] the requirement in the equivalent HK exemption—that the offer be made to no more than 50 persons—necessarily means that an offer to the world using a web portal is precluded.

C. *Exemption for Offers Requiring Significant Minimum Consideration or Denomination*

The HK threshold for this exemption—HK$500,000—is lower than that of the UK (approximately equivalent to HK$865,000) and Singapore (approximately equivalent to HK$1.143 million).

US	UK	Singapore
—	€100,000 Minimum consideration or denomination of €100,000: *FSMA* sections 86(1)(c) and 86(1)(d) respectively, as amended by *Prospectus Regulations 2012* (SI 2012/15388). These exemptions continue under article 4(c) of the *EU Prospectus Regulation 2017/1127*.	S$200,000 *Securities and Futures Act* s 275(1A)

Unlike the UK and Singapore equivalents, the HK exemption is unencumbered by a restriction against general advertisement.[38]

D. *Professional Investor who is a Natural Person*

The carve-out for fund-raising from high net worth individuals and entities with a substantial portfolio of investible assets is defensible on the ground that they either have the sophistication or the means and incentive to access expert advice for the evaluation of investment opportunities. As each jurisdiction typically has several routes for qualifying as what might generically be termed the "professional investor", the present section chooses the high net worth individual as the comparator. A summary table is found below. HK uses a rough-and-ready criterion—investment portfolio of HK$8 million. While the figure is close to the net worth criteria under US federal securities law, "net worth" is conceivably broader than "investment portfolio". Moreover, HK does not have a qualification based on annual income.

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[36] *SFA*, *supra* note 24, s 272B(1)(b).

[37] See text to *infra* note 49.

[38] See UK: text to *supra* note 30, 31. *SFA*, *supra* note 24, s 275(1A).

US	UK	Singapore
Accredited investor defined to include a natural person whose net worth (alone or whose joint net worth with the spouse) exceeds $1 million; and a natural person whose individual income exceeds $200,000 in each of the last two recent years, or whose joint income with the spouse exceeds $300,000 in each of the last two recent years. *Regulation D* section 230.501(5) and (6).	"Qualified investor" Article 1(4)(a) and article 2(e) of the EU Prospectus Regulation 2017/1127 incorporating various definitions found in the Markets in Financial Instruments Directive. Implemented by FSMA section 86(7), as amended by SI 2012/1538. The amendments of SI 2019/707 come into effect on exit day.	Net personal assets of at least S$2 million, or Income of not less than S$300,000 in the last 12 months[39]

That said, fundraising from professional investor is often encumbered with other conditions. Under US federal securities law, offers and sales to a person with high net worth or high income meeting the definition of "accredited investor" under *Regulation D* can be carried out under either rule 505 or rule 506. Rule 505 provides for an exemption from registration where the offer or sale does not exceed $5 million and the number of purchasers does not exceed 35. Significantly, accredited investors do not count toward the limitation on the maximum number of purchasers.

Rule 506 removes the ceiling on the maximum amount of funds that can be raised. It provides for two principal sets of conditions under which the exemption may be appropriated. Rule 506(b) is similar to rule 505 in requiring that the sales be made to no more than 35 purchasers (not including accredited investors); the difference with rule 505 is that whereas rule 505 prescribes no conditions relating to the nature of the non-accredited investor, rule 506(b) requires that the non-accredited investor either alone or with his adviser possess the knowledge and experience to evaluate the merits and risks of the proposed investment or alternatively, that the issuer has reasonable grounds for believing this to be so.[40] The industry shorthand for this requirement is that the investors must be "sophisticated".[41] Both rule 505 and rule 506(b) are subject to the prohibition against general solicitation and advertising.[42]

It is apposite at this junction to refer to the initiative to increase the access to accredited investors found in Title II of the *JOBS Act*. Title II directed the SEC to create a rule—what is now rule 506(c)—to which the prohibition against general

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39 See *SFA*, *supra* note 24, s 4A.

40 See *Securities Act of 1933 General Rules and Regulations*, 17 CFR § 230.506(b)(2)(ii) (2013) [*Securities Act General Rules*].

41 Ze'-ev D Eiger, Anna T Pinedo & David Lynn, "JOBS Act Quick Start: A brief overview of the JOBS Act" (2016) Intl Fin L Rev at 42.

42 See *Securities Act General Rules*, *supra* note 40, § 230.502(c) read with § 230.505(b), § 230.506(b)(1) respectively.

solicitation and general advertisement does not apply.[43] This, therefore, is one of key attractions of rule 506(c) over rule 506(b); though both have no limitation on the amount that can be raised, rule 506(c) permits the issuer a much broader pool of investors through the allowance for general solicitation and general advertisement. The restriction in rule 506(c) is that the offer or sale must *only* be made to accredited investors; the allowance for sale to no more than 35 non-accredited investors found in rule 506(b) is not available in an offering proceeding under rule 506(c).

The qualified investor exemption to the requirement for a prospectus contained in s 86(1)(a) of the UK *FSMA* has a fairly involved definition following that found in the *EU Prospectus Regulation*.[44] Apart from institutional professional investors, a qualified investor includes a client who has requested to be regarded as such and who may be so regarded under section 1 to Annex II of *MiFID*. The client must have been assessed by an intermediary to be capable of making his own investment decisions and understanding the risks involved. The Directive prescribes that *at least two* of the following criteria must be satisfied in assessing the expertise, experience and knowledge of the client:

(i) The client has carried out transactions, in significant size, on the relevant market at an average frequency of 10 per quarter over the previous four quarters,
(ii) The size of the client's financial instrument portfolio, defined as including cash deposits and financial instruments exceeds EUR 500,000,
(iii) The client works or has worked in the financial sector for at least one year in a professional position, which requires knowledge of the transactions or services envisaged.

Financial promotion to certified high net worth individuals, certified and self-certified sophisticated investors is permitted provided the conditions circumscribing such promotion are complied with.[45]

In Singapore, the utilisation of the accredited investor exception is subject to the same restrictions on advertising and marketing as those applicable for the small offer exemption described above. That is, there must be no advertising,[46] and marketing is channelled through regulated intermediaries.[47]

In all three jurisdictions—the US, the UK and Singapore—the exemptions from the general registration and prospectus requirements and the permission to carry out certain offers or sales do not lead to a right to generally market the securities or solicit for investors. Variants of the gatekeeper strategy are adopted to discipline the process of marketing the securities. The regulatory strategy adopted in the UK saliently illustrates this. Marketing falls within the ambit of "financial promotion"; under the *FSMA Order*, it is permitted only under specified conditions. The prohibition against

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43 The final rules were adopted by the SEC on 10 July 2013, and became effective on 23 September 2013.

44 See EC, *Prospectus Regulation (EC) 2017/1127 of 14 June 2017 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market, and repealing Directive 2003/71/EC*, [2017] OJ L 168/12 [*EU Prospectus Regulation*].

45 See *FSMA Order*, *supra* note 31, art 48 (certified high net worth individuals), art 50 (certified sophisticated investors), art 50A (self-certified sophisticated investors).

46 See *SFA*, *supra* note 24, s 275(1)(a).

47 *Ibid*, s 275(1)(b).

general solicitation is also found in *Regulation D* under the US federal securities law and the Part XIII exemptions in the Singapore *SFA*.

Compared with these jurisdictions, it is striking that HK does not have restrictions on solicitation and advertising conditioning the use of the exemptions.[48] To be sure, a common condition underlying the exemptions in the Seventeenth Schedule of the *CWUMPO* consists of requirement that each amounts to an "offer". The broad definition of "prospectus" (which document attracts the statutorily prescribed requirements) has a two-part definition in the alternative[49] which suggests that the notion of the offer is that which applies at general law *viz* a willingness to be bound once the terms are unequivocally accepted.[50] If this is correct, the issuer needs to be careful that the solicitation is not an advertisement or marketing material *simpliciter*. It must contain definite terms which are capable of acceptance and must indicate an intention that one is ready to enter into a binding transaction upon acceptance by the offeree. Apart from this, it appears that there is room for issuers to reach out to potential investors more generally though they should be careful to circumscribe the terms of the offer in a manner which comports with the conditions for the exemptions.[51] This portends the possibility of an issuer seeking funds through its own web portal, an avenue precluded in regimes with a prohibition against general solicitation. In other words, this mode of crowdfunding is available to the entrepreneur seeking funding under a relevant exemption in the Seventeenth Schedule of *CWUMPO*. However, to the extent that crowdfunding is intermediated by a crowdfunding portal

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[48] Offers falling within *CWUMPO*, *supra* note 5, Seventeenth Schedule, Pt 1 are exempt from the prohibition against advertising in *SFO* s 103(1). *SFO*, supra note 5, s 103(2)(ga).

[49] *CWUMPO*, s 2 defines "prospectus" as follows: [emphasis added]

> (a) subject to paragraph (b), means any prospectus, notice, circular, brochure, advertisement, or other document—
>
> (i) *offering* any shares in or debentures of a company (including a company incorporated outside Hong Kong, and whether or not it has established a place of business in Hong Kong) *to the public* for subscription or purchase for cash or other consideration; or
>
> (ii) *calculated to invite offers by the public* to subscribe for or purchase for cash or other consideration any shares in or debentures of a company (including a company incorporated outside Hong Kong, and whether or not it has established a place of business in Hong Kong); . . .

[50] Edwin Peel, ed, *Treitel: The Law of Contract*, 14th ed (London: Sweet & Maxwell, 2015) at 10. "An offer is an expression of willingness to contract on specified terms, made with the intention that it is to become binding as soon as it is accepted by the person to whom it is addressed". See also *Pharmaceutical Society of Great Britain v Boots* [1953] 1 QB 401 (CA) and *Partridge v Crittenden* [1968] 1 WLR 1204 (HC).

[51] For example, an offer under *CWUMPO*, *supra* note 5, Seventeenth Schedule, Pt 1, s 1 should clearly stipulate that the offer is only capable of acceptance by those meeting the statutory definition of "professional investor". In *Pacific Sun Advisors Ltd v Securities and Futures Commission* [2015] 2 HKC 595 [*Pacific Sun Advisors*], the issue arose whether the advertisements, invitation or document came within the exemption in *SFO*, *supra* note 5, s 103(3)(k) *viz* whether they were "made in respect of securities or structured products, or interests in any collective investment scheme, that *are or are intended to be* disposed of only to professional investors" [emphasis added]. The Court of Final Appeal held that in the context of this particular exemption, no particular form of words was necessary as long as it was demonstrated that the investment product is or is intended for disposal only to professional investors. The burden on the Fund was discharged by proving that it had a screening process to exclude persons who are not professional investors. *Pacific Sun Advisors*, *ibid* at para 18, 19. The text for the exemption in *CWUMPO*, *ibid*, Seventeenth Schedule, Pt 1, s 1 needs to be considered on its own terms. In the view of the present author, the document in question must amount to an "offer to professional investors". The terms of the offer must therefore be sufficiently clear to indicate this.

which collates the fundraising efforts of different entrepreneurs, the business of the intermediary is a regulated one. It is noteworthy that HK regulations over marketing activities apply not at the point when an exemption is invoked, but when an intermediary is used to solicit investor interest.

IV. How Have the Reference Jurisdictions Responded to the Call to Accommodate Crowdfunding?

There are three broad policy questions to be considered in re-tailoring regulations affecting securities crowdfunding. First, the question of audience—to whom may the securities be marketed? Should the audience extend to the general public, as is the practice for rewards crowdfunding? If so, should there be limits to the amounts that can be solicited from each investor? Alternatively, should the audience be restricted to the audience currently covered by existing exemptions—materially, those falling within the notion of high net worth or sophisticated investors. This policy choice informs the answers to the second and third questions.

The second broad policy question relates to the issuer. What are the obligations upon the issuer in carrying out crowdfunding? This second broad policy question covers a number of more specific issues, including: the entities entitled to carry out crowdfunding, the maximum amount that can be raised, and the disclosures that the issuer must provide to the investors.

The third broad policy question relates to the platform—the intermediary which collates funding proposals and exposes them to interested investors. What gatekeeping responsibilities should they take on, and how might the performance of these obligations be safeguarded?

The relevant questions for regulators to consider are first, whether the existing regulatory regime is well suited for a crowdfunding portal, and second, whether the current regulatory regime should be re-tailored for a better balance between crowdfunding and investor protection. Insofar as mature capital markets invariably require financial intermediaries to be licensed or subject to some manner of oversight, the question to be considered is whether the existing regulations need to be re-tailored for crowdfunding platforms.

The three reference jurisdictions provide a good range of policy choices that have been made.

A. *The United States: Specially Tailored Regime for Crowdfunding*

The *JOBS Act* passed by the US Congress on April 2012 established a regulatory structure for securities crowdfunding through the internet. Three features stand out in the design of Part III of the *JOBS Act*. First, general solicitation of interest from members of the public is permitted, though there is a low ceiling to the amount that can be raised—US$1 million. Second, there are prescribed limits to how much an individual can invest. For an investor with annual income or net worth of less than US$100,000, the amount is the greater of either US$2,000 or 5% of the annual income or net worth. For an investor whose annual income or net worth exceeds US$100,000, the maximum amount that can be invested is 10% of either the annual income or net

worth (whichever is greater); in either case, the amount invested must not exceed $100,000. Third, the use of an intermediary as gatekeeper. The intermediary must either be registered as a broker-dealer, or registered under a new scheme for "funding portals".

The Securities and Exchange Commission ("SEC") was tasked to write the more precise rules and forms to implement the allowance for crowdfunding under Title III of the *JOBS Act*. The proposed rules and forms were first introduced for comment in October 2013. The final rules—*Regulation Crowdfunding*—were finalised in November 2015 and came into full force on 16 May 2016. Perhaps the most salient portion of *Regulation Crowdfunding* relates to the detailed working of the disclosure strategy for the protection of investors. An issuer is (predictably) required to discuss its financial condition and provide financial statements and tax returns.[52] This is in addition to describing the intended use of the proceeds,[53] the price or the method by which the offer price was arrived at,[54] and information relating to its officers and directors.[55]

Crowdfunding platforms, which must be registered as a broker or as a funding portal,[56] have the burden of providing investors with disclosures relating to the risks of the investments and educational material. The responsibility of the crowdfunding platform was specifically mandated by the *JOBS Act*; the SEC was delegated the task of working out the precise disclosure rules and has done so in *Regulation Crowdfunding*.[57] There are two other noteworthy obligations imposed on crowdfunding platforms. First, the intermediary is required to host communication channels by which investors may interact and discuss the offering amongst themselves, as well as with the representatives of the issuer.[58] Second, the intermediary is obliged to facilitate the offer and sale of the crowdfunded securities.[59] It is thus envisaged that the intermediary facilitating the crowdfunded offering should be responsible both for the marketing as well as the transactional aspects, and importantly, that there should not be a disaggregation of the functions. Upon the intermediary is placed a number of gatekeeping functions. It is required to carry out due diligence to ensure that it has a reasonable basis for believing that the issuer has complied with its regulatory obligations.[60] If the intermediary is registered as a broker, it is authorised to handle

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52 *Regulation Crowdfunding General Rules and Regulations*, 17 CFR §§ 227.201(s), 227.201(t) (2017) [*Regulation Crowdfunding*] respectively.

53 *Ibid*, § 227.201(i).

54 *Ibid*, § 227.202(m)(4).

55 *Ibid*, § 227.201(b).

56 Broker registration under *Securities Exchange Act*, 15 USC § 78o(b) (1934) [*Exchange Act*]; requirements for registration as a funding portal are prescribed under *Regulation Crowdfunding*, *supra* note 52, § 227.400. Additionally, the funding portal must be a member of Financial Industry Regulatory Authority ("FINRA"). *Securities Act*, *supra* note 20, § 77d-1(a)(2). (The provision also allows for registration with any other national securities association registered under § 78o-3 of the *Exchange Act*, *ibid*. However, as FINRA is currently the only national securities association registered under the provision, the practical effect of *Securities Act*, *ibid*, § 77d-1(a)(2), is that all funding portals must be registered with FINRA.)

57 See *Regulation Crowdfunding*, *supra* note 52, § 227.302(b)(i)-(ix).

58 *Ibid*, § 227.303(c).

59 See *ibid*, § 227.303(d), (e).

60 See *ibid*, § 227.301(a), (b).

the funds transmitted by the investors and is obliged to ensure that the offering proceeds are only transmitted to the issuer after the capital raised has at least reached the target amount stated in the offering.[61] If the intermediary registers as a crowdfunding portal, it is not authorised to handle funds and must instead channel the investor to a qualified third party who is authorised to handle such funds.[62]

The fundraising space opened up by *Regulation Crowdfunding* should be seen alongside the allowance for general solicitation and general advertisement under Title II of the *JOBS Act* and rule 506(c) discussed earlier. *Regulation Crowdfunding* addresses crowdfunding from the general public. Its more paternalistic overtones—the limitation on the amount that an ordinary investor can invest, the restriction on the maximum that an issuer can raise (US$1 million), initial disclosure obligations and on-going reporting requirements—stand in marked contrast to an offering under rule 506(c), which might also be advertised generally through an internet portal. The material difference is this: under rule 506(c), the issuer must carry out due diligence checks to verify that each interested purchaser meets the criteria to be regarded as an accredited investor.

B. *The United Kingdom: Extension of Existing Norms to Crowdfunding Intermediaries*

The *EU Prospectus Regulation*[63] and the *MiFID*[64] provide the framework regulations affecting fundraising; though there is some room for member states to create carveouts from the EU norms, they do impose significant constraints on the extent to which the UK can redesign fundraising regulations for crowdfunding.[65] This might explain why there has not been a more extensive reconsideration of crowdfunding regulation. The amendments suggested by the Financial Conduct Authority ("FCA") Policy Statement issued in March 2014[66] can be characterised as adjustments to bring crowdfunding squarely within the existing norms. Perhaps the most noteworthy response relevant to securities fundraising is the application of the marketing

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61 *Securities Act*, *supra* note 20, § 77d-1(a)(7) and *Regulation Crowdfunding*, *supra* note 52, § 227.303(e)(1) requiring the intermediary registered as a broker to comply with *General Rules and Regulations under Securities Exchange Act of 1934*, 17 CFR § 240.15c2-4 (1976).

62 See *Regulation Crowdfunding*, *supra* note 52, § 227.303(e)(2).

63 *EU Prospectus Regulation, supra* note 44.

64 See EC, Directive 2004/39/EC of 21 April 2004 *on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC*, [2004] OJ, L 145/1 [*MiFID*].

65 *Ibid*, art 3 permits member states to create exemptions for crowdfunding platforms. However, the exemption is permitted on the condition that the platform does not hold client funds or securities, does not provide any investment advice apart from the reception and transmission of orders, and that the transmission of order is made to other authorised firms. See also art 3(2) introduced by *MiFID2, supra* note 29. For the views of the European Securities and Markets Authority on crowdfunding, see European Securities and Markets Authority, "Opinion: Investment-based Crowdfunding" Opinion Paper ESMA/2014/1378 (December 2014), online: ESMA <https://www.esma.europa.eu/sites/default/files/library/2015/11/2014-1378_opinion_on_investment-based_crowdfunding.pdf>. With Brexit, the UK might in the future revisit these rules which were created while it was a member of the European Union.

66 See Financial Conduct Authority, *The FCA's regulatory approach to crowdfunding over the internet, and the promotion of non-readily realisable securities by other media: Feedback to CP13/13 and final rules*, Policy Statement PS14/4 (2014).

restrictions to "non-readily realizable securities".[67] Under the *COBS*,[68] a firm may only communicate a direct-offer of such non-readily realisable securities to retail clients under either of two sets of conditions. The first set of conditions revolves around suitability. In addition to a retail client who is a corporate finance contact or a venture capital contact, a financial intermediary may market to a retail client if either it undertakes to comply with the suitability rules in relation to the investment, or the retail client has confirmed before the promotion that he is the retail client of another that will comply with the suitability rules.[69] The suitability rules are premised on a financial intermediary assuming an advisory responsibility and making an assessment of the suitability of the financial product given the client's investment objectives, his financial capacity to bear the risks related to the investment, and his experience and knowledge for understanding the risks involved in the transaction.[70]

The second set of conditions relates to certain defined categories of retail clients. These are: certified high net worth investors, both certified and self-certified sophisticated investors, and certified restricted investors.[71] The last category refers to a person who does not necessarily fulfil the requirements to be considered a high net worth investor or a sophisticated investor but who opts, by a restricted investor statement, to be included as a "certified restricted investor" in the pool of clients to whom the marketing material may be sent.[72] The second requirement under this set of conditions is that the financial intermediary undertakes to comply with the rules on appropriateness.[73] These require the financial intermediary to determine whether the client has the necessary experience and knowledge to understand the risks relating to the promoted product.[74] This entails obtaining the necessary information from the client to make the assessment,[75] and providing a warning if it determines that the product is not appropriate for the client.[76]

C. *Singapore: Facilitative Tweaks to the Existing Regulatory Structure*

The MAS issued its consultation paper, "Facilitating Securities-Based Crowdfunding" in February 2015.[77] An extended period of deliberation took place after the close

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67 The original target securities were termed "unlisted shares" and "unlisted debt securities". As these terms could conceivably apply to securities traded, or soon to be traded, on a recognised investment exchange, a new term, "non-readily realizable security" was adopted to clearly mark out the scope of the rules: *ibid*, para 1.16.

68 Financial Conduct Authority, *Conduct of Business Sourcebook*, UK: FCA, 2019, online: FCA <https://www.handbook.fca.org.uk/handbook/COBS.pdf> [*COBS*].

69 *See, ibid*, s 4.7.8R.

70 *See, ibid*, s 9.2.2R(1).

71 *See, ibid*, s 4.7.7R.

72 *See, ibid*, s 4.7.10. By the Restricted Investor Statement, the investor declares that he has not and will not invest more than 10% of his net assets in non-readily realisable securities.

73 Generally, see *ibid*, s 10.2.

74 *See, ibid*, s 10.2.1R.

75 *See, ibid*, s 10.2.1R.

76 *See, ibid*, s 10.3.1R.

77 MAS, "Facilitating Securities-Based Crowdfunding" Consultation Paper P005-2015 (February 2015), online: MAS <https://www.mas.gov.sg/~/media/MAS/News%20and%20Publications/ Consultation%20Papers/Facilitating%20Securities%20Based%20Crowdfunding.pdf>.

of submissions. On 8 June 2016, the "Response to Feedback Received—Facilitating Securities-based Crowdfunding"[78] was published together with the revised guidelines on advertising restrictions[79] and on personal offers.[80] The revised regime reflects the view of the MAS that issuers should not have unrestricted access to the retail investors.[81] As such, it is intended that the current regulatory safeguards should apply with full force when offers of securities are made to retail investors. Nonetheless, the notion of what constitutes personal offers for small offers was tweaked to facilitate greater access to securities crowdfunding for suitable retail investors. Under the Guidelines on Personal Offers made pursuant to the Exemption for Small Offers,[82] a person who has given prior indication that she is interested in particular kinds of securities may be considered a "qualified investor", one to whom fundraising information may be forwarded under the small offers exemption. Prior to the revision on 8 June 2016, the pre-qualification checks intermediaries had to perform required them to ensure both that the investor has the financial competence and is suitable to invest in the relevant product given her investment objectives, financial means and risk tolerance. Under the revised guidelines, the intermediary needs only check for either financial competence or suitability to invest in crowdfunded securities. The revision also relaxed the definition of financial competence. The prior requirement to ascertain financial competence by the twin criteria of knowledge and experience has been relaxed so that satisfaction of *either criterion* would now suffice.[83] The pre-qualification criteria maintain the policy objective of limiting access to the general public. Nonetheless, the relaxation of the pre-qualification criteria allows for investors who are prepared to adopt aggressive risk strategies the opportunity to be on the mailing list of intermediaries; with the revision, an investor who has indicated that she is prepared to lose all her capital may be solicited under the small offers exemption.[84] Indeed, an essential step to becoming a qualified investor is the return of a signed acknowledgment by the investor that she understands the contents of the risk disclosure statement and that she acknowledges the risks related to a securities crowdfunding exercise.

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78 MAS, *Guidelines on Personal Offers Made Pursuant to the Exemption for Small Offers*, *supra* note 28.

79 MAS, *Guidelines on the Advertising Restrictions in Sections 272A, 272B and 275* (Singapore: MAS, June 2016), online: MAS <https://www.mas.gov.sg/~/media/MAS/News%20and%20 Publications/Consultation%20Papers/Crowdfunding/Annex%20B%20%20Guidelines%20on%20Advertising%20Restrictions.pdf>.

80 MAS, *Guidelines on Personal Offers Made Pursuant to the Exemption for Small Offers*, *supra* note 28. The revised 2018 version extends the guideline to securities-based derivatives contracts: MAS, *Guidelines on Personal Offers Made Pursuant to the Exemption for Small Offers* (Singapore: MAS, October 2018), online: MAS <https://www.mas.gov.sg/regulation/guidelines/guidelines-on-personal-offers-made-pursuant-to-the-exemption-for-small-offers>.

81 MAS, *Guidelines on the Advertising Restrictions in Sections 272A, 272B and 275*, *supra* note 79 at paras 3.1-3.7.

82 MAS, *Guidelines on Personal Offers Made Pursuant to the Exemption for Small Offers* (2018), *supra* note 80.

83 MAS, *Guidelines on Personal Offers Made Pursuant to the Exemption for Small Offers* (2016), *supra* note 28 at para 3.5; MAS, *Guidelines on Personal Offers Made Pursuant to the Exemption for Small Offers* (2018), *supra* note 80.

84 MAS, *Guidelines on Personal Offers Made Pursuant to the Exemption for Small Offers* (2018), *supra* note 80 at para 6.10 (Step 4 & Appendix 2). Under the revised Guidelines, *ibid* at para 6.10 (Step 2), the intermediary is not under an obligation to *administer* both the "knowledge and experience test" and the suitability test; instead, it suffices that the intermediary administers either test.

To underscore the principle that general solicitation for funds from the public attracts the full force of the prospectus requirement, the revised Guidelines on Advertising Restrictions for Exempted Offers state clearly that an unrestricted access platform does not conform to the advertising restriction.[85] The Guidelines should be strictly complied with for breach of the advertising restriction would mean that the exemption cannot be used. Even if the platform provides for a restricted section where information relating to offers or intended offers is provided only to qualified investors, the unrestricted section of the platform cannot draw attention to any offer or intended offer. As such, crowdfunding platforms cannot attract investors to sign up to its services through existing or impending offers, though the publicising of its track record by citing past offers is allowed.[86] The Guidelines on the Advertising Restrictions extend beyond the small offers exemption to apply to the private placement exemption (where an offer is made to no more than 50 persons), and the institutional and accredited investor exemptions under sections 274 and 275 respectively of the *SFA*.

Thus, apart from signing on qualified persons for the purposes of an offer under the small offers exemption, the crowdfunding platform may continue to sign up accredited investors and institutional investors. It is noteworthy how Singapore securities law permits intermediaries to build up their contact list of investors through the internet.

Where the crowdfunding portal is restricted to serving accredited and institutional investors and functions merely to connect the investors and the issuer without holding any client monies or assets, the base capital requirement and minimum operational risk requirement for such dealing licensee-platforms have been lowered from $250,000 and $100,000 respectively to the figure of $50,000. Moreover, the previous requirement for a security deposit of $100,000 has been removed. The changes to the financial requirements reflect the judgment made by the regulator that such portals that do not handle client monies and assets present only limited risks, and that the financial requirements can be reduced accordingly.

V. Less is More?

What Singapore and the UK do demonstrate is a keenness to foster the growth in the market for financial intermediation by a number of incremental yet significant changes; this, while firmly maintaining the gatekeeping strategy. First, it can be observed that both jurisdictions have taken the initiative to expand the class of persons who can apply to be included in the mailing list of financial intermediaries which serve to connect issuers to funders. In Singapore, the extension of what counts as a "personal offer" to include individuals who have knowledge of the risks involved with the securities offered expands the potential of the small offers exemptions. In the UK, the changes to the *COBS* to include "certified restricted investor" amongst persons to whom a direct-offer financial promotion of non-readily realisable security may be made means that a person who has certified that she is willing to risk

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[85] MAS, *Guidelines on the Advertising Restrictions in Sections 272A, 272B and 275*, *supra* note 79 at para 3.6.

[86] *Ibid* at para 3.8.

no more than 10% of her net assets may potentially be the subject of such marketing.[87] Second, both jurisdictions explicitly employ varieties of the gatekeeper strategy. In Singapore, the expanded notion of personal offer is predicated on the use of an intermediary to do the due diligence required. Similarly, the allowance for financial promotion in the UK to a certified restricted investor (along with the certified high net worth investors, the certified and self-certified sophisticated investor) is coupled with the requirement for the intermediary to comply with the rules on appropriateness.

The strategy of requiring the intermediary behind the funding portal to pre-qualify persons before they are sent or given access to information pertaining to current fundraising exercises serves to introduce a screen between the general public and the issuers. Only those who qualify and who acknowledge that they are fully aware and accept the associated risks are eligible to be considered for access to the information relating to current fundraising exercises. Notably the pre-qualification is not necessarily a suitability assessment, although suitability constitutes an independent criterion.[88] The alternative test of appropriateness employed in the UK maps the Singapore alternative to the suitability test—the knowledge or experience test. The difference between them lies in the degree of specification. Whereas the Singapore knowledge or experience test is to be met by satisfying one of the three specified criteria—a minimum of 3 consecutive years of working experience, education qualification in a finance related field, or at least 6 similar investments in securities offered under the small offers exemption—the UK *COBS* is more open textured. The firm is required to:

> . . . ask the client to provide information regarding his knowledge and experience in the investment field relevant to the specific type of product or service offered or demanded so as to enable the firm to assess whether the service or product envisaged is appropriate for the client.[89]

The information includes the type of investments which the client is familiar with, the client's past experience with the investments in question, as well as the client's education level and profession.[90] Materially, the appropriateness assessment is a substantive one—for the firm "must determine whether the client has the necessary experience and knowledge in order to understand the risks involved in relation to the product. . ."[91] There is, however, a difference in how the investor is protected under the appropriateness test of the UK and the knowledge or experience test in Singapore. Under the *COBS*, an intermediary who determines that the product is not appropriate to the client must serve a warning on the client;[92] however, if the client insists on proceeding despite the warning, the firm is not prohibited from doing the transaction. Under the Singapore knowledge or experience test, non-satisfaction means that the intermediary is unable to pre-qualify the client.

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87 *COBS*, *supra* note 68, s 4.7.10R.
88 *Ibid*, s 4.7.8.
89 *Ibid*, s 10.2.1(1)R.
90 *Ibid*, s 10.2.2R.
91 *Ibid*, s 10.2.1(2)R.
92 *Ibid*, s 10.3.

VI. The Way Ahead for Hong Kong

To the casual observer, the absence of a special initiative to address crowdfunding might seem puzzling. The analysis of the existing HK regulatory regime and of the equivalent regimes in the US, the UK and Singapore provides some clues to the puzzle.

First, HK has existing avenues for companies to fundraise that do not require the costly preparation of a statutory prospectus.[93] A start-up company seeking to raise funds in HK does not necessarily need to prepare a statutory prospectus. It may avoid the requirement for a statutory prospectus by proceeding under one of the exemptions found in Part I to the Seventeenth Schedule of *CWUMPO*. A useful exemption for a start-up with modest funding needs and not seeking to raise more than HK$5 million is the small offers exemption. While the ceiling for this exemption may be lower than the equivalent exemptions in the US, the UK and Singapore,[94] it does not come with the onerous conditions that attach to equivalent exemptions in the other reference jurisdictions. The advertising restrictions predicated by section 103 of the *SFO* are wholly disapplied in the case of an exempted offering under the Seventeenth Schedule. Apart from incorporating a mandatory precautionary statement warning the potential investor that the offering document has not been reviewed by the regulatory authorities, that he needs to exercise caution in making the investment decision, and that he should consult an independent financial adviser in the event of any doubt,[95] the issuer is largely free to decide how to structure the solicitation as long as it amounts to an "offer". Since there is no restriction equivalent to the "personal offers" condition which obtains in the Singapore version of the small offers exemption, the HK exemption is markedly more liberal than the Singapore exemption—even when compared with the broadened notion of what counts as a "personal offer" under the Singapore Guidelines issued on 8 June 2016. The absence of a prohibition against general solicitation and advertisement leaves the issuer free to make the offer using its own web portal. In short, the issuer has the room to conduct crowdfunding itself within the existing limitations of the exemptions found in the Seventeenth Schedule of *CWUMPO*. Of course, not all exemptions are amenable to being offered through the internet; in its very nature, since an offer through the internet is *ex facie* an offer to the world at large, it is not possible to fit the limited offerees exemption—an offer to no more than 50 persons—in an offer conducted through an internet portal. Apart from this, the portal-based offering is not inconsistent with the significant minimum consideration exemption or the professional investor exemption. The current room for start-ups to appropriate the exemptions to

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93 The conclusions reached in this regard are similar to those found in Alexa Lam, "Less is More? Different Regulatory Responses to Crowdfunding and Why the Hong Kong Model Stacks Up Well" (2018) 48 Hong Kong LJ 192. While broadly agreeing with Lam, this article goes into detail to show how the Hong Kong exemptions tend to have lower ceilings (*eg*, small offers exemption) and higher thresholds (*eg*, professional investors). As will be seen more explicitly later in the main text, the HK regulatory regime is not quite 'state-of-the-art' when compared to the reference jurisdictions.

94 See Section III.

95 *CWUMPO*, *supra* note 5, Eighteenth Schedule, Pt 3, as required by *CWUMPO*, *ibid*, Seventeenth Schedule, Pt 1, s 2. The requirement to strictly comply with the formal requirements stipulated by the statute was discussed by the HK Court of Final Appeal in *Pacific Sun Advisors*, *supra* note 51 at paras 27-31.

crowdfund undercuts the notion that the current regulatory regime prevents start-ups from using crowdfunding, even if the allowance is within more limited terms.

The greater liberality of the HK regime compared to the three reference jurisdictions lies also in the employment of intermediaries. The current fundraising regime in HK does not have the effect of directing issuers to use intermediaries in exempted offerings. This is in contrast to Singapore, where the existence of a prohibition against general solicitation and advertisements coupled with restricted permission for advertising expenses channels the issuer to use regulated intermediaries. The general prohibition against financial promotion in the UK—albeit punctured by many exceptions—has a similar effect. To the extent that the usual business model for crowdfunding contemplates that third-party crowdfunding portals serve as intermediaries between issuers and funders, it is only to be expected that these financial intermediaries will be licensed.

As such, the current HK fundraising regime already affords the liberties sought to be provided by the initiatives undertaken in the US, the UK and Singapore. While the HK$5 million ceiling for the small offers exemption is slightly less generous than the US$1 million ceiling that applies to crowdfunding under section 4(a)(6) of the *Securities Act* and *Regulation Crowdfunding*, it is not encumbered with the restrictions that attend crowdfunding under US federal securities law. In the UK and Singapore, the regulatory initiatives sought to increase the pool of investors who can pre-qualify with financial intermediaries and choose to be sent fundraising information. Such building up of pre-qualified investors in order to enlarge the pool of people to whom fundraising information may be sent is not mandatory under HK law. As long as the solicitation is in the nature of an "offer" that satisfies the statutory elements for the exemption—*eg*, professional investors—the HK regulatory regime does not necessarily require that the information be disseminated only to these investors. In an offer to "professional investors", for example, the due diligence may, in theory, be performed at the stage when an investor purports to accept the offer as a professional investor.[96]

In the premises, the notion that the HK fundraising rules are unduly restricting crowdfunding has to be regarded with some scepticism. The reasons for the low level of activity are likely to lie elsewhere. It may be that HK investors prefer investments with greater liquidity rather than one where the prospect of exit is uncertain and returns unassured. Or more generally, HK investors may prefer to invest in familiar asset classes like properties and listed securities. Indeed, it may be that those with the risk appetite for start-up financing already have access to venture capital and hedge funds, which provide additional value by searching for opportunities internationally,

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[96] In *Pacific Sun Advisors*, *supra* note 51, the Securities and Futures Commission took issue with a Fund which published through its website advertisements relating to a collective investment scheme which was intended for professional investors only, but which advertisements could be accessed by the general public. However, the HK Court of Final Appeal held that, based on the text of *SFO, supra* note 5, s 103(3)(k), there was no requirement that the advertisement, by its terms, confines the investment product to professional investors. For text of the provision, see *supra* note 51. For the purposes of *SFO*, *ibid*, s 103(3)(k), it sufficed that the Fund had a screening process in place to transact only with professional investors. Notably, the Securities and Futures Commission did not in *Pacific Sun Advisors* argue that the Fund was required to pre-qualify professional investors; any such contention would have failed in the absence of a statutory basis rendering it necessary.

perform the necessary due diligence and bargain for the protections against strategic action.

Whereas the use of exemptions from the prospectus requirement in the US, the UK and Singapore might mean one continues to face advertising restrictions and might be required to employ a regulated intermediary, no such restrictions apply in the use of the HK exemptions from the prospectus requirement. This attracts the obverse question: might the exemptions be too liberal in not employing access conditions to place some safeguards against vulnerable investors making unsuitable investments?

In the US, *Regulation Crowdfunding* allows for crowdfunding from the retail investors. It is in the context of crowdfunding from such investors that the three regulatory parameters operate. The first involves limiting the amount of capital at risk: the issuer is permitted to raise no more than $1 million and investors face individual investment ceilings depending on their asset holding and income levels. The second is the use of the gatekeeper strategy by requiring the intermediary to carry out specified due diligence on the issuer, providing investors with educational material relating to the risks involved, and obtaining written acknowledgment from investors that they appreciate the nature of these risks. The third is the use of the familiar disclosure strategy. Both the intermediary and the issuer come under certain disclosure obligations. A number of the disclosure items are standard: the nature of the business, the directors and officers, the material factors which make the investment risky or speculative, the target amount to be raised and its intended use. They provide comparators and facilitate ready cross comparisons with other fundraising initiatives. Materially, ongoing reporting requirements require an annual report together with a financial statement appropriate to the amount of capital raised.[97]

The UK and Singapore have adopted a slightly different strategy. They hold firm to the position that the general public should not be subject to solicitation for specific crowdfunding exercises. Instead, the funding portals might interest investors to pre-qualify so that they might be included in the pool of pre-qualified investors to whom solicitation material may be sent. The requirement that interested investors provide written confirmation in which they acknowledge and accept the risks associated with such illiquid investments serves an important cautionary function. A difference with the US regulatory model for crowdfunding lies in the substantive gatekeeping role that the funding portal is made to undertake. Merely indicating that one is prepared to take the risks associated with illiquid crowdfunded projects is insufficient. In Singapore, where the substantive requirement has now been relaxed to require satisfaction of *either* the knowledge or experience test *or* the suitability assessment test, inability to satisfy the criteria means that the interested investor cannot be included as a pre-qualified investor. The former tracks the appropriateness test to be applied for the investors with similar aggressive risk appetites in the UK, although the non-satisfaction of the appropriateness test only triggers a warning by the intermediary. In the UK, the intermediary is in theory free to accept such an investor; nonetheless, the warning would in practice serve as a "red flag" both to the investor as well as to the intermediary. The nuances between the gatekeeping roles performed by the funding portal in the UK and Singapore notwithstanding, they represent an astute

[97] See *Regulation Crowdfunding*, *supra* note 52, § 227.202(a).

use of the gatekeeping strategy in order to screen out investors who are ill-suited for such investments.

A key question for HK is whether to increase the degree of investor protection by regulating advertising and solicitation when exemptions found in the Seventeenth Schedule are employed—for it is by conditioning the access to the potential investors that the other investor protection measures have efficacy. These include: the issuer's disclosure responsibilities, the portal's responsibilities and if desired, limitations on the amount that an investor can invest. The US *Regulation Crowdfunding* conditions the use of the exemption in Title III of the *JOBS Act* on, *inter alia*, mandatory initial and on-going disclosure, while Singapore effectively requires advertising and solicitation to be done by regulated intermediaries.

The related strategy of using the intermediary as a gatekeeper should also be considered. This strategy stands out strongly in how the UK and Singapore respond to crowdfunding. In holding firm to the principle that the general public should not be subject to solicitation, the UK and Singapore permit intermediaries to build up a pool of interested potential investors; the process of onboarding such investors requires the intermediary to check on the suitability or appropriateness of the investment given the investor's profile. In addition to the intermediary checking on the potential mismatch between the financial product and the risk appetite of the investor, the process also serves the cautionary function of requiring the investor to acknowledge and consciously accept the nature of the risk that he is taking on. How much gatekeeping to require is, of course, a matter of judgment.[98] The additional requirements under the US *Regulation Crowdfunding*—that the funding portal host communication channels for investors to discuss amongst themselves and with the issuer and to facilitate the secondary market—go toward protecting the interests of the investors; however, if the market is smaller and intermediaries make the judgment that the associated costs are uneconomical, the conditions may have the effect of rendering illusory the utility of the exemption. At the moment, however, HK is at the other end of the spectrum on the question of whether to make it mandatory for intermediaries to be involved, and if so, how they should be involved.

There is yet room for hard or recommended ceilings on the amounts an investor should invest. The 'hard ceiling' is seen in *Regulation Crowdfunding*, where there are rules on how much an investor can invest. In the UK, the restricted investor statement requires the investor to warrant that he has not invested more than 10% of his net assets; he is thereby cautioned against doing so. Singapore does not adopt such a quantitative limitation on the amount that an investor can risk. Nonetheless, the elements of the knowledge or experience test sift out the unsophisticated, while the mandatory basic questions to be administered in the suitability assessment test provide a measure of safeguard against an investor taking on risks beyond what is suitable for his or her risk tolerance. The common thread to the strategy

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[98] Christian Hofmann, "An Easy Start for Start-ups: Crowdfunding Regulation in Singapore" (2018) 15 Berkeley Business LJ 219, for example, argues for a greater measure of safeguards for the Singapore regime. The present article does not argue for any particular safeguards; rather, it serves to highlight the fact that the HK regulatory regime, while arguably liberal, seems not to be 'state-of-the-art' when compared to how the reference jurisdictions balance the desire for less onerous avenues of raising capital and safeguards in the interest of investors.

for investor protection in the UK and Singapore consists of making sure that the investor's attention is brought to bear on the fact that the risks are appreciable.[99]

Crowdfunding is, in its nature, highly speculative. There is only so much that regulation can do. Neither the US, the UK nor Singapore have provided for any safeguards against strategic action or the extraction of private benefits of control. Given that there is a limit to how far regulators can and should go in fashioning an exemption regime intended to avoid high compliance costs, a useful strategy may lie merely in highlighting the risk and leaving it to the issuer to provide the assurances. The Risk Disclosure Statement to be provided during the pre-qualification of potential investors under the Singapore regime expressly warns that the issuers and intermediaries have no statutory obligation to make disclosures, or that the financial statements provided by the company will be accurate or accessible.[100] Stated in such stark terms, the burden is on the issuer to provide the potential investor with sufficient credible assurances whether relating to audited financial statements, pre-emption rights or the extraction of private benefits of control. In some of the more intractable risks, perhaps all the regulator can do is flag the relevant risks and prompt the issuer to decide how to respond.

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99 To be sure, *Regulation Crowdfunding* requires that the portal receives from the investor a representation that he has reviewed the intermediary's education material, that he understands that the entire amount may be lost and that he has the capacity to bear the loss. *Regulation Crowdfunding*, *supra* note 52, § 271.303(b)(2)(i). There is, however, no equivalent suitability or appropriateness assessment to be made by the intermediary.

100 MAS, *Guidelines on Personal Offers Made Pursuant to the Exemption for Small Offers (2018)*, *supra* note 80 at Appendix 2.