



REPORT | JANUARY 2017

Crowdfunding in East Africa: Regulation and Policy for Market Development

REDUCING POVERTY
THROUGH FINANCIAL SECTOR DEVELOPMENT

Cambridge
**Centre
for Alternative
Finance**



UNIVERSITY OF
CAMBRIDGE
Judge Business School





Key points East Africa

01

No bespoke or specific crowdfunding regulation in East Africa or South Africa – yet. No specific crowdfunding rules have yet been introduced in Kenya, Rwanda, Uganda or Tanzania nor in South Africa by the financial regulators – the central banks, capital market authorities or communication authorities.

02

Existing regulations still likely govern crowdfunding activity. Rules relating to AML & KYC checks, money lending, marketing & promotion of public offers & electronic payments were some common themes that emerged in East Africa as well as Malaysia, the UK, South Africa, New Zealand, India & the USA.

03

Non-financial return-based models dominate market activity in East Africa. Donation & reward-based crowdfunding accounted for the largest proportion of market activity in East Africa yet typically fall outside the purview of financial regulators.

04

Equity & debt-based crowdfunding are only in the very earliest stages in Africa. However, debt and equity-based models dominate total global activity, and account for the majority of market activity in more established markets, while donation and reward crowdfunding account for a small percentage of total market activity.

05

Regulators broadly recognized the importance of crowdfunding for East Africa. Additional capital raising channels provided via crowdfunding were identified as a great opportunity for entrepreneurs and consumers alike in the region – providing risks can be proportionately addressed to protect funders.

06

Regulators can play a key role in facilitating crowdfunding market development. Engaged, open, proactive regulators have demonstrably stimulated crowdfunding market development as in Malaysia, New Zealand and the UK – something that could be replicated in East Africa.

07

Recommendations to facilitate market development were grouped into 3 phases:

Phase 1: Sector mapping, capacity building and industry engagement activities. Platform database, crowdfunding regulator capacity and awareness building, industry events and conferences.

Phase 2: Crowdfunding ecosystem trust-building initiatives. No bespoke regulation right now, register of regulator-acknowledged firms, 'RegLab', industry association, digital certification of documentation.

Phase 3: Government support and endorsement. Public/private co-investment fund, currency volatility fund, signpost regulatory process.

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Executive Summary

Alternative finance, which includes donation-based, reward-based, equity-based and loan-based crowdfunding, is a rapidly growing sector composed of innovative financial instruments and channels that have collectively raised over \$145 billion in 2015¹ alone. Loan and equity-based crowdfunding models account for the vast majority of activity, which is concentrated in a few countries – notably China, the USA and the UK.

For developing and emerging markets, an estimated \$430 million² for 2015 - not all years to date, has already been provided to SMEs, individual consumers and various organisations via online crowdfunding channels since the sector emerged around the turn of the millennium.³ In Africa alone, over \$250 million was raised via various alternative finance channels in the period 2013-15,⁴ and East Africa was the largest alternative finance regional market across Africa in the same period. It seems there is a material and fast-growing market opportunity for East African economies to engage. At the same time, as in many countries globally, the crowdfunding market is only beginning to emerge from a very embryonic state. It is therefore unclear whether the East African crowdfunding market will follow similar trajectories to those more established markets in China, the USA and the UK. Nevertheless, it is important to assess the enabling landscape in East Africa that could help these innovative channels and instruments to take root and thereby provide much needed additional financing options for SMEs and consumers in Kenya, Rwanda, Tanzania and Uganda.

Given this context, FSD Africa,⁵ the Cambridge Centre for Alternative Finance⁶ (CCAF) and Anjarwalla and Khanna⁷ (A&K) collaborated to conduct a comparative assessment of the existing and evolving regulatory and policy landscape for crowdfunding in East Africa. This project outlines key priority areas necessary for regulatory and policy development in Kenya, Uganda, Rwanda and Tanzania. Furthermore, while it draws upon insights and experience of the UK, USA, Malaysia, New Zealand and India with respect to regulatory and policy developments, the CCAF has also conducted research into other markets that provide valuable insights but are beyond the scope of this project.⁸

This project aims to:

- **Highlight key trends and developments** within crowdfunding globally, with a focus on the existing and emerging regulatory and policy landscape.
- **Outline the existing characteristics and state of play** regarding regulation for crowdfunding in Kenya, Tanzania, Uganda and Rwanda.
- **Measure, compare and contrast** the key characteristics, risks, constraints, requirements, assumptions and dependencies of the existing crowdfunding regulatory landscapes within the UK, USA, Malaysia, India and South Africa alongside Kenya, Rwanda, Tanzania and Uganda.
- **Highlight, through recommendations, the best practices and most effective stimulation measures** identified in more established crowdfunding markets.
- **Provide impartial, clear guidance for a proposed regulatory and policy development roadmap** for East Africa, building upon the insights and best practice identified by the CCAF.⁹

Key findings:

- **There are no bespoke or specific regulations**, or policies, governing crowdfunding in East or South Africa at the time of publication of this report.
- **Non-financial return-based crowdfunding models dominate market activity** in East Africa while financial return-based loan and equity models are only in the very earliest stages.
- **Loan and equity-based models dominate total global activity**, and account for the majority of market activity in more established markets, while donation and reward-based models account for a small percentage of total market activity.
- **New, bespoke regulation created in East Africa is not recommended at present.** Nevertheless, there are other policy-led and regulator-led initiatives that could aid the development of the sector, which include advocating for industry-led self-regulation as recommended below.
- **Regulators broadly recognise the importance of crowdfunding** as an additional source of capital for providing financial channels that can benefit businesses, individuals and non-profit organisations, while also promoting financial inclusion and economic development.

Key crowdfunding-specific risks

The key risks identified that need to be addressed across online crowdfunding platforms include the following:

- **Adverse selection** – is there potentially more information asymmetry via crowdfunding?
- **Information access** – crowdfunding investors typically have access to less information than banks.
- **Fundraiser quality** – are funders on non-bank channels of lower quality than those on bank channels?
- **Funder inexperience** – a large number of new, additional retail funders entering the market.¹⁰
- **Platform failure** – well over 4,000 platforms globally with many that have already shut down.¹¹
- **Governance/conflicts of interest** – platforms need to manage potential moral hazard risks.
- **Lack of liquidity** – due to the absence of secondary markets or issuer exit strategies.¹²
- **Cyber risks** – most platforms are online, so data protection and security are particularly pertinent.
- **Default and business failures** – lack of historical data to benchmark asset performance.
- **Lack of due diligence** – potentially due to platforms lacking resources or experience.

Key crowdfunding benefits

The various crowdfunding models examined in this study can, potentially, provide a host of economic and societal benefits that must be considered when determining the enabling framework that will allow such platforms to provide their services. Such benefits include:

- **Potentially overcoming systemic biases in financial services**, e.g. geography, gender or sector.
- **Speed, customer service and convenience** of providing capital in a more efficient manner.¹³
- **Lower cost and speed of deployment of capital** to business and consumer customers alike.
- **Potentially higher, risk-adjusted returns** for investors compared to traditional finance.
- **Portfolio diversification** for investors – wider set of options.
- **Widening pool of available capital** to fundraisers of all kinds – additionality.
- **Increased competition** in finance and investment, traditionally dominated by a few providers.

Methodology

This report covers crowdfunding regulation and policy developments in Kenya, Uganda, Rwanda and Tanzania while drawing insights from more established crowdfunding markets such as the UK, Malaysia, New Zealand, the USA and South Africa. To conduct this assessment, the research teams at the CCAF and at A&K undertook an extensive literature and legal review of the crowdfunding sector with regard to regulatory and policy developments in these jurisdictions. Based on these reviews, a questionnaire was developed incorporating the key comparative parameters identified. The questionnaire focused on different aspects of equity, loan and reward/donation-based crowdfunding regulation. This questionnaire enabled the research team to conduct over 40 semi-guided interviews with regulators, crowdfunding platforms and legal experts in East Africa, the UK, Malaysia, New Zealand, India and the USA. The interview responses, taken together with the findings from the literature and legal reviews, were used to inform the regulatory analysis of the jurisdictions examined, as well as identifying the best practices in more established crowdfunding markets that helped to direct and guide the proposed recommendations and policy roadmap for crowdfunding market development in East Africa.

Key recommendations based on best practice identified in more established markets

Phase 1: Mapping, education and engagement

- **Platform database** – provide a detailed database of all currently existing platforms in each East African jurisdiction, with descriptions of crowdfunding model employed and contact details.
- **Crowdfunding regulator capacity and awareness building** – provide comprehensive training sessions, conducted by industry experts, to bring regulators in East Africa up to speed on how each crowdfunding model works, as well as to provide regular insights from other jurisdictions.
- **Industry meetings and regulatory engagement opportunities** – provide a programme of events and opportunities for the regulator to engage with the industry, practitioners, experts, potential funders and fundraisers, in order to bring national regulators up to speed on industry developments and begin the process of consultation as to the best course of action to take forward.

Phase 2: Crowdfunding ecosystem trust-inducing initiatives

- **No bespoke regulation now** – given the nascency of the crowdfunding sector and lack of market activity in East Africa, it is not recommended that any bespoke regulation is created at this time by the regulators as this might stifle market development. Rather, there are an array of other proactive initiatives that can be undertaken to enable the market to develop while ensuring effective consumer protection safeguards are in place. Furthermore, regulators can encourage the industry to impose self-regulation, guidelines and principles to foster innovation while protecting investors.
- **Register of regulator-acknowledged firms and regulator endorsement** – having engaged the industry and identified the key players, provide a register of firms that have engaged with the regulators and ensure the latter are aware of the industry's evolving activities.
- **Regulatory laboratory/sandbox – 'RegLab'** – a public-private-funded, structured programme to help facilitate dialogue between industry players and regulators and to guide new businesses seeking to operate in East Africa through the relevant regulatory processes while securing regulatory input and guidance wherever possible.
- **Crowdfunding industry associations** – encourage the East African crowdfunding industry to build a regionally focused industry association, in partnership with the African Crowdfunding Association, in

order to reach consensus and begin implementing self-governing rules and principles for members, to include every platform operating in the region.

- **Digital certification of documentation** – identify startups that specialise in digitising information documentation and processes, in order to facilitate industry standardisation of expected minimum requirements for fundraisers, while meeting the existing regulatory requirements and obligations of each jurisdiction in East Africa.

Phase 3: Government support and endorsement

- **Public-private co-investment funding** – seek out opportunities for public or private funding bodies that will match-fund or guarantee certain fundraisers using crowdfunding platforms, replicating, for example, the DFID-funded CrowdPower initiative which co-funds renewable energy crowdfunding projects across Africa while attracting wider funding from individuals.
- **Currency volatility hedge fund** – a public-private fund to help mitigate against currency fluctuations – a key risk identified by many loan-based crowdfunding models.
- **Signpost regulatory process Map for East Africa** – provide a clear, regulator-endorsed and sanctioned signpost to guide new crowdfunding businesses, seeking to operate in East Africa, through the existing regulatory and licensing requirements for each jurisdiction.

Biographies

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Reservations, disclaimer and qualifications

The advice given in this memorandum is subject to the following qualifications and reservations: any views which are expressed in respect of any law, statute, regulation or similar rules, are expressed in respect of the relevant law, statute, regulation as it was in force, with the provisions thereof, as of September 2016, as far as the research team were able to practically determine. The opinions expressed herein relate only to those jurisdictions reviewed herein. We do not purport to have investigated the laws of any other jurisdiction, nor to express opinion on questions arising under other jurisdictions.

**NEARLY \$90 MILLION
RAISED ACROSS EAST
AFRICA BETWEEN
2013-2015**

*– Africa & Middle East
Alternative Finance
Benchmarking Report
(January, 2017)*



1. Crowdfunding in Context

Crowdfunding in the period 2000-2016

1.1 Timeline

2000	<ul style="list-style-type: none"> • Artist Share¹⁴ launches first crowdfunding platform for creative industries
2005	<ul style="list-style-type: none"> • Zopa¹⁵ becomes the world's first peer-to-peer consumer lending platform • Kiva¹⁶ (microfinance lending platform) launches
2007	<ul style="list-style-type: none"> • Indiegogo¹⁷ launches in US (rewards crowdfunding platform)
2009	<ul style="list-style-type: none"> • Kickstarter¹⁸ launches in US (rewards crowdfunding platform)
2011	<ul style="list-style-type: none"> • Peer-2-Peer Finance Association¹⁹ launches in the UK • Crowdcube,²⁰ first equity crowdfunding platform, launches in the UK
2012	<ul style="list-style-type: none"> • UK Crowdfunding Association²¹ launches • President Obama signs JOBS Act²²
2013	<ul style="list-style-type: none"> • UK FCA launches consultation on crowdfunding²³ • Italy (CONSOB) introduces (strict) equity crowdfunding regulations²⁴
2014	<ul style="list-style-type: none"> • New Zealand introduces crowdfunding legislation²⁵ • India launches equity crowdfunding consultation²⁶ • IPO of Lending Club (consumer lending platform)²⁷
2015	<ul style="list-style-type: none"> • Malaysia introduces equity crowdfunding regulation²⁸ • TrustBuddy (Swedish lending platform) files for bankruptcy due to mismanagement²⁹ • DFID launches 'CrowdPower' for renewable energy crowdfunding in developing countries³⁰
2016	<ul style="list-style-type: none"> • UK HMRC launches 'Innovative Finance Individual Savings Account'³¹ • Lending Club faces grand jury subpoena for improper financial disclosure³² • India conducts consultation of online lending regulation³³ • Funding Circle lists SME fund for institutional investors³⁴ • Ezubao, Chinese lending platform, is exposed as \$7.6bn Ponzi scheme³⁵ • UK FCA launches first Regulatory 'Sandbox'³⁶ • Regulatory Sandboxes launch in Singapore,³⁷ Australia,³⁸ Malaysia,³⁹ Hong Kong,⁴⁰ UK FCA • Malaysia introduces peer-to-peer lending framework⁴¹ • USA – Regulation CF is finalised under Title III⁴² • China introduces peer-to-peer lending guidelines⁴³ • FSD Africa hosts an indaba in June to discuss potential of crowdfunding for East Africa⁴⁴

1.2 Taxonomy and Definitions⁴⁵

Crowdfunding can be defined as the provision of funding for projects, individuals, commercial and non-commercial entities by raising funds, small and large, from large groups of individuals and institutions. The crowdfunding market can be subdivided into four broad groupings – donation, reward, equity and loan-based models, as depicted in the figure below. Crowdfunding is a subset of the broader field of ‘alternative finance’, which refers to financial channels and instruments that have emerged outside the traditional financial system and includes crowdfunding, alternative currencies and third-party payment platforms.

Crowdfunding	
Non-Financial Return Models	
Donation-based Crowdfunding	Reward-based Crowdfunding
Financial Return Models	
Equity-based Crowdfunding	Loan-based Crowdfunding/ Peer-to-Peer Lending

Donation and reward-based crowdfunding are non-financial return models and typically fall outside the purview of financial regulators. Loan and equity-based models are, typically, regulated financial activities in most countries. Loan-based crowdfunding is also referred to as peer-to-peer lending, whereby individuals/peers lend to other peers/borrowers via online electronic platforms. Given increased levels of institutional funding and participation, particularly in the USA but also in other markets, this debt-based model of funding is often called ‘marketplace lending’. This accounts for lending from individual peers, as well as increasingly substantial proportions of institutional investment from pension funds and investment banks (for example).

Each of these four models can be subdivided as listed below:

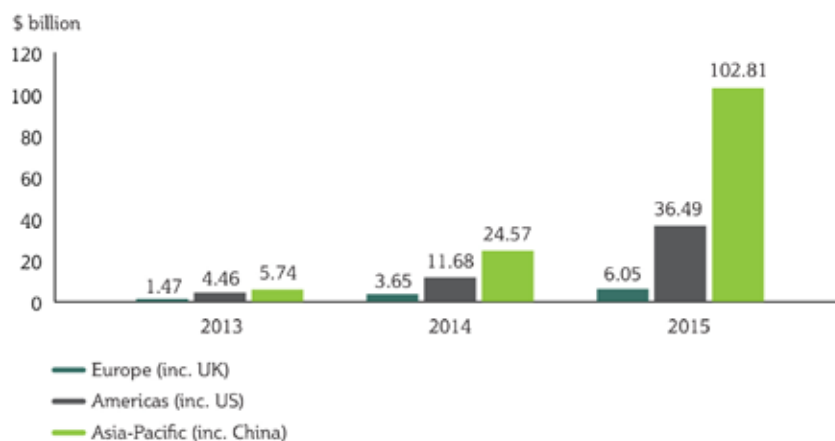
- **Donation-based crowdfunding** – no legally binding financial obligation to funders/donors incurred by fundraisers/recipients; *no expectation of financial or material returns*.
- **Reward-based crowdfunding** – funders/donors *have an expectation* that fundraisers will provide tangible but non-financial rewards or products in exchange for their money.
- **Equity crowdfunding:**
- **Equity-based crowdfunding** – sale of registered securities, by mostly early-stage businesses, to sophisticated, institutional and retail investors.
- **Equity-based real estate crowdfunding** – direct investment into a property by individuals, usually through the sale of a registered security in a special purpose vehicle (SPV).
- **Loan-based crowdfunding:**
 - **Peer-to-peer business lending** – secured and unsecured debt-based transactions between individuals/institutions and businesses with trading history – mostly for SMEs.
 - **Peer-to-peer consumer lending** – debt-based transactions between

individuals/institutions and individuals including sole traders; most are unsecured personal loans.

- **Peer-to-peer property lending** – property-based secured debt transactions between individuals/institutions and, mostly, businesses; most of which are property development businesses.

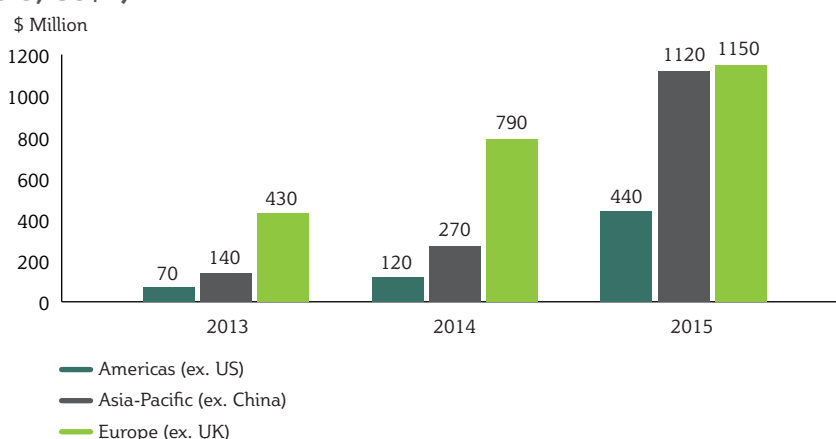
1.3 Global Market Data

1.3.1 Total Alternative Finance⁴⁶ Volumes by Region – Europe, Americas, Asia Pacific (2013-2015, US\$)



Total global market volume for 2015 exceeded \$145 billion; however, this was dominated by three countries – China (with over \$100 billion⁴⁷), the USA (over \$36 billion⁴⁸) and the UK (almost \$5 billion⁴⁹). It should be noted that this number is derived from total volumes attributed to both non-financial return (i.e. reward-based crowdfunding) and financial return models (i.e. equity and loan-based crowdfunding).

1.3.2 Total Volumes by Region, Excluding China, USA and UK (2013-2015, US\$⁵⁰)



Excluding China, the USA and the UK, both Europe and the Asia Pacific regions' alternative finance markets exceeded \$1 billion in 2015, while Latin America approached \$0.5 billion. In Q4 of 2016, the *Middle East and Africa Alternative Finance Report* will be released, covering market activity in these regions and providing accurate data on the state of the crowdfunding market in Africa for the first time. What we know is that the alternative finance market is growing rapidly across the globe, and is fast becoming an

established component of the global financial system. With an appropriate and proportionate policy, and regulatory framework and strategy preemptively in place, East Africa stands to benefit from the economic and societal benefits these financial models potentially bring with them.⁵¹

1.4 Economic Development, Financial Inclusion and Poverty Reduction

The development of crowdfunding markets has the potential to drive poverty reduction in East Africa and in many other countries in a number of ways, from efficiently mobilising and channeling savings towards growing companies in important industry sectors, to reducing the vulnerability of some of the poorest people by matching individuals requiring finance to those with savings to invest or donate. Crowdfunding models provide much-needed, new forms of financing for startups, SMEs, individual consumers, charities, social enterprises and various community-based projects. There is a great deal of potential for these new forms of finance to provide access to funding, and thereby promote economic development and financial inclusion in developing, emerging and developed countries alike. Underdeveloped capital or credit markets are typical characteristics of emerging or developing countries such as those in East Africa. This is particularly relevant to small businesses or individual retail clients who lack access to finance. Therefore, where traditional paths to finance do not exist, new and innovative financial channels, such as crowdfunding models, are welcome additions to incumbent systems.

Research undertaken by the Cambridge Centre for Alternative Finance suggests that, to date, market activity measured by alternative finance per capita more closely correlates with those countries with higher GDP per capita.⁵² While more research is necessary, it is likely that a large number of factors contribute to this finding. For example, higher levels of internet, social media, smartphone, online payments and banking and ecommerce market penetration⁵³ likely contribute to higher levels of alternative finance contribution per capita. These factors provide the necessary infrastructure to get these markets established and operational.

Another key determinant of crowdfunding market development is the policy and regulatory environment which permits crowdfunding models to exist. Government or regulatory endorsement and tax incentives⁵⁴ utilised by crowdfunding models have proven to be highly effective at drawing public attention to this sector. For example, in the UK, the British Business Bank lent directly through an array of loan-based crowdfunding platforms, providing a loan guarantee fund.⁵⁵ In addition, public and private funding bodies such as Creative England⁵⁶ and Ben & Jerry's ice cream⁵⁷ have match-funded capital raised through reward-based crowdfunding and helped incite public interest in those projects raising capital. Such initiatives could prove promising in the context of East Africa and other developing economies. There is already some precedent here. One example is the DFID-GVEP initiative CrowdPower⁵⁸ which part-funds crowdfunding projects in developing countries that focus on renewable energy.

According to AlliedCrowds,⁵⁹ an estimated \$430 million for 2015 - not all years to date, worth of projects in developing countries have been crowd-funded to date (excluding China – the world's largest market). Donation

and reward-based models are the largest contingent (estimated to be around 80%) of crowdfunding activity in such countries, compared with the global market share which is dominated by loan-based models and, to a lesser extent, equity-based crowdfunding. Indeed, in Kenya, Rwanda, Uganda and Tanzania, it has become clear that non-financial return-based models account for the bulk of market activity. Such models include donation, reward and non-financial return lending platforms, like Kiva.⁶⁰ However, when considering the global market context, models which enable financial return, and in particular loan-based crowdfunding models, account for around 90% of global activity, with equity-based models accounting for around 10%, while donation and reward-based models make up a very small fraction of the total global market. Therefore, in order for East Africa to benefit from both loan and equity-based crowdfunding, there is an important enabling role that both regulators and policymakers could play to help the market get established.



**IN DEPTH REVIEW
OF DONATION,
REWARDS, EQUITY
AND LOAN-BASED
CROWDFUNDING
MODELS**



2. Crowdfunding Models and Structures

Loan, equity, donation and reward crowdfunding models present different risks and opportunities for East Africa.

2.1 Crowdfunding Risks and Opportunities

Crowdfunding, through online platforms and offering investors equity and loans, is a relatively recent innovation which has been taking off globally since around the turn of the millennium. From an investor protection perspective, the risks associated with these financial models has often been compared to those risks associated with the purchase of private securities, typically from a private business. However, it is also important to highlight additional risks:

- **Disclosure** – usually less intensive for crowdfunded companies than for publicly listed firms, especially where no specific disclosure is mandated by regulation.
- **Lack of regulatory clarity** – lack of clarity on oversight and rules in most jurisdictions.
- **Default and business failures** – lack of historical data for crowdfunding asset performance.
- **Platform failure** – well over 4,000 platforms globally, with many that have already shut down.⁶¹
- **Lack of liquidity** – due to the absence of secondary market or issuer exit strategies.⁶²
- **Governance/conflicts of interest** – introducing moral hazard due to misalignment of incentives.
- **Information asymmetry** – potentially preventing investors from access to sufficient disclosure.
- **Funder inexperience** – a large number of new, additional retail investors entering the market.⁶³
- **Lack of due diligence** – potentially due to platforms lacking resources or experience.

Regulation of the crowdfunding sector is certainly something that needs to be considered carefully to avoid such risks and protect retail clients, while also ensuring these new financial models are able to grow and innovate further. Regulating such a new sector may be perceived as rubber-stamping

or approving an as-yet unproven industry through regulation, thus lending credibility to it without proper consideration. On the other hand, regulations may also be perceived as too stringent, stifling the growth of a new, innovative sector.⁶⁴

Crowdfunding can provide a host of benefits that include:

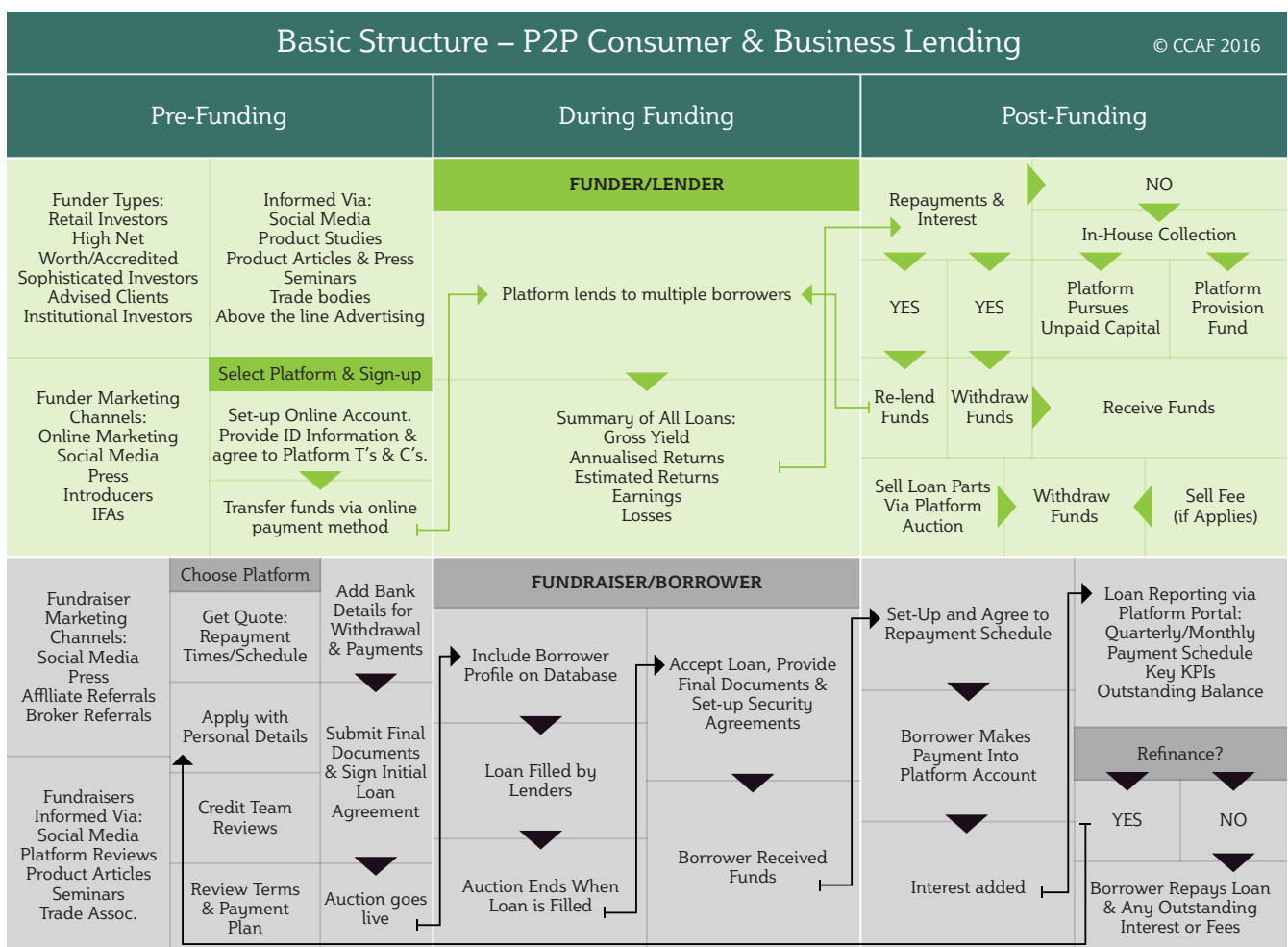
- **Lower cost and speed of deployment of capital** to business and retail customers alike.⁶⁵
- **Potentially higher, risk-adjusted returns** for investors than via mainstream banks.
- **Portfolio diversification** for investors with different, additional financial instruments and channels.
- **Widening pool of available capital** to fundraisers of all kinds – additionally.
- **Increased competition** in finance and investment, traditionally dominated by few providers.
- **Speed, customer service and convenience** of providing capital in a more efficient manner.⁶⁶
- **Potentially overcome biases within financial services**, e.g. geography, gender, ethnicity, sector.

Given that crowdfunding models are currently in an embryonic stage of development and do not pose an immediate systemic risk, it would be prudent for regulators in East Africa to identify key industry actors in the region and take the opportunity to understand the workings of their models before determining the regulatory and policy framework they will use to govern the industry.

The working structure and risks of crowdfunding models will now be reviewed in more depth.

2.2 Loan-based Crowdfunding/Peer-to-Peer Lending

Loan-based crowdfunding, including also known as peer-to-peer lending, enables investors to provide loans to either individuals or businesses via online platforms. The diagram below explains the structure, which is different from that of bank deposits, both from the perspective of those providing funds (**funders/lenders**) and those receiving funds (**fundraisers/borrowers**). Globally, loan-based crowdfunding models account for the largest proportion of total market activity, around 90%. This model also has the largest potential market size, with consumer and SME credit providing far more capital traditionally than equity or non-financial return-based models.⁶⁷ Typically, loan-based crowdfunding is a regulated financial activity either governed by existing regulation, or in certain jurisdictions, by bespoke or specific regulation that has been created to govern this relatively new market activity.



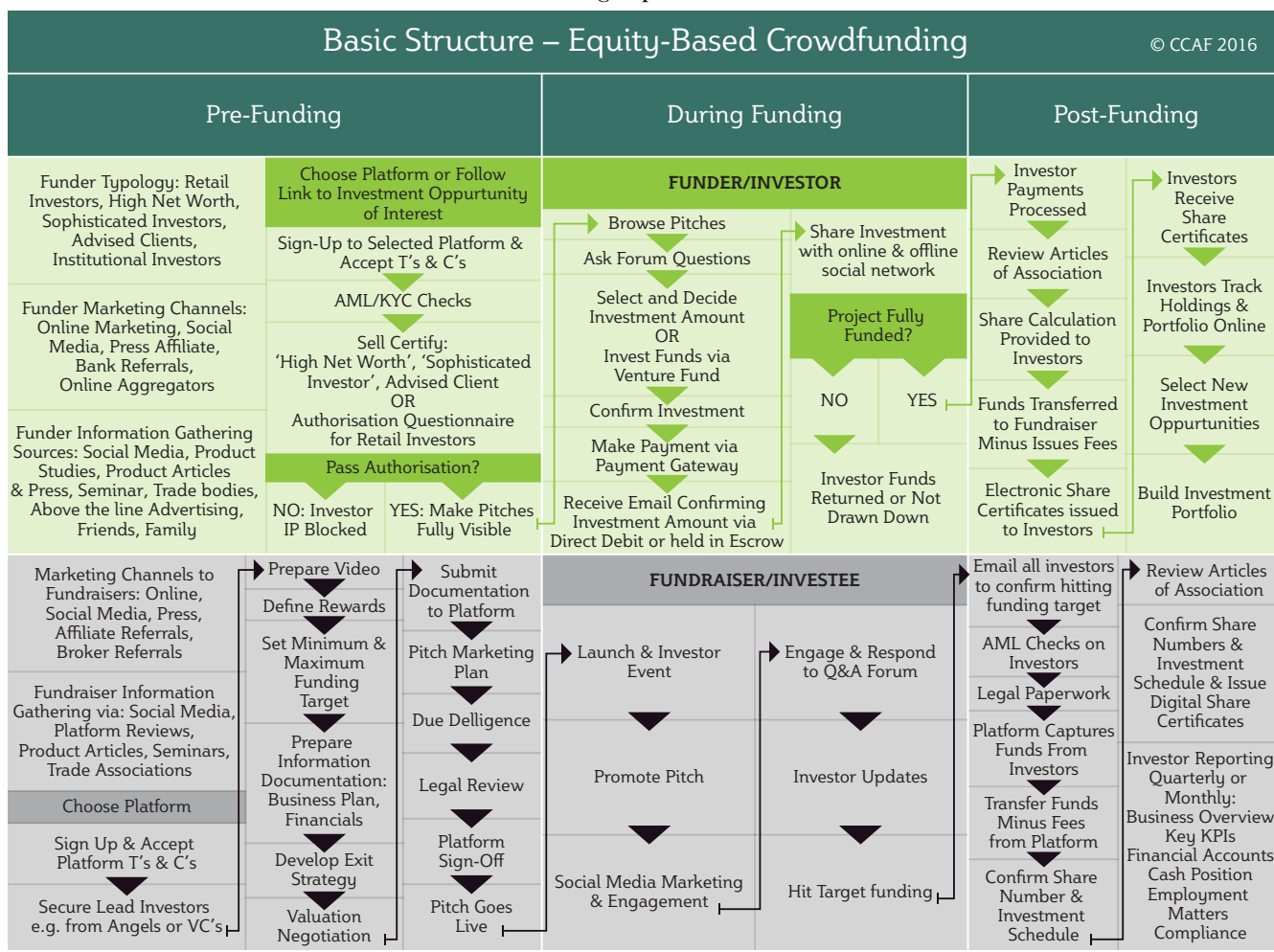
The key risks for loan-based models include the following:

- For regulators – a challenge to identifying all existing platforms and monitor new, emerging ones.⁶⁸
- For regulators – levels of lender financial literacy; ensuring lenders understand the product is not a deposit, the need to spread their funds across multiple loans, the risk of default and liquidity.⁶⁹
- For regulators, platforms and funders – proper communication of risks to funders/lenders.

- For regulators, funders and platforms – lack of insolvency plans in the event of platform failure.
- For regulators and funders – sufficient and rigorous platform underwriting and credit/risk analysis.
- For regulators and funders – transparency with data, risks, loan performance and regulator reporting.
- For regulators and funders – conflicts of interest between platforms, funders and fundraisers.
- For regulators and funders – client money management – ensuring customer and platform monies are segregated.⁷⁰
- For all stakeholders – platform or borrower fraud and malpractice.
- For all stakeholders – information asymmetries between actors.
- For all stakeholders – exogenous shocks – credit cycles, financial crises and currency fluctuation.⁷¹
- For all stakeholders – incompetence or mismanagement by platforms and authorised persons.⁷²
- For all stakeholders – lack of regulatory clarity.
- For all stakeholders – responsible lending to borrowers – affordability requirements.

2.3 Equity-based Crowdfunding

Equity-based crowdfunding includes finance for businesses, but also property development and real estate. The model involves investors providing capital in exchange for shares in their chosen investment opportunities. The diagram below outlines how equity-based crowdfunding works both from the perspective of those providing capital (**funders/investors**) and those receiving capital (**fundraisers/issuers**).



Equity-based crowdfunding makes up the second largest grouping of alternative finance models behind loan-based crowdfunding, with just under 10% of the total global market. Given the typically higher risks associated with equity instruments as compared with loans, equity-based crowdfunding is typically regulated with an emphasis on restricting the types of investors that may participate, as well as the disclosure, reporting and marketing and promotion rules.

Key risks associated with equity-based crowdfunding models include:

- For regulators – identifying all existing and emerging equity-based crowdfunding platforms.
- For regulators – investor education and levels of financial literacy, experience and understanding.⁷³
- For regulators and funders – unauthorised advice from platforms or associates.
- For regulators and funders – ensuring enough information is provided – due diligence and disclosure.
- For funders – herding; investors may be using sub-optimal heuristics to make decisions.⁷⁴
- For platforms, regulators and funders – suitability and affordability tests for funders – can funders withstand losses?
- For all stakeholders – communication of risks, e.g. loss of capital, dilution, lack of liquidity.
- For all stakeholders – platform viability; what happens in the event of platform failure?
- For all stakeholders – fraud and malpractice on the part of platforms and issuers.
- For all stakeholders – exogenous shocks – credit cycles – impact of next financial crisis?
- For all stakeholders – data protection and cyber security.
- For all stakeholders – transparency with data, risks, investee performance.⁷⁵
- For all stakeholders – incompetence or mismanagement on the part of platforms.
- For all stakeholders – lack of regulatory clarity for equity-based crowdfunding platforms.

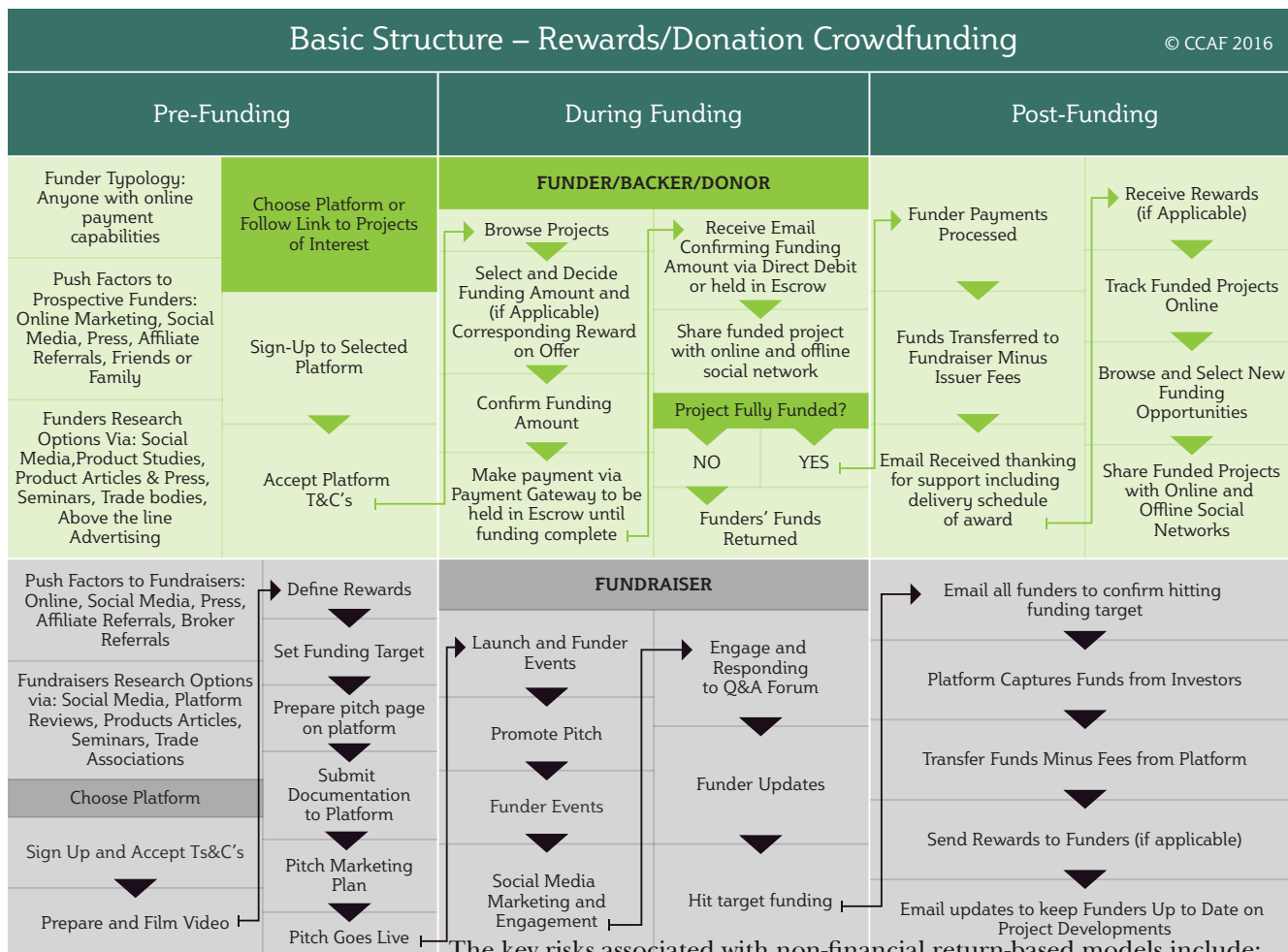
2.4 Donation and Reward-based Crowdfunding

Donation and reward-based crowdfunding are both *non-financial return* models, meaning those providing funding (**funders**) do not receive nor expect any kind of financial return. The diagram below outlines the basic working structure of these crowdfunding models.

This crowdfunding model is unregulated by securities regulators, as the financial activities involved are typically non-regulated. Nevertheless, certain jurisdictions have rules that apply to charities for donation-based models such as payments regulations which govern how funds are procured, held, received and distributed. Furthermore, KYC checks may be undertaken to reduce risks relating to the funding of illicit or criminal activities, such as terrorism.

In the UK, while donation and reward-based models are not within the jurisdiction of the FCA, the UK Crowdfunding Association requires that all

member platforms, regardless of model type, adhere to a set of self-governing principles and rules.⁷⁶ Perhaps, therefore, in East Africa, while financial regulators may currently deem these models to be outside of their jurisdictions, there is an opportunity for national or regional industry associations to implement self-governing rules and principles. These self-governing principles will be outlined later in this report.



The key risks associated with non-financial return-based models include:

- For regulators – the ability to identify all existing and emerging platforms.
- For funderunders – transparency of funding opportunities to ensure information is properly communicated.
- For all stakeholders – communication of risks to funders – make it clear that no financial return is offered.⁷⁷
- For all stakeholders – Viability of platforms’ business models – what happens in the event of platform failure?
- For all stakeholders – issues relating to fraud and malpractice by those raising funds – are checks in place?
- For all stakeholders – data protection and cyber security to ensure funders’ identity and details are protected.
- For all stakeholders – incompetence or mismanagement by either the platform or those raising funds.

Crowdfunding, in its various forms, is a relatively new innovation and as such, financial regulators around the world are still in the process of

assessing and implementing their approach to regulating the sector. Some countries, such as the UK, Malaysia and New Zealand, are further ahead than others (like India and China). Nevertheless, this is still a very nascent, fast-evolving market with regulatory and legislative frameworks likely to shift and change well into the foreseeable future.



**FINANCIAL
REGULATORS
AROUND THE
WORLD ARE STILL
IN THE PROCESS
OF ASSESSING AND
IMPLEMENTING
THEIR APPROACHES
TO CROWDFUNDING**



3. Crowdfunding Regulatory Approaches

3.1 Regulatory Regimes

The table below illustrates some of the existing regulatory approaches, highlighting the diversity of national approaches to governing different crowdfunding models in order to protect consumers, while also enabling the industry to innovate and develop.

Regulatory Regime	Description
Exempt Market/Lack of Definition	Market classified as exempt, or lack of legislative definition. In some cases, regulation protecting investors and fundraisers still applies. Relates to, for example: unfair interest rates, affordable credit, false advertising.
Intermediary/Platform Regulation	Regulates equity and loan-based platforms as an intermediary, and usually requires registration and other regulatory requirements depending on the jurisdiction. Generally, requirements relate to platform registration, but also include prescriptions relating to business conduct, governance and, in some cases, reporting requirements.
Banking Regulation	Regulates platforms as if they were banks, due to their credit intermediation requirements. Platforms therefore essentially need a banking licence, and are subject to full disclosure and reporting requirements.
Both National and Local/Provincial Regulation	Two levels of regulation and required licensing; e.g. in the US, federal regulation is monitored by the SEC, and state regulation is applicable to state-level securities agencies. Some states have imposed an outright ban on equity and debt-based activities, while others have implemented crowdfunding exemptions, which allow for a broader investment base (non-accredited investors) to participate in securities sold on platforms.
Prohibited	Equity crowdfunding and loan-based crowdfunding is banned outright.

3.2 Key Aspects of Crowdfunding Governed by Regulation

3.2.1 Platform Regulation or Guidance

- a. **Authorisation or registration requirements** – both equity and loan-based platforms may have to be registered before they are able to conduct activities.⁷⁸
- b. **Capital and insurance** – may specify capital requirements for crowdfunding-related activities. These may include, for example, indemnity insurance, specific minimum capital or prudential requirements in order to cover regulatory fees, issuer failures or platform bankruptcy.⁷⁹
- c. **Marketing of the intermediary or the offering** – may stipulate restrictions on soliciting and recommending opportunities and requirements to disclose received compensation and selection criteria.
- d. **Conducting due diligence on the offering** – may have requirements relating to due diligence with precise, minimum, pre-determined criteria and required information to be submitted by issuers.⁸⁰
- e. **Use of a website** – a crowdfunding platform may have to use an electronic portal, or website, to conduct their primary business activities.
- f. **Communication channels** – many platforms make use of electronic forums and they may be required to monitor communications to ensure statements are not false, deceptive or misleading.
- g. **Custody of assets (client money rules)** – issues relating to how funder money is procured, held and distributed; avoid concerns of platform money co-mingling with funder money.⁸¹
- h. **Conflict of interest management** – measures to manage conflicts of interest, such as clearly outlining interest and compensation mechanisms to all parties or substantial ownership stakes of platforms.
- i. **Risk mitigation** – procedures and controls for mitigating and managing risk in order to avoid operational interruptions should be clearly outlined. Typically, general AML or KYC frameworks apply.
- j. **Complaints** – procedures, recording and regulatory reporting requirement for customer complaints.

3.2.2 Fundraiser/Issuer/Borrower/Recipient Requirements

- a. **Location of the issuer** – there may be limitations on the location of an issuer or platforms that can engage in crowdfunding activities, e.g. India stipulates that only Indian-based companies operate nationally.
- b. **Size and limit of the offering** – there may be restrictions on the size, sector or legal structure of an issuer.
- c. **Offering document disclosure, other than financial disclosure** – there may be specific disclosure requirements that are highly prescribed or are perhaps provided in the form of general guidelines.
- d. **Disclosure regarding risks** – risks may have to be outlined by fundraisers in all documentation made available to funders, e.g. lack of liquidity or loss or capital dilution.
- e. **Financial disclosure in offering documents** – there may be specific financial statements that must be included in offer documents, which may differ depending on the size of the offering (e.g. Malaysia).
- f. **Ongoing disclosure requirements** – see Invrep-KPMG angel reporting guidelines – best practice.⁸²

3.2.3 Funder/Investor/Lender/Donor Requirements

- a. **Investing limits** – there may be limits on the investment amount for different types of funders.
- b. **Cancellation and resale limits** – funder cancellation rights may be stipu-

lated, e.g. 14-day cooling off period. Retail funders may have rescission rights in the event of material changes to the offering.

- c. **Risk acknowledgement** – funders may have to sign risk acknowledgement forms that provide certain warnings to investors. Issuers may be required to obtain a signed risk acknowledgement form from the investor, in which the investor confirms that he/she falls within the investment limits and acknowledges the risks associated with the investment⁸³.
- d. **Education requirements** – there may be stipulations relating to platform responsibilities for providing education tools and material to educate investors and improve financial literacy.



@Jake Lyell

**RELEVANT
REGULATION FOR
CROWDFUNDING IN
EAST AFRICA**



4. Regulation in East Africa: Kenya, Uganda, Rwanda and Tanzania

We now turn to reviewing the existing relevant regulation and policy in East Africa. To conduct this research, Anjarwalla & Khanna have engaged their associated ALN member firms in each jurisdiction to use their expertise to review the current state of regulation and policy that may be applicable to crowdfunding in Kenya, Uganda, Rwanda and Tanzania.

4.1 Kenya: Legal Review of Existing Regulatory Landscape

4.1.1 Background

In 2015, around \$22 million was raised in Kenya, with an additional \$8.5 million raised in Q1 2016. This suggests the market is rapidly growing,⁸⁴ (at a rate of well over 50% year-on-year), albeit from a low base point. Donation-based crowdfunding accounts for around two-thirds of market activity, with the rest provided by non-financial return-based lending models, such as Kiva. It is likely that most funding comes from funders outside of Kenya, given the location of platforms providing funding. This, however, needs to be further investigated. Peer-to-peer business and consumer lending and equity-based crowdfunding are seemingly non-existent, or at least only just beginning to emerge at present. This is despite the fact that both debt and equity-based crowdfunding account for the largest proportion globally.

Given Kenya's track record with innovative financial services, such as with mobile money and payments, and various microfinance models, we anticipate that Kenya, and East Africa more broadly, will be a hot bed of innovative alternative financial services. Research conducted by the Cambridge Centre for Alternative Finance over the period 2013-2015 reveals that Kenya and East Africa are the market leaders for crowdfunding and alternative financial models across Africa.⁸⁵ (This research will be published in December 2016.)

4.1.2 Regulators and Relevant Existing Regulation

Currently, no existing legislation regulates donation, rewards, loan or equity-based crowdfunding in Kenya. Having conducted a review of existing regulation in Kenya, we believe the following regulatory bodies could

East Africa is the largest regional crowdfunding market in Africa with ~\$90 million raised between 2013-15.

potentially regulate all of the above:

- a. **The Capital Markets Authority (CMA)**, under the legislation listed in the end notes.⁸⁶
- b. **The Central Bank of Kenya (CBK)**, under the legislation listed in the end notes.⁸⁷
- c. **The Communications Authority** of Kenya, under the legislation listed in the end notes.⁸⁸

4.1.3 National Payment Systems (NSP) Act and NPS Regulations

To the extent that a platform provides the services of sending, receiving, storing or processing payments, or provision of other services in relation to payment services through any electronic system, the platform would require a payment service provider licence from the CBK under the NPS Act and NPS Regulations.⁸⁹ It is arguable that the provisions of the NPS Act and NPS Regulations would not be applicable where the platform envisaged does not undertake the activities listed in the end notes.⁹⁰

4.1.4 Money Remittance Regulations (MR Regulations)

To the extent that a platform may be involved in the business of transmitting money, or representations of money, without any payment accounts being created in the name of the payer or payee, such a platform would require approval from the CBK under the MR Regulations. Where it is envisaged that the platform will use third parties, for example the M-Pesa system in Kenya, in order to remit monies between lenders and borrowers and vice versa, it *may* be arguable that the MR Regulations will not be applicable.

4.1.5 Kenya Information and Communications Regulations

Platforms offering crowdfunding services by sending information over communication systems through short-code services will need to be licensed as Communication Services Providers (CSPs) by the Communications Authority of Kenya. If a platform offering crowdfunding services provides notifications and alerts in connection with the crowdfunding products that it offers, the platform will need to be licensed as an Applications Service Provider (ASP). If the platform will not operate a communications infrastructure in Kenya but has servers located outside of Kenya, and if the platform is web-based and does not provide any alerts or notifications, it *may* be arguable that the platform will not require either a CSP or an ASP licence.

4.1.6 The Microfinance Act (MA Act)

If the platform is deposit-taking, the provisions of the MA Act will apply to it. If the platform is defined as a 'specified' non-deposit-taking microfinance institution, it is unclear whether it would require a licence under the MA Act, as the relevant regulation has yet to be implemented in Kenya. The evolution and development of microfinance regulations in Kenya, and also in other jurisdictions in East Africa, will likely provide some useful insight into the potential trajectory of crowdfunding regulations in the region.

4.1.7 Anti-Money Laundering Regulation

The Proceeds of Crime and Anti-Money Laundering Act (POCAMLA) of 2009 introduced various obligations and restrictions on 'financial institutions' as measures for combating money laundering. The extent to which the POCAMLA affects the operations of a crowdfunding or P2P lending platform depends on whether the platform falls within the definition of a

‘financial institution’,⁹¹ or that of a ‘designated non-financial business.’^{92, 93} As things stand, it will be a matter of interpretation as to whether a crowdfunding activity can be defined as a financial institution under the POCAM-LA.⁹⁴ Regardless, platforms are obligated to monitor and report suspected money laundering activities to the Financial Reporting Centre.⁹⁵

4.1.8 Capital Markets Act

Part IV and section 23 of the Capital Markets Act deal with activities involving securities,⁹⁶ which require a licence from the CMA.⁹⁷ Where a platform issues tradable debt instruments in a loan-based crowdfunding scenario, it is arguable that the tradable debt instrument will be considered by the CMA to be a security, and the platform will be considered as ‘dealing in securities’ and as a ‘securities exchange’ (and therefore will require a licence from the Authority). In a loan-based crowdfunding scenario, the securities are considered to be public offers and the investor and the platform will be required to issue a prospectus approved by the CMA prior to offering the securities. They will also be required to comply with the other provisions of the Public Offer Regulations.

4.1.9 Banking Act (The BA Act)⁹⁸

The Banking (Amendment) Bill (2015) affects key changes to lending by institutions licensed under the BA⁹⁹. While the legislation does not directly impact loan-based crowdfunding in Kenya, it is likely to restrict pricing options available to loan-based platforms.

4.1.10 Public Offer Regulations

Offering securities to the Kenyan public requires compliance with provisions of the Capital Markets Act and the Public Offer Regulations. A person is deemed to offer securities to the public in Kenya if the offer is not a private offer. Section 34A of the Capital Markets Act imposes sanctions for breaches of the Capital Markets Act.¹⁰⁰

4.1.11 Equity Funders

A public offer, pursuant to the Capital Markets Act, is made when an offer of securities is made to the public or a section of the public. Equity crowdfunding investors will either be able to take advantage of an exemption in order to do away with the requirement to submit a prospectus to the CMA when making a public offer, or fall within the definition of a private offer and submit a short-form information notice as required by the CMA.¹⁰¹

4.1.12 Platforms – Donation and Reward Crowdfunding

Under the proposals set out in the Public Fundraising Appeals Bill (2014),¹⁰² a licence will be required prior to collecting money through a fundraising system. The Public Fundraising Appeals Bill (2014) establishes elaborate licensing procedures to adequately vet fundraising appeals before being made public.

4.1.13 Government and Regulator Policies, Initiatives and Approaches

Although not explicitly set out in legislation, the CBK, CMA and CCK have the ability to endorse new crowdfunding models in the absence of strict governing legislation.¹⁰³

4.2 Uganda: Legal Review of Existing Regulatory Landscape

4.2.1 Background

In 2015, a total of \$7.5 million was raised, with an additional \$4.8 million raised in Q1 2016.¹⁰⁴ The vast majority (83%) of crowdfunding activity taking place in Uganda is via donation platforms, primarily those based in developed countries. There is little domestic platform activity, with over 80% of market activity funded via donations from foreign platforms and almost 20% coming from non-financial return-based lending. Uganda currently has no legislation that specifically provides for equity or loan-based crowdfunding. Donation and reward crowdfunding fall outside the jurisdiction of financial regulators.

4.2.2 Relevant Regulations and Applicable Legislation

Relevant regulations and applicable legislation are as follows:

1. The Bank of Uganda has a wide mandate regulating those in the business of extending credit.
2. The Capital Markets Authority has a mandate to regulate persons dealing in securities, and prohibits any invitation by such persons to the public to subscribe for securities without a prospectus approved by the Capital Markets Authority.

Further relevant legislation is listed in the endnotes.¹⁰⁵

4.2.3 Tier 4 Microfinance and the Money Lenders Act (2016)

The Money Lenders Act established an autonomous body, to be known as the Ugandan Microfinance Regulatory Authority, to regulate, license and supervise tier 4 microfinance institutions and money lenders and promote the stability, integrity and sustainability of the microfinance industry in Uganda, as well as regulating and supervising commodity-based microfinance institutions. Non-deposit-taking microfinance institutions may exhibit some of the characteristics of loan-based consumer and business crowdfunding platforms, and this Act may therefore be applicable to loan-based crowdfunding activities.¹⁰⁶

4.2.4 The Financial Institutions Act

The Financial Institutions Act (2004) and the Amendment Act (2016)¹⁰⁷ prohibit any person from engaging in any financial institution business in Uganda without a licence from the Bank of Uganda. Financial institution business is widely defined under this Act.

4.2.5 The Capital Markets Authority Act

The Capital Markets Authority (Amendment) Act (2011) prohibits the offering of securities without a prospectus approved by the Capital Markets Authority.

4.2.6 The Communications Act

The above notwithstanding, it is noteworthy that the Uganda Communications Act (2013) grants the Uganda Communications Commission a wide mandate to monitor, supervise, control and regulate communication services within Uganda. These services are defined to include any dissemination or interchange of audio, visual or data content using telecommunications media or data communication. In this case, crowdfunding platforms *may* be regulated accordingly.

4.2.7 The Anti-Money Laundering Act

The Anti-Money Laundering Act (2013) and the Financial Institutions (Anti-Money Laundering) Regulations (2010) set out detailed requirements and obligations on accountable persons involved in financial transactions. Requirements include establishing ‘know-your-customer’ systems and processes, recording of certain transactions and mechanisms for reporting suspicious transactions. Crowdfunding businesses would qualify as accountable persons under the Anti-Money Laundering Act, and as such would be affected by the prohibitions and requirements highlighted above.

4.2.8 Government Policies or Initiatives

We are currently unaware of any regulations that allow the operation of crowdfunding models as they are being developed. Regulators in Uganda do not have the power to endorse such models in the absence of governing legislation.

4.3 Rwanda: Legal Review of Existing Regulatory Landscape

4.3.1 Background

In 2015, \$3.5 million was raised in Rwanda with an additional \$2 million raised in Q1 2016. Around three-quarters of market activity was non-financial return-based lending, with donation crowdfunding accounting for around another quarter.¹⁰⁸ Akin to Kenya and Uganda, most of the funding is likely to be coming from countries outside Rwanda, however further research needs to be undertaken to ascertain the proportion of both domestic and international funding. The equity and reward-based models have yet to really emerge in Rwanda.

As far as we are aware, there is no legislation in place as yet that regulates and supervises debt or equity crowdfunding. The bodies listed below would be the ones likely responsible for regulation and supervision, subject to interpretation of existing legislation.

4.3.2 Relevant Regulators and Legislation

- a. Relevant regulators and legislation include: The Capital Market Authority, under the legislation listed in the end notes.¹⁰⁹
- b. The National Bank of Rwanda, under the legislation listed in the end notes.¹¹⁰

4.3.3 Licensing Requirements

There are a number of restrictions in regard to the operation of a platform offering. According to the capital markets regulation in Rwanda,¹¹¹ a person shall not carry out or purport to carry out capital market business in Rwanda unless he/she is licensed, approved or exempted under that regulation, nor shall a foreigner be authorised to carry out capital market business in Rwanda subject to the satisfaction of Capital Market Authority that the person is regulated and licensed by a foreign agency with equivalent power.

4.3.4 Anti-Money Laundering

Rwanda’s stance against money laundering is a strong one, which can affect the operation of crowdfunding or peer-to-peer lending platforms

under the following law.¹¹² Money laundering under this law constitutes the performance of any one of a number of acts¹¹³. Furthermore, laws on the prevention of money laundering and the financing of terrorism will also likely govern crowdfunding activities.¹¹⁴ Of particular significance to crowdfunding is article 10 of the law which requires all reporting entities to identify their customers in a number of different cases.¹¹⁵

4.3.4 Government Policies or Initiatives

There is no regulation that we are aware of that allows for new crowdfunding models to operate separately from regulation as products are developed. There is one instance that suggests this is possible; the operation of Kountable Rwanda Limited since 2015.¹¹⁶

Under article 74 of law N°01/2011 of 10/02/2011 regulating capital markets in Rwanda, the Capital Market Authority shall have powers to issue all required regulations provided for which set out guidelines and directives required for the effective functioning of the capital market business in Rwanda.

Furthermore, as one of its missions, the National Bank of Rwanda seeks to enhance and maintain a stable and competitive financial system without any exclusion.¹¹⁷

From the above provisions, the Capital Market Authority and the National Bank of Rwanda are allowed to endorse new crowdfunding models in the absence of strict governing legislation.

4.4 Tanzania: Legal Review of Existing Regulatory Landscape

4.4.1 Background

In 2015, a total of \$4.2 million was raised, with an additional \$2.8 million raised in Q1 2016.¹¹⁸ Donation-based crowdfunding models accounted for two-thirds of the total market volume, with an additional third representing non-financial return-based lending. Akin to the other markets in East Africa, both equity and loan-based models are yet to make their mark on the domestic crowdfunding market. Further research needs to be undertaken to determine the proportion of funds being sourced domestically, as opposed to internationally.

As far as we are aware, there are no legal definitions set out in any primary or secondary legislation, or official government policy documents for equity crowdfunding or loan-based crowdfunding in Tanzania. Whether the various types of crowdfunding described above require licences from the regulator is subject to interpretation of applicable existing legislation reviewed below.

4.4.2 Regulations and Relevant Existing Regulation

The following regulatory bodies potentially regulate crowdfunding activities, subject to interpretation of the existing pieces of legislation:

- a. The Bank of Tanzania (BOT)
- b. The Capital Markets Authority (CMA)

Further relevant legislation is listed in the endnotes.¹¹⁹

4.4.3 NPS Act and NPS Regulations

To the extent that a platform provides certain services,¹²⁰ the platform would require a payment service provider licence from the BOT under the NPS Act and NPS Regulations. Where the platform envisaged does not engage in any of the services under section 6 of the NPS Act, it is arguable that the provisions of the NPS Act and NPS Regulations *may* not be applicable.

Section 2 of the NPS Act creates the class of a ‘payment system participant’.¹²¹ In our view, it is difficult to determine whether this will apply to crowdfunding platforms. Payment system participants, while still regulated under the NPS Act, do not require a licence and are not as heavily regulated as payment system providers; the latter must be licensed bodies under the NPS Act in order to operate.

4.4.4 Electronic Money Regulations

Platforms may be involved in the business of issuing electronic money, but will be required to establish a separate legal entity as a payment system provider, and apply for a licence from the BOT, as provided under sections 12 and 13 of the Electronic Money Regulations.¹²² The method of money transfer between the borrower and the investor is clearly a determinant factor of whether the intermediary will fall under these provisions.¹²³

4.4.5 Anti-Money Laundering Regulations

The Anti-Money Laundering Act (2006) (AMLA) was introduced with the stated aim of introducing better provisions for the prevention and prohibition of money laundering, as well as disclosure of information on money laundering. In our view it is debatable whether crowdfunding services would fall under those terms. It is foreseeable that crowdfunding could expressly be brought under the terms of AMLA. For completeness, and in the event that a crowdfunding entity is designated as a reporting person, section 15 of AMLA places an obligation upon such reporting persons to take reasonable measures to satisfy themselves of the true identity of any applicant seeking to enter into a business relationship with them. In such a case, there will be a requirement for crowdfunding entities to obtain official identity records that would be reasonably capable of establishing the true identity of an applicant.¹²⁴

4.4.6 The Microfinance Act (MA Act)

If the platform takes deposits, the provisions of the MA Act will apply to the platform. Returning to the BOT, section 6 of the Bank of Tanzania Act (2006) gives the BOT a mandate to regulate, monitor and supervise payment, clearing and settlement systems, including all products and services relating to such activity. Were any crowdfunding activity to touch on one of these areas, which may seem unlikely but cannot be ruled out, then the BOT may also conduct oversight functions on such systems in any bank, financial institution or infrastructure service provider or company.

4.4.7 The Capital Markets Act (CMA Act)

Where a platform issues tradable debt instruments in a loan-based crowdfunding scenario, it is arguable that the tradable debt instrument will be considered by the CMA Act to be a security, and the platform will be considered as ‘dealing in securities’ and as a ‘securities exchange’ (and therefore the platform will require a licence from the CMA). Furthermore, no person shall carry on the business of dealing in securities or present

himself as carrying on such a business unless he is the holder of a dealer's licence issued under part IV of the CMS Act. Section 2 of the CMS Act defines securities to mean, inter alia, debentures, stock, shares, bonds or notes issued or proposed to be issued by a body corporate and any right, warrant or option.

4.4.8 Banking and Financial Institutions Act (BAFIA)

Section 2 of BAFIA defines banking business as:

the business of receiving funds from the general public through the acceptance of deposits payable upon demand or after a fixed period or after notice, or any similar operation through the frequent sale or placement of bonds, certificates, notes or other securities, and to use such funds, in whole or in part, for loans or investments for the account of and at the risk of the person doing such business; "control" shall be presumed.

Based on the definition of the term 'banking business', a platform offering loan-based crowdfunding would be regulated under BAFIA if it accepts deposits from members of the public in exchange for debt securities. In such circumstances, the platform would require a banking licence from BOT.

4.4.9 Donation and Reward-based Crowdfunding

Donation and reward-based crowdfunding are unregulated financial activities.

4.4.10 Government Policy and Initiatives

Section 70 of the Bank of Tanzania Act (BOTA) gives power to the Minister of Finance to create theregulations necessary to give effect to the provisions of BOTA. Read in conjunction with section 6 of BOTA, which, as stated above, sets out BOTA's regulatory and supervisory functions with respect to clearance and settlement systems, the ambit of ministerial powers in this regard is wide. For example, the Minister of Finance could introduce a regulation that made the current NPS legal framework applicable to crowdfunding arrangements.

**UK, SOUTH AFRICA,
MALAYSIA, INDIA,
NEW ZEALAND, THE
USA.**



5. Insights from Existing Regulatory Regimes

5.1 UK

5.1.1 Background

In 2015, the UK was the third largest market in the world for alternative finance, with \$4.2 billion raised that year.¹²⁵ Of that amount, \$3.15 billion accrued from loan-based models, while \$0.44 billion was from equity-based models. Reward-based crowdfunding accounted for around \$50 million, while donations hit approximately \$15 million. This market structure is almost exactly the opposite of what can be seen in East Africa, with return-based lending and equity models making up the vast majority of the market in the UK, and donation and reward-based crowdfunding accounting for only a small fraction of the total market.

The Financial Conduct Authority (FCA) is the regulating body which monitors and supervises crowdfunding activities in the UK.¹²⁶ Reward and donation-based crowdfunding are not regulated activities. The FCA implemented crowdfunding regulation with interim measures and prudential requirements to allow firms to become gradually compliant. After a lengthy consultation period,¹²⁷ in April 2014 certain crowdfunding activities became a regulated activities under FCA supervision and rules. Prior to this, industry organisations and trade associations acted as a self-regulating body, implementing and imposing best practice rules.¹²⁸ New rules for promotion of investment-based crowdfunding were also introduced in April 2014, which extended the types of investor that unlisted securities offered via crowdfunding platforms could be communicated to.

As of July 2016, there were 32 authorised crowdfunding firms, of which nine were loan-based crowdfunding platforms and 23 were investment-based crowdfunding platforms. Eleven were appointed representatives, and 88 loan-based crowdfunding platforms had applications under consideration, many with interim permissions.¹²⁹ Many leading platforms offer internal secondary markets to enable investors to sell on investments to other investors on their platform. However, no multi-platform secondary market currently exists.

5.1.2 Code of Conduct outside of Formalised Regulatory Regime

The two prominent trade organisations in the UK are the UKCFA (United Kingdom Crowd Funding Association¹³⁰) and the P2PFA (the Peer-to-Peer Finance Association¹³¹). These two organisations played a sizeable role when advocating for regulation of the new industry, with both organisations working closely with governmental bodies throughout the consultation and implementation periods. Prior to the introduction of formal regulation by the Financial Conduct Authority, the UKCFA and the P2PFA implemented ‘codes of conduct’ aimed at providing guidance and rules for organisation member firms. These rules are purposefully broad-stroke, and serve as self-imposed rules to go above and beyond regulatory requirements. For firms that are members of these institutions, but that fall outside of the regulatory regime (e.g. donation or reward-based crowdfunding), these ‘codes of conduct’ serve as ‘self-regulation’ standards and provide legitimacy to the industry.^{132, 133}

5.1.4 Disclosure Requirements

All firms must comply with disclosure requirements, with all communications on their website and through other channels being ‘fair, clear and not misleading’. The minimum set of information firms must share includes performance of products, comparative information and relevant transactions.

5.1.5 Client Money Rules

All platforms are obliged to conform to client money rules around ‘adequate protection’ – i.e. no co-mingling of client monies, clear and transparent holding of client monies, etc.¹³⁴ At the crux of the client money rules is the notion that firm money must always be held separately from any consumer or client money. For loan-based crowdfunding, new rules further clarify the FCA’s parameters for correct use of client money and client money segregation, and were modified in 2016, streamlining the rules relating to how firms dealt with investor money when some of the loan-part investors might be businesses as well as individuals.¹³⁵

5.1.6 Social Media and Customer Communications

The FCA also provides rules around social media and customer communications.¹³⁶ The core of the FCA’s supervisory approach is the notion that ‘any and all communication that can be deemed as a promotion be reflective not only of any benefits to a consumer, but must also address any relevant risk associated with the use of the product being promoted.’ The key purpose of this guidance is to address and define the parameters platforms might use on social media platforms and the sufficient risk warnings.

5.1.7 Loan-based Crowdfunding

The applicable licence (defined by HMT) falls under Article 36H RAO: operating an electronic system.¹³⁷ The relevant regulated activity relating to loan-based crowdfunding is set out in Article 36H of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (RAO). With the introduction of crowdfunding rules in April 2014, firms were obliged to adhere to top-level FCA rules and requirements, while still being fully operational while preparing their application or awaiting full authorisation. Any firm entering after 1 April 2014, however, is subject to all FCA rules and could not operate on interim permissions.¹³⁸

Loan-based crowdfunding in the UK requires platforms to facilitate direct contracts between lenders and borrowers, in adherence to 36H, and is not considered a deposit-taking activity. Key rules which apply to loan-based platform activity deal with the application of core consumer protections by the regulator, including guidance and supervision relating to promotions, AML, etc. In particular, the FCA has implemented prudential requirements.¹³⁹ The FCA is phasing in these requirements to give firms time to adjust to new obligations. A key component of the implementation of prudential requirements¹⁴⁰ relates to reporting requirements imposed upon platforms once they are fully authorised. Platforms are expected to report to the FCA on a quarterly basis (with monthly reporting of any information relating to the holding of client monies)¹⁴¹ and are required to record complaints.

5.1.8 Investment-based Crowdfunding

The FCA defines the instruments traded on investment-based crowdfunding as ‘non-readily realisable securities’ that are not listed on regulated stock markets, and are distributed and sold over the internet. Models which fall under this definition include equity-based crowdfunding, real estate equity-based crowdfunding and debt-based securities, such as mini-bonds and debentures. Key rules which apply to investment-based crowdfunding include those concerning disclosure, client money, and promotion. Additionally, specific marketing restriction rules apply, which dictate how firms can make direct offers to retail clients and how such retail clients are defined.

5.1.9 Equity-based Crowdfunding Funders

The FCA divides retail consumers into three categories, based upon their ability to meet certain criteria. Funder categorisation is only applicable to equity-based activities at present, as there are no restrictions placed on retail investors engaging in loan-based activities. Depending upon the categorisation of the individual investor,¹⁴² a platform may only direct offer promotions to retail consumers that meet the following criteria:

- i. Certified high-net-worth or sophisticated investors.
- ii. Ordinary retail investors who receive regulated advice.
- iii. Ordinary retail investors who invest less than 10% of net assets. In this instance, firms are required to check consumer understanding of risks if not receiving regulated advice. Investment-based crowdfunding platforms must also verify that the retail investor is aware of the risks associated with their activity via an online appropriateness test.

5.1.10 Best Practice and Insight

A number of strategic policies have been put forward by the UK government, which promote the inclusion of crowdfunding models. New policies, from government co-investment schemes to tax-wrapper inclusion, have promoted the quick development and adoption of crowdfunding activities within the UK. Below we will outline several key government-led or government-promoted policies that have had significant material impact on the market.

5.1.11 ‘Project Innovate’ Sandbox

The FCA regulatory sandbox creates a ‘safe space’ for innovative businesses to test products, services or new models within a ‘live’ environment while

enjoying pre-regulation constraints.¹⁴³ Pre-authorized firms that operate within financial activities that typically require authorisation are invited to apply to the sandbox. This sandbox serves as an example on how regulators may foster innovation while creating a regulatory framework applicable to the new business type. The first round of applications to this sandbox closed in July 2016.¹⁴⁴

5.1.12 Co-Investment Funds

As part of the 'Business Finance Partnership'¹⁴⁵ scheme, the British government effectively lends via the peer-to-peer lending platform, alongside retail investors and other institutional investors who lend via the platform. As for the London Co-Investment Fund, equity crowdfunding platforms have access to part of a £20 million fund to co-invest around 25% of funds targeting SMEs within the technology, digital and science sectors.¹⁴⁶

5.1.13 Industry Associations

As previously mentioned, the UKCFA and P2PFA were instrumental in enacting self-governing principles before bespoke regulation was introduced by the FCA. They have also played an ongoing role promoting the industry and providing an effective point of engagement for the regulators to maintain communications and interaction with the crowdfunding industry.

5.1.14 Industry Engagement

The FCA has provided numerous opportunities for industry participants, press, the public and academics to engage with the regulators to contribute to, and respond to, the FCA's approaches to regulation through roundtables, consultations and events.¹⁴⁷

5.1.15 Tax Incentives

Crowdfunding platforms have been able to take advantage of several tax wrappers, which have incentivised retail investors and provided some level of risk mitigation. Lenders utilising debt-based platforms may also take advantage of tax wrappers. In 2015, the Personal Saving Allowance (PSA) scheme was launched, enabling lower-rate tax payers to earn tax-free interest (including that raised on loan-based platforms) up to a threshold depending on their tax band (for lower-rate tax payers the threshold was £1,000, and for higher-rate tax payers it was £500¹⁴⁸). This allows for tax-free interest upon outstanding lending, thus encouraging more retail lending. A number of SIPP providers have partnered with specific platforms to manage such accounts. For equity crowdfunding, there are also generous tax incentives enabling investors to offset their risk against risky early-stage company investments.¹⁴⁹ There are also tax incentives for loan-based and equity-based platforms to offer investments to qualifying social enterprises, community projects or charities via SITR¹⁵⁰ (Social Investment Tax Relief) or CITR (Community Investment Tax Relief).

Finally, in 2016, the UK government has implemented the Innovation Finance ISA, a tax wrapper specifically for loan-based crowdfunding activity. While firms must be authorised in order to cater to IFISA users, it is anticipated that this ISA will bolster retail lending supply significantly in 2016 via loan-based platforms receiving their full authorisation from the FCA.

5.2 South Africa

5.2.1 Background

In 2015, a total of \$10.4 million was raised by South African crowdfunding platforms with a further \$4.1 million raised in Q1 2016.¹⁵¹ As in East Africa, donation-based crowdfunding accounts for a major proportion of total market activity in South Africa, with a total of 57% in 2015. Reward-based crowdfunding plays a larger role in South Africa than in East Africa, with a total 34% of market activity. Equity and loan-based models account for a much less substantial proportion, with 6% and 3% respectively.

5.2.2 Regulators and Legislation

There is no explicit mention of crowdfunding in legislation in South Africa, and at this stage, legislation has not been proposed in parliament. A person interested in offering crowdfunding services, either by issuing opportunities or as an investor, should engage the Financial Services Board directly in order to ensure they stay within the existing regulations.¹⁵² While gaining in popularity in South Africa, the regulations of peer-to-peer lending and equity crowdfunding seem currently unclear. Crowdfunding firms are applying for Financial Services Board (FSB) licences, but the FSB has stated that this activity falls outside their jurisdiction. This regulation may be relevant.¹⁵³

5.2.3 Industry Associations

The Africa Crowdfunding Association¹⁵⁴ is a new industry association with around 50 member platforms currently developing its governing rules and principles.

5.2.4 Loan-based Crowdfunding

The National Credit Act No. 34 of 2005 (NCA) could potentially cover debt-based or peer-to-peer crowdfunding. The NCA defines a credit provider as a party who extends credit under an agreement whereby the credit provider undertakes to pay the consumer an amount of money and defer repayment, and charge a fee for such an arrangement.

5.2.5 Loan-based Crowdfunding Funders

The Consumer Protection Act obliges platforms of all types to ensure that their users understand what they are doing and are in no way misinformed.

5.2.6 Equity-based Crowdfunding Platforms

Platforms must be licensed in terms of section 7 of the Financial Advisory and Intermediary Services Act No. 37 of 2002. Platforms are deemed as an 'offer of securities to be issued to any section of the public' in terms of section 95 of the South African Companies Act (2008). Unless the platforms have one of the exemptions listed in section 96 of that act (such as 'offers to persons whose ordinary business is to deal in securities'), the entity that owns the platform will be required to be a public company. The platform will therefore be regulated by all the disclosure, financial reporting, auditing and general governance requirements regulating public companies in terms of the Act and other financial legislation.

5.2.7 Equity-based Crowdfunding Funders

If crowdfunding platforms are registered as venture capital companies in terms of section 12J, any funds invested in the crowdfunding platform may

be deductible for tax purposes. Investors would receive preference or normal shares in the SPV which would be proportionate to their investment.

5.2.8 Equity-based Crowdfunding Fundraisers

Equity-based crowdfunding projects which would likely be facilitated through offers of securities to the public by private companies. Section 100 of the Companies Act No.71 (2008) states that, when unlisted securities are to be offered to the public, such an offer must be accompanied by a detailed prospectus. The content and registration of prospectuses must be in compliance with chapter 4 of the Companies Act.



5.3 Malaysia

5.3.1 Background

In 2015 a total of \$3.36 million was raised across Malaysia.¹⁵⁵ This was a substantial increase on the \$1.03 million raised in 2014. Donation-based crowdfunding accounted for the majority of market activity, with over 92% (with an additional 6% coming from reward-based crowdfunding). In 2016, regulation governing equity crowdfunding came into force with six equity platforms¹⁵⁶ becoming licensed after a period of 18 months of the regulator engaging with the industry through consultation.

On August 21st 2014, the Malaysian Securities Commission began a dialogue inviting contributions from various stakeholders regarding the regulatory framework for equity-based crowdfunding, making it the first ASEAN country to do so. Malaysia's first guidelines were issued on 10 February 2015, with the passing of the Capital Markets and Services Bill (2015) on 2 July. Subsequently, in September 2015, the Malaysian Securities Commission (MSC) launched the Alliance of FinTech Community in order to catalyse greater interest in the development of financial technology and help raise awareness, and to provide regulatory clarity to promote responsible innovation in the sector.

As part of the MSC's effort to support innovation in FinTech, the equity crowdfunding regulatory framework was introduced in February 2015. Building upon this initiative, the MSC is now introducing its P2P regulatory framework, which sets out requirements for registering as per the amended *Guidelines on Recognized Markets*.¹⁵⁷

5.3.2 Loan-based Crowdfunding

Investors who invest through an MSC-registered P2P platform are buying securities in the form of an investment note or Islamic investment note, issued by the businesses or companies. The new P2P framework came into effect on 2 May 2016. Operators interested in establishing and operating a P2P platform were able to submit their application to the regulator from 2 May to 1 July 2016. The MSC stipulated a number of key duties for platforms.^{158, 159}

5.3.3 Loan-based Crowdfunding Funders

Loan-based crowdfunding is open to all investors, but retail investors are *encouraged* to limit their exposure on any platform to a maximum of \$11,333 (50,000 MYR) at any given time.¹⁶⁰

5.3.4 Equity-based Crowdfunding

Equity-based crowdfunding legislation came into force at the end of 2015. Malaysia was the first country in South East Asia to enact such bespoke legislation. The market is, as yet, very small.

5.3.5 Equity-based Platforms

Equity-based platforms have a wide range of duties, which are outlined in detail in the endnotes.¹⁶¹

5.3.6 Equity-based Crowdfunding Funders

A person (local and foreign) may invest subject to the following limits:

- i. Sophisticated investors: no restrictions on investment amount.
- ii. Angel investors: a maximum of RM500,000 (\$125,000) within a 12-month period.
- iii. Retail investors: a maximum of RM5,000 (\$1,250) per issuer with a total amount of not more than RM50,000 (\$12,500) within a 12-month period.

5.3.7 Equity-based Crowdfunding Fundraisers

There are a number of restrictions and responsibilities in place. The key ones are outlined in the endnotes.¹⁶²

5.3.8 Malaysia Reward and Donation-based Crowdfunding

No financial regulation by the MSC.

5.3.9 Key Lessons and Insights, and Government and Policy Initiatives

The Malaysian Securities Commission stands out as one of the most proactive and innovative securities commission in the Asia Pacific region. They offer a number of crucial insights and best practices, which are outlined below.

5.3.10 Proactive Regulator

The Malaysian Securities Commission acted early, before the market even existed, to preempt market developments and achieve their objectives of promoting financial inclusion and making Malaysia a regional leader in financial technology.

5.3.11 Consultation Process

The MSC engaged with industry at an early stage, through a participatory consultation process which helped to identify industry and expert insights and perspectives, as well as informing how the regulation took shape. The MSC also meets with the industry monthly.

5.3.12 Engagement with Industry

There have been a number of opportunities for the industry, press, academia and the wider public to engage through conferences such as the Synergy and Crowdfunding Forum (SCxSC)¹⁶³ in 2014, 2015 and 2016.

5.3.13 Encouraging Formation of Trade Associations

The MSC has encouraged equity and loan-based crowdfunding industry players to collaborate in order to form a single trade body with whom the regulator can regularly interact and better monitor industry developments.¹⁶⁴

5.3.14 Angel Investing Tax Relief

Malaysian Business Angels,¹⁶⁵ via the Cradle startup investment programme, is already providing opportunities for traditional angel, and even venture capital, investors to co-invest in equity crowdfunding deals. Angel investors receive up to \$125,000 of tax relief two years after they have invested in a Malaysia-based startup.

5.3.15 July 2016 – Regulatory Sandbox

The Central Bank of Malaysia is proposing a regulatory sandbox that is currently undergoing consultation¹⁶⁶ and will likely include:

- a. **Informal steer** – the Bank of Malaysia will provide guidance and advice

to the financial institutions or FinTech companies on the modifications that can be made to their proposed business model or solution to fit prevailing laws and regulations.

- b. Regulatory sandbox** – financial institutions or FinTech companies can test their innovation in a controlled environment, subject to the eligibility criteria specified by the Bank. The Bank may provide guidance and support in the form of regulatory flexibilities during the testing period where appropriate.



5.4 New Zealand

5.4.1 Background

A total of \$268 million was raised in 2015, up substantially on the \$22 million of 2014 and a sizable increase on the \$3 million of 2013.¹⁶⁷ These figures demonstrate the speed at which crowdfunding models can develop from almost nothing. Peer-to-peer consumer lending dominates the New Zealand market, with over 90% of the market (\$244 million in 2015). This is followed by equity-based crowdfunding, with almost \$12 million in 2015 (around 5%). Both donation and reward-based crowdfunding account for very small proportions of the market, unlike in East Africa where these models dominate industry activity.

The New Zealand Market Act has enacted bespoke regulation governing equity crowdfunding since the end of 2015, with loans being regulated from 2016. As with the other more established markets, both reward and donation-based models are not regulated activities.

5.4.2 Loan-based Crowdfunding

Loan-based crowdfunding received bespoke regulation in New Zealand in 2016. It is defined as providing a facility by means of which offers of debt securities are made; and the principal purpose of the facility is to facilitate the matching of lenders with borrowers who are seeking loans for personal, charitable or small-business purposes.

5.4.3 Loan-based Crowdfunding Platforms

Eligibility criteria and responsibilities of peer-to-peer lending services under section 396(a) of the FMA Act are listed in the endnotes.¹⁶⁸

5.4.4 Equity-based Crowdfunding Platforms

Platforms have a range of duties and responsibilities they must adhere to.¹⁶⁹

5.4.5 Equity-based Crowdfunding Funders/Investors

There are no limits on what a retail investor can invest in each offer. However, marketing and promotions must include sufficient information to enable investors to make informed decisions about the financial services offered.

5.4.6 Equity-based Crowdfunding Fundraisers/Issuers

Fundraisers and issuers are governed by a range of responsibilities and duties.¹⁷⁰

5.4.7 Reward-based and Donation-based Crowdfunding

These are not considered crowdfunding services under the FMA Act, and are therefore unregulated. If the service is only used for charitable or philanthropic fundraising, and donors don't receive shares, then the service is not a regulated financial activity.

5.4.8 Best Practices and Insights

a. Proactive approach of regulator – engaged the industry early on and created bespoke regulation. This led to New Zealand becoming one of the most successful markets for crowd finance based on total market volumes in the Asia Pacific region – fourth behind China, Japan and

Australia.

- b. **Prospectus exemption** - this means equity issuers are not bound by stringent requirements.
- c. **No prescribed disclosure requirements** – this gives issuers and platforms more flexibility.
- d. **Use of ongoing legislation-making** – this is used as an opportunity to consider how current efforts to update any securities, capital markets or other relevant regulation could also preempt and incorporate new crowdfunding models in order to make use of the opportunity while legislation is still being made.



5.5 India

5.5.1 Background

In 2015, a total of almost \$40 million was raised by platforms across India.¹⁷¹ This figure was a substantial increase on the circa \$12 million raised in 2014, and the \$5 million raised in 2013. The vast majority of market activity was equally shared between peer-to-peer consumer lending and equity-based crowdfunding, which accounted for almost \$19 million apiece. Reward-based crowdfunding was in third place in 2015 with a total of almost \$2 million, while peer-to-peer business lending accounted for just over \$0.5 million.

5.5.2 Regulators and Regulation

While crowdfunding equity, debt and funds would fall under the purview of the capital markets regulator (SEBI), P2P lending would fall within the domain of the Reserve Bank of India. In 2015 alone, around 20 new online P2P lending companies were launched in India. At present, there are around 30 startups in the P2P lending industry in India.¹⁷² Some of the relevant legislation is listed in the endnotes.¹⁷³

5.5.3 The Scope of the Reserve Bank's Regulation

The Reserve Bank of India has powers to regulate entities which are in the form of companies or cooperative societies. However, if the P2P platforms are run by individuals, proprietorships, partnerships or limited liability partnerships, they do not fall under the purview of RBI. Hence, it is essential that P2P platforms adopt a company structure. No entity other than a company can undertake P2P activity. This renders such services provided under any other organisational structure illegal. Alternatively, the other forms of structure may be regulated by the state governments.

5.5.4 What is Regulated and What is Not

In June 2014, a consultation paper was released to review equity crowdfunding regulation in India. However, the regulators deemed the market too small to regulate at that time, and therefore only accredited investors were permitted to participate. In April 2016, a consultation process to review the regulatory approach to peer-to-peer lending was launched. This consultation process is still taking place. There are a number of activities that the regulators in India will potentially undertake to govern the crowdfunding sector (these are still under review).¹⁷⁴

5.5.5 Loan-based Crowdfunding

Presently, there are around 30 startup P2P lending companies in India. P2P lending platforms are largely tech companies registered under the Companies Act. It is being proposed that, by defining P2P platforms as Non-Banking Financial Companies under section 45I(f) (iii) of the RBI Act (by issuing a notification in consultation with the Government of India), P2P lending platforms will come under the purview of the Reserve Bank's regulation. Once notified as NBFCs, RBI can issue regulations under sections 45JA and 45L.¹⁷⁵ After the notification, RBI can issue directions under sections 45JA and 45L of the RBI Act to such platforms regarding registration requirements and prudential norms.

5.5.6 Loan-based Platforms

Proposed rules include *highly* prescriptive stipulations, as outlined in the endnotes.¹⁷⁶ In order to address regulator concerns about deposit-taking regulation, there was a proposal in the current P2P consultation about requiring funds to be transferred *directly and only* between borrowers and lenders and completely circumventing platforms. This, however, presents major logistical issues and a number of platforms were strongly opposed to it being introduced.

5.5.7 Equity-based Crowdfunding

The Bank of India and Securities and Exchange Board of India (SEBI), in a 2014 consultation paper, specifically focused on equity-based crowdfunding. The Board decided not to take regulatory action as the market was too small.¹⁷⁷

5.5.8 Equity-based Crowdfunding Funders

Given the risk of information asymmetry, SEBI proposed that only ‘accredited investors’ will be allowed to participate in the crowdfunding process. Accredited investors include institutional investors, companies, high-net-worth individuals and financially secure retail investors. The cap on such retailers would be \$900, or 10% of their net worth.

5.5.9 Equity-based Crowdfunding Fundraisers

Fundraisers are limited by many factors.¹⁷⁸

5.5.10 Donation and Reward-based Crowdfunding

No financial return in the form of a yield or return on investment is expected by funders, so donation and reward-based crowdfunding fall outside the purview of the securities market regulator.

5.5.11 Key lessons and Insights

The highly prescriptive disclosure requirements and high levels of precisely who is able to invest, are potentially key reasons for why the Indian market is so small relative to China, for example..¹⁷⁹

5.6 USA

5.6.1 Background

In 2015, a total of \$36 billion was raised across the USA.¹⁸⁰ The vast majority of market activity was for debt-based models, accounting for almost 95% of total activity. Equity and reward-based crowdfunding accounted for almost 1.5% of market activity apiece. Donation-based crowdfunding made up less than 1% of the total market.¹⁸¹ Therefore, we see non-financial return-based models accounting for a very small proportion of market activity, with loans dominating the US market.

In 2012, President Obama signed the Jumpstart Our Business Start-ups Act (JOBS Act) into law, which included subsections which set forth initial parameters which encompass crowdfunding activities (Titles II, III and IV). While the legality of crowdfunding was resolved in 2012, it has taken the Securities and Exchange Commission (SEC) an additional four years to implement all the final rules under the JOBS Act.

Title II is an update of the existing Regulation D. Now separated between 506b and 506c, issuers selling securities under 506b may not advertise an offer and may only accept investments from accredited investors. New 506c rules allow an issuer to advertise an offer to accredited investors. Platforms that list 506c offers must verify that an investor qualifies as accredited. Under 506b, an investor may self-certify their accredited investor status.

Title III is a new exemption that allows issuers the ability to raise up to \$1 million from either accredited or non-accredited investors. This is known as Regulation Crowdfunding (or Regulation CF) and streamlines the registration process for crowdfunding portals with the SEC and the Financial Industry Regulatory Authority (FINRA).

Title IV is an update to a little-used exemption called Regulation A. Now called Regulation A+, the exemption has been divided into two separate sets of rules. Under Tier I, an issuer may raise up to \$20 million but must qualify the offer within each state in which the offer is available. Under Tier II, an issuer may raise up to \$50 million without qualifying the offer in each state. The need for state 'blue sky review'^{182, 183} removed a significant hurdle that undermined its original form. Both Tier I and Tier II require a qualification process and certain disclosures.

At the Federal level, the JOBS Act brings together a number of provisions geared at modernising existing private capital markets regulation, thus encompassing crowdfunding activities. In particular, the JOBS Act gives accredited investors increased access to deal flow, and implements provisions that enable general solicitation or promotion – most frequently provided online.

5.6.2 Regulators

As mentioned above, crowdfunding in the United States is, at the federal level, regulated by the SEC and monitored by FINRA. At present, some 30 states have also passed intra-state crowdfunding exemptions. In general, at the state level, issuers must operate in the state where the fundraising is taking place, and investors must prove they are residents of the state before

purchasing the securities offer.

5.6.3 General Rules and Key Legislation

All platforms which promote or sell a security must be registered with the SEC and FINRA. As such, regulation for crowdfunding is more akin to broker-deal rules, and focuses on securities sold on crowdfunding platforms.¹⁸⁴ Key legislation is listed in the endnotes.¹⁸⁵

5.6.4 Crowdfunding Platforms

Crowdfunding platforms have a range of duties and obligations in the USA.¹⁸⁶

5.6.5 General Rules Relating to Funders/Investors under Regulation Crowdfunding

There are a large number of rules relating to both funders and investors under Regulation Crowdfunding.¹⁸⁷

5.6.6 General Rules for Fundraisers/Issuers

There are a range of stipulations governing fundraisers and issuers, including a limit of \$1 million for securities issued in a 12-month period.¹⁸⁸

5.6.7 Loan-based Crowdfunding

In addition to adhering to general rules (as described above), several key federal and state statutes apply to loan-based crowdfunding, as the security offered is akin to bank and non-bank credit provisions. While debt-based crowdfunding falls within the JOBS Act, many of these rules focus more on the sale of equity securities products. As such, loan-based models are obligated to adhere to rules and laws which sit outside of, but alongside, the JOBS Act.

In addition to securities laws (as implemented by the SEC) and state-level securities rules, loan-based platforms also abide by state-level banking regulations relating to lender registration, and state and federal licensing.

As it currently stands, crowdfunding platforms (often referred to as 'funding portals') are required to register with the SEC, and are mandated to register with FINRA. It is important to emphasise that the regulatory structure for crowdfunding in the US remains highly fragmented, with rules applicable at both state and federal levels. Loan-based platforms must also abide by consumer protection laws aimed at fair lending practices, and must include insolvency and bankruptcy contingency plans.¹⁸⁹

5.6.8 Loan-based Crowdfunding Fundraisers

The SEC approach relates more to the potential risk to the investor, while the FDIC approach relates to protecting the business or consumer borrower. As such, a number of key laws relate to borrower protection.¹⁹⁰

5.6.9 Equity-based Crowdfunding

The JOBS Act is the key piece of legislation which has enabled the sale of equity securities via an electronic funding portal. Many existing platform operators, prior to the implementation of Regulation CF, have made use of Regulation A+ and Title II (506c) to maintain operations while waiting for the official implementation of Regulation CF. Though Regulation CF has officially come into action in 2016, many platforms will continue using

Title II and IV regulations, as they allow for higher issuer caps. As such, the JOBS Act is the key piece of law that an equity platform must adhere to, and generally there are no additional parameters, unless the platform also offers debt products.

5.6.10 Fundraisers

Businesses utilising a crowdfunding site must register their securities offer, and provide investors with identifying information.¹⁹¹ If utilising Regulation CF, the business may not solicit or 'test the waters' with their offer prior to SEC registration and approval, and may *only* solicit their offer via the electronic platform or advertisement with minimal information. Should the business wish to issue their offer via a platform utilising Regulation A or A+, they may test the waters according to rules. Regardless of the provision used, the fundraiser must register their offering in each state where the security is being offered. Under Title II, a filing is made with the SEC, but minimal information is disclosed.

5.6.11 Donation and Reward-based Crowdfunding

Donation and reward-based platforms are not viewed as offering securities products. As such, these platforms fall outside of SEC regulation.

5.6.12 Key Lessons and Insights

- a. **Emphasis on dual protection** – in the case of loan-based crowdfunding, SEC regulation focuses on enforcing investor protection, while consumer credit regulation focuses on protecting the issuer or borrower. By doing so, both the investor and investee are sufficiently protected, and the funding portal has clear guidelines on best practices towards the two groups that the platform inherently caters to.
- b. **Third-party licensing/registration** – FINRA maintains a publicly available list of all active funding portals. FINRA is a private industry body, which acts as a self-regulating membership organisation and monitors firms according to the applicable SEC or Consumer Protection framework. A list of platforms is publicly available, allowing for greater transparency in a nascent industry.
- c. **Electronic recording** – issuers of a security (either via an electronic portal, or with respect to the portal itself) must publicly file applicable financial data, via the EDGAR system, with the SEC. This encourages transparency, especially towards unlisted companies using an electronic funding portal.
- d. **State versus federal** – given the plethora of state-specific rules, crowdfunding registration can be challenging for platforms and potential fundraisers, as each offer must be registered with the federal and state authority where funds are being sought. This also limits investor cohorts by geography, dependent on where an offer has been registered. This remains an issue for regulators to tackle in 2016.
- e. **Time lag in implementation** – despite the JOBS Act being signed in 2012, it has taken four years for the implementation of a regulatory framework. As such, many firms have had to apply related yet non-specific rules to allow for the continuation of their operations within the four-year period. This lag has presented a variety of operational difficulties and may present complications to businesses that have operated using adjacent regulatory frameworks, i.e. Regulation A or A+.

REGULATION
AND POLICY
RECOMMENDATIONS
FOR MARKET
DEVELOPMENT IN
EAST AFRICA



6. Key Recommendations and Policy Road Map

Having reviewed the existing regulatory landscape in Kenya, Rwanda, Uganda and Tanzania, as well as that of other, more established markets, a three-phased set of policy and regulatory recommendations are proposed in order to encourage the growth and development of crowdfunding models in East Africa – while putting in place the necessary precautionary and monitoring measures to protect all stakeholders, especially retail customers.

6.1 Phase 1: Mapping, Education and Engagement

6.1.1 (Short-term/Ongoing) Platform Database

Provide a detailed database of all currently existing platforms in each East African jurisdiction, with a description of crowdfunding model employed and contact details. This database would be made available to regulators in East Africa and updated and maintained regularly. The World Bank would be very well placed to host and potentially fund such a database as part of their financial access and inclusion programmes.

6.1.2 (Short-term/Ongoing) FinTech Regulator Capacity and Awareness Building

Provide comprehensive training sessions to all regulators in Uganda, Rwanda, Tanzania and Kenya, conducted by industry experts and stakeholders, to bring regulators up to speed on how each crowdfunding model works as well as how other countries and regulators are operating. There are a number of industry experts that could provide such training and capacity-building across the crowdfunding industry. Given the rapidly changing nature of this market, it is recommended these capacity building exercises are conducted on a biannual basis in order to help keep regulators abreast of industry developments and appropriate regulatory and policy responses. In addition, it would also be helpful for regulators in East Africa to engage industry experts and stakeholders to maintain awareness of developments in other jurisdictions that may provide useful insights.

**East African
Regulators
can Facilitate
Crowdfunding
Market
Development**

6.1.3 (Short to Medium-term/Ongoing) Industry Meetings and Regulatory Engagement Opportunities

Provide a programme of events and opportunities for the regulator to engage with the industry, practitioners, experts, potential funders and fundraisers, to bring national regulators up to speed on industry developments and begin the process of consultation as to the best course of action to take forward. Both the UK and Malaysia provide a very good blueprint for how this could be undertaken. These events could be hosted by the various regulators, to provide a regular set of ‘open door’ opportunities to allow various stakeholders to engage with the regulators in East Africa.

6.2 Phase 2: Crowdfunding Ecosystem and Trust-inducing Initiatives

6.2.1 (Medium-term) No Bespoke Regulation Just Yet

It is not recommended that any bespoke regulation is enacted at this time, given the current size of the market. Rather, there is an array of other proactive initiatives that can be taken to see how the market develops while ensuring effective consumer protection safeguards are in place. It is advised that the regulators encourage crowdfunding industry groups to implement self-governing regulations and rules.

6.2.2 (Medium-term) Register of Regulator-acknowledged Firms and Regulator Endorsement

Having engaged the industry and identified platforms, a public register of firms that have engaged with the regulators, and that the regulators are aware of, should be provided. It should be hosted on the East African regulator website, and could be hosted in a single location with links from each of the regulators’ websites in East Africa linking to this central database. Akin to the approach undertaken by the Malaysian Securities Commission, providing a list of those platforms that have already engaged the regulator would be very helpful for the wider public, funders and fundraisers, the press and academia, in order to know which platforms are more credible.

6.2.3 (Medium-term) East African Regulatory Laboratory/Sandbox – ‘RegLab’

A privately funded and structured pilot programme to help facilitate dialogue between industry players and regulators, and to guide new businesses seeking to operate in East Africa through the required licensing processes and rules, while securing regulatory input and guidance where possible. Insights can be drawn from the UK FCA’s ‘Project Innovate’. There are a range of strategic partners that could be involved in such an initiative. It would engage a wide range of industry stakeholders, in order to foster the right enabling environment to encourage the responsible development of the crowdfunding market in East Africa, while giving regulators in the region the opportunity to more efficiently engage the industry and establish its approach to managing the sector. Given resource and capacity constraints, it is recommended that a regional regulatory laboratory is established, in order to harmonise the outcomes across East Africa but also to make more effective use of regulatory resources and to facilitate knowledge exchange.

6.2.4 (Short-term/Ongoing) Crowdfunding Industry Associations

Encourage East African platforms to build a regionally focused industry association, in partnership with the African Crowdfunding Association, to build consensus and begin implementing self-governing rules and principles that apply to all members (which ideally would include every platform operating in the region). The African Crowdfunding Association is currently at a very early stage of development, yet has already built up a substantial membership base. If regulators in East Africa could proactively engage this association early on, it would provide vital impetus for every serious platform in Africa to join this industry association and thereby create a single organisation through which the crowdfunding industry could be effectively engaged – not only in East Africa, but across the continent.

6.2.5 (Medium – Long-term) Digital Certification of Documentation

Identify startups that specialise in digitising information documentation and processes, in order to facilitate a standardisation of paperwork that could be expected and accepted by crowdfunding platforms' due diligence processes, while meeting the existing regulatory requirements of each jurisdiction in East Africa. This is a major challenge identified by many crowdfunding platforms and investors. Fundraisers that lack appropriate documentation, or an online means of verification, will find it difficult to raise funding via crowdfunding platforms. The Omidyar Network could be a useful partner to help identify potential startups that could provide a standardised set of documentation that could become established for the crowdfunding industry in East Africa and further afield.

6.3 Phase 3: Government Support and Endorsement

6.3.1 (Medium – Long-term) Public-Private Co-Investment

Seek out opportunities for public or private funding bodies that will match-fund or guarantee certain fundraisers using crowdfunding platforms – replicating, for example, the DFID-funded CrowdPower initiative, which co-funds renewable energy crowdfunding projects across Africa. This will help to stimulate public funding and awareness. It is recommended that the board of the CrowdPower Initiative be engaged by the regulators in order to review their progress and impact to date. It would be useful to determine the process and procedure they undertook, in order to develop similar match-fund initiatives.

6.3.2 (Medium – Long-term) Currency Volatility Hedge Fund

Develop a public-private fund to help mitigate currency fluctuations and avoid this key risk (which has been identified by many platforms, in particular peer-to-peer lending models). This fund could operate a first-loss policy, covering a proportion of investor losses that are made because of currency volatility. A large number of platforms interviewed, operating in Africa, identified currency volatility as a key risk impeding the development of peer-to-peer lending. The Omidyar Network identified an initiative in India that successfully addressed this issue. This initiative needs further examination to see there is potential relevance for the context of East Africa.

6.3.3 (Medium-term) Signpost Regulatory Process Map for East Africa

Provide a clear, regulator-endorsed, verified and sanctioned signposting process to guide new crowdfunding businesses, seeking to operate in East

Africa, through the existing regulatory and licensing requirements for each jurisdiction. FSD Africa would be well placed to work with the regulators in East Africa to discuss and agree the exact licensing requirements for each regulator along with their strategic partners. FSD Africa and its partners could then develop a clear signposting system which can be cross-checked and verified by each regulator before being piloted on currently operating crowdfunding platforms, in order go through a process of iteration before the final version is shared on the regulators' website, as well as being published and promoted on the FSD Africa website.



7. Endnotes

1. The Cambridge Centre for Alternative Finance 2016 Reports for Asia Pacific, the Americas and Europe reveal a total global market volume exceeding \$145 billion. This figure is an amalgamation of the total volumes attributed to the 12 alternative finance models included in the alternative finance taxonomy used by Cambridge: <https://www.jbs.cam.ac.uk/faculty-research/centres/alternative-finance/publications/>
2. <http://alliedcrowds.com/reports>
3. The first internet-based crowdfunding platform in 2001: <https://www.artistshare.com/v4/about>
4. The 2015 Africa and Middle East Alternative Finance Benchmarking Report, published December 2016.
5. <http://www.fsdafrica.org/news/crowdfunding-on-the-move-approaching-p2p-market-regulation-in-east-africa/>
6. <https://www.jbs.cam.ac.uk/faculty-research/centres/alternative-finance/publications/>
7. The African Legal Network: <http://www.africalegalnetwork.com/kenya/>
8. Given time and resource constraints, the study was limited to these five markets. However, the CCAF has conducted extensive research into other markets that also offer valuable insights into regulatory and policy developments, as well as market insights. This research could not be adequately covered in this report, but can be viewed at <https://www.jbs.cam.ac.uk/faculty-research/centres/alternative-finance/publications/>
9. <https://www.jbs.cam.ac.uk/faculty-research/centres/alternative->

- finance/publications/
10. While a range of jurisdictions, such as the UK, Malaysia and New Zealand, allow retail participation, certain jurisdictions, such as Hong Kong, have effectively excluded retail market participation with very high minimum investment thresholds (HKD1 million HKD or more) per loan or equity crowdfunding investment. Therefore, while regulators seek to protect consumers, excluding retail investors from participating may well prohibit the crowdfunding market from developing.
11. While it is extremely difficult to determine exactly how many platforms currently exist and are still operational, data collected by the CCAF since 2013 suggests that platform incorporation is beginning to plateau; while in China, some estimates of over 50% of existing alternative finance are 'problematic problems.'
12. Many equity-based crowdfunding investment opportunities in particular lack sufficient secondary markets to enable investors to exit, and therefore will often have to wait many years until they realise any profits (while also being aware of the very high risks and potential loss of all capital).
13. Understanding Alternative Finance, Cambridge Centre for Alternative Finance, 2014 – see Borrower Motivations on page 38, for example: <https://www.jbs.cam.ac.uk/faculty-research/centres/alternative-finance/publications/>
14. <https://www.artistshare.com/v4/>
15. <https://www.zopa.com/>
16. <https://www.kiva.org/>
17. <https://www.indiegogo.com>
18. <https://www.kickstarter.com/>
19. <http://p2pfa.info/>
20. <https://www.crowdcube.com/>
21. <https://www.ukcfa.org.uk/>
22. <https://www.sec.gov/spotlight/jobs-act.shtml>
23. <https://www.fca.org.uk/publications/consultation-papers/cp13-13-fca%E2%80%99s-regulatory-approach-crowdfunding-and-similar>
24. <http://www.consob.it/main/trasversale/risparmiatori/investor/crowdfunding/index.html>
25. <https://fma.govt.nz/consumers/ways-to-invest/crowdfunding/>
26. http://www.sebi.gov.in/cms/sebi_data/attachdocs/1403005615257.pdf
27. <https://www.ft.com/content/261f046e-80b9-11e4-b5cf-00144feabdc0>
28. <https://www.sc.com.my/digital/afinitysc-industry-call-for-participation/crowdfunding/>
29. <http://www.reuters.com/article/idUSFWN12G01T20151019>
30. <http://www.energy4impact.org/about/programmes>
31. <https://innovativefinanceisa.org.uk/>
32. <https://www.ft.com/content/4732ce90-1bc9-11e6-b286-cddde55ca122>
33. <http://cis-india.org/raw/rbi-consultation-paper-on-p2p-lending-summary>
34. <https://www.ft.com/content/3333a8dc-968c-11e5-95c7-d47aa298f769>
35. <http://www.telegraph.co.uk/finance/china-business/12138931/Its-a-Chinese-Ponzi-scheme-that-should-really-scare-us.html>
36. <https://www.fca.org.uk/firms/project-innovate-innovation-hub/regulatory-sandbox>
37. <http://www.mas.gov.sg/News-and-Publications/Media-Releases/2016/MAS-Proposes-a-Regulatory-Sandbox-for-FinTech-Experiments.aspx>
38. <http://asic.gov.au/about-asic/media-centre/find-a-media-release/2016-releases/16-185mr-asic-consults-on-a-regulatory-sandbox-licensing-exemption/>
39. http://www.bnm.gov.my/guidelines/50_others/dp_regulatory%20sandbox_July2016.pdf

40. <http://uk.reuters.com/article/us-hongkong-banks-regulator-idUKKCN11C0EV>
41. https://www.sc.com.my/post_archive/sc-introduces-regulatory-framework-to-facilitate-peer-to-peer-financing/
42. <https://www.sec.gov/news/pressrelease/2015-249.html>
43. http://news.xinhuanet.com/english/2016-08/24/c_135630643.htm
44. <http://www.fsdafrica.org/news/crowdfunding-on-the-move-approaching-p2p-market-regulation-in-east-africa/>
45. Taxonomy developed by the Cambridge Centre for Alternative Finance since 2012.
46. Page 4, The Rise of Future Finance: The UK Alternative Finance Benchmarking Report 2013, Cambridge Centre for Alternative Finance. <https://www.jbs.cam.ac.uk/faculty-research/centres/alternative-finance/publications/the-rise-of-future-finance/>
47. The Asia Pacific Alternative Finance Benchmarking Report, Cambridge Centre for Alternative Finance, 2016.
48. The Americas Alternative Finance Benchmarking Report, Cambridge Centre for Alternative Finance, 2016.
49. The UK Alternative Finance Benchmarking Report, Cambridge Centre for Alternative Finance, 2016.
50. The European Alternative Finance Benchmarking Report, Cambridge Centre for Alternative Finance, 2016
51. https://www.infodev.org/infodev-files/crowdfunding_infographic_high_res.pdf
52. See page 31 of the Asia Pacific Alternative Finance Benchmarking Report, Cambridge Centre for Alternative Finance: <https://www.jbs.cam.ac.uk/faculty-research/centres/alternative-finance/publications/harnessing-potential/#.V-0X6JMrJ-Q>
53. See wearesocial.com for data on various digital penetration metrics across different jurisdictions.
54. Small Business Finance Markets, 2014 <http://british-business-bank.co.uk/wp-content/uploads/2014/12/Chapter-3-Finance-Markets-further-diversity-needed.pdf>
55. <http://british-business-bank.co.uk/wp-content/uploads/2016/02/British-Business-Bank-Small-Business-Finance-Markets-Report-2015-16.pdf>
56. <http://www.crowdfunder.co.uk/funders>
57. <http://www.benjerry.co.uk/values/join-our-core>
58. <http://www.energy4impact.org/about/programmes>
59. <http://www.fsdafrica.org/knowledge-hub/documents/funding-the-frontier-the-crowdfunding-landscape-in-east-africa/>
60. <https://www.kiva.org/about/where-kiva-works>
61. While it is extremely difficult to determine exactly how many platforms currently exist and are still operational, data collected by the CCAF since 2013 suggests that platform incorporation is beginning to plateau; while in China, some estimates of over 50% of existing alternative finance are ‘problematic problems.’
62. Many equity crowdfunding investment opportunities in particular lack sufficient secondary markets to enable investors to exit and therefore will often have to wait many years until they realise any profits while being aware of the very high risks and potential loss of all capital.
63. While a range of jurisdictions, such as the UK, Malaysia and New Zealand, allow retail participation, certain jurisdictions, such as Hong Kong, have effectively excluded retail market participation with very high minimum investment thresholds (HKD1 million HKD or more) per loan or equity crowdfunding investment. Therefore, while regulators seek to protect consumers, excluding retail investors from participating may well prohibit the crowdfunding market from developing.
64. Italy, despite being the first country in the world to regulate equity-based crowdfunding, imposed rules that restricted the type of startups

- that could use equity crowdfunding platforms to ‘innovative startups’, in addition to other provisions that required institutional investor participation. As a result, the market seems to have been stifled. In 2016, many of these restrictive measures were lifted, which has already led to an increase (50% quarter-on-quarter growth since the regulations were amended) in domestic Italian equity crowdfunding activity.
65. UK survey data collected by the Cambridge Centre for Alternative Finance in 2014 revealed that both business and consumer customers very much like the speed and customer service offered by alternative finance providers as opposed to traditional incumbents.
 66. See funder and fundraiser motivations for each alternative finance model in Understanding Alternative Finance, Cambridge Centre for Alternative Finance, 2014: <https://www.jbs.cam.ac.uk/faculty-research/centres/alternative-finance/publications/>
 67. <http://www.disruptivefinance.co.uk/2014/03/15/what-is-the-market-size-of-peer-to-peer-finance/>
 68. It is unclear exactly how many platforms exist globally, but estimates range from 3,000 to 5,000, with the majority in China. The Cambridge Centre for Alternative Finance has directly surveyed over 1,200 platforms and identified over 2,000.
 69. <https://www.ft.com/content/7663e4b4-44fb-11e6-b22f-79eb4891c97d>
 70. PS16/8: FCA Handbook changes regarding the segregation of client money on loan-based crowdfunding platforms, the Innovative Finance ISA, and the regulated activity of advising on peer-to-peer agreements: <https://www.fca.org.uk/publications/policy-statements/ps16-8-fca-handbook-changes-regarding-segregation-client-money-loan>
 71. Zopa’s performance during the 2007/08 recession: <http://blog.zopa.com/2016/07/15/zopas-performance-during-the-2007478-recession/>
 72. <http://www.crowdfundinsider.com/2015/10/75669-trustbuddy-loses-trust-peer-to-peer-platform-closes-following-suspected-misconduct-swedish-police-contacted/>
 73. The FCA and the Cambridge Centre for Alternative Finance are partnering to conduct a review of the alternative finance industry and the impact it is having on funders and fundraisers: <http://insight.jbs.cam.ac.uk/2016/joining-forces-to-review-the-alternative-finance-industry/>
 74. Page 5, Equity Crowdfunding: A New Phenomena – Said Business School, Oxford University: http://www.sbs.ox.ac.uk/sites/default/files/Entrepreneurship_Centre/Docs/OxEPR2/vulkan-et-al-new-phenomenon-equity-crowdfunding.pdf
 75. <http://p2pfa.info/p2pfa-unveils-new-transparency-standards>.
 76. UK Crowdfunding Association Code of Practice: <https://www.ukcfa.org.uk/code-of-practice-2/>
 77. <https://www.theguardian.com/technology/shortcuts/2014/mar/26/oculus-rift-facebook-fury-kickstarter-funders>
 78. List of Registered Market Operators for ECF – Malaysian Securities Commission: <https://www.sc.com.my/digital/equity-crowdfunding/list-of-registered-market-operators-for-ecf/>
 79. Loan-based crowdfunding platforms: Summary of our rules: <https://www.fca.org.uk/firms/project-innovate-innovation-hub/loan-based-crowdfunding-platforms-summary-our-rules>
 80. Chapter 7, Guidelines on Regulation of Markets under Section 34 of CMSA, Malaysia Securities Commission: https://www.sc.com.my/wp-content/uploads/eng/html/resources/guidelines/rep/guidelines_rep_150210.pdf
 81. PS16/8: FCA Handbook changes regarding the segregation of client money on loan-based crowdfunding platforms, the Innovative Finance ISA, and the regulated activity of advising on peer-to-peer agreements: <https://www.fca.org.uk/publications/policy-statements/ps16-8-fca-handbook-changes-regarding-segregation-client-money-loan>
 82. <http://www.kpmgtechgrowth.co.uk/wp-content/uploads/2014/04/UK-Business-Angels-Association.pdf>
 83. Key risks associated with crowdfunding: it is a risky investment the investor could lose all of

- the money he/she invests the investor may never be able to sell the securities the investor will be provided with no disclosure or less disclosure than public companies the investor will not have the benefit of protections associated with an investment made under a prospectus.
84. <http://www.fsdafrica.org/knowledge-hub/documents/funding-the-frontier-the-crowdfunding-landscape-in-east-africa/>
 85. The Africa and Middle East Alternative Finance Report, published [by whom?] in December 2016, reveals that East Africa accounts for almost 40% of the total alternative finance market activity across Africa. Kenya itself is the largest alternative finance market in Africa, with around 10% of the total market volume for Africa.
 86. Potentially relevant Kenyan Capital Market Authority legislation:
 - a. Capital Markets Act Cap 485A
 - b. Laws of Kenya (the Capital Markets Act)
 - c. Capital Markets (Securities) (Public Offers, Listings and Disclosures) Regulations 2002
 87. Potentially relevant Kenyan Central Bank legislation:
 - a. Central Bank of Kenya Act (the CBK Act), National Payment Systems Act No. 39 of 2011 (NPS Act)
 - b. National Payment Systems Regulations 2014 (the NPS Regulations)
 - c. Money Remittance Regulations (the MR Regulations)
 - d. Banking Act Cap 488 Laws of Kenya (the BA Act)
 - e. Microfinance Act No of 2006 (the MA Act)
 - f. Credit Reference Bureau Regulations 2013 (the CRB Regulations)
 88. Potentially relevant Kenya Communications Authority legislation:
 - a. Kenya Information and Communications Act (the KIC Act)
 - b. Kenya Information and Communications Regulations (KIC Regulations)
 89. Regulation 4 of the NPS Regulations: any person who intends to be authorised as a payment service provider must apply to CBK for authorisation before commencing such business.
 90. The NPS Act and NPS Regulations would not be applicable where the platform envisaged does not undertake the following:
 - a. Send or receive money as set out in section 2 of the NPS Act
 - b. Store money, but instead where the platform acts as an intermediary facilitating the movement of monies from lenders to borrowers
 - c. Where the platform cannot be said to be a payment system
 91. A financial institution is defined under the POCAMLA as: *any person or entity, which conducts as a business one of the following activities or operations:*
 - a) *accepting deposits and other repayable funds from the public;*
 - b) *lending, including consumer credit, mortgage credit, factoring with or without recourse, and financing of commercial transactions;*
 - c) *financial leasing;*
 - d) *transferring of funds or value, by means including both formal and informal channels;*
 - e) *participation in securities issues and the provision of financial services related to such issues;*
 - f) *individual and collective portfolio management;*
 - g) *safekeeping and administration of cash or liquid securities on behalf of other persons;*
 - h) *otherwise investing, administering or managing funds or money on behalf of other persons;*
 - i) *underwriting and placement of life insurance and other investment related insurance; and*
 - j) *money and currency changing.*
 92. Designated non-financial business' is defined in the POCAMLA to include 'such other business or profession in which the risk of money laundering exists as the Minister may, on the advice of the Centre, declare.' Under the advice of the Financial Reporting Centre, any business in which the risk of money laundering exists is to be a designated non-financial business.

93. Under Section 2 of the POCAMLA.
94. If it is not, it will be for the Cabinet Secretary to designate crowdfunding as a designated non-financial business.
95. The platform would be obliged, pursuant to section 45 of the POCAMLA, to verify a customer's identity as part of its 'know your client' requirements, and will be obligated to maintain a system for complying with requests for information from the Financial Reporting Centre as may be required under section 33 of the POCAMLA.
96. Which is defined to include any instrument creating or acknowledging indebtedness which is issued or proposed to be issued.
97. Section 23 requires a person who is carrying on business as a securities exchange or authorised securities dealer to obtain a licence.
98. The Kenyan Banking Act defines banking as: 'The accepting from members of the public of money on deposit repayable on demand or at the expiry of a fixed period or after notice.' Based on the definition of the term banking business, a platform offering loan-based crowdfunding would be regulated under the BA Act if it accepts deposits from members of the public in exchange for debt securities. The platform would require a banking licence from the CBK.
99. New Kenyan credit regulation stipulates the following, which may affect nationally operating peer-to-peer lenders:
- The maximum interest rate now chargeable on a credit facility in Kenya cannot be more than 4% of the base rate set and published by the Central Bank of Kenya (currently 10.5%).
 - The minimum interest rate to be earned on an interest-earning account in Kenya shall be at least 70% of the base rate set and published by the CBK (so currently the minimum rate is 7.35%).
 - A person who enters into an agreement or arrangement to borrow or lend at an interest rate in excess of that prescribed above and any contravention of these provisions commits an offence which is punishable by a fine of not less than KES 1 million and/or imprisonment for a term of not less than one year.
- d. The new law further provides that a bank is under a duty to disclose all charges and terms relating to a loan to a borrower before granting the loan.
100. In the recent past, we have seen two examples where parties have attempted to offer crowdfunding models, but have quickly been prevented from operating by the regulators. In February 2016, the CMA prohibited Propertyzote Crowdfund Limited from making offers to potential investors to raise funds for real estate projects, stating that the company required a licence from the CMA in order to operate.
101. Private offers in Kenya are permitted to be promoted to the following persons:
- Members or employees of the company.
 - Members of the families of any such members or employees, or
 - The securities are offered to a restricted circle of persons whom the offeror reasonably believes to be sufficiently knowledgeable to understand the risks involved in accepting the offer.
 - Further rules governing private offers are:
 - The minimum subscription for securities per applicant is not less than Kenya Shillings **one hundred thousand (KES 100,000)**.
 - The securities result from the conversion of convertible securities and a prospectus relating to the convertible securities was approved by the Authority and published in accordance with the Public Offer Regulations.
 - The securities of a listed company are offered in connection with a take-over scheme approved by the Authority, or
 - The securities are not freely transferable.
102. If enacted, fundraising appeals will be categorised as follows:
- public fundraising for public purposes.
 - public fundraising for private purposes.
 - private appeals.
- However, the latter will not be regulated by the proposed law. It should be noted that the Public Fundraising Appeals Bill 2014, currently in its second stage of reading in parliament, seeks to require those wishing to raise funds for benevolent purposes to obtain a permit.

103. The Kenyan regulators are able to use their authorities in the following ways:
- a. The CBK can use its macro-prudential authority under section 4A of the CBK Act to authorise new alternative finance models to operate in the absence of strict governing legislation. In using this power, the CBK may issue a letter of no objection or a letter of comfort to a party seeking to operate a new crowdfunding model. As an example, in 2007, the CBK issued Safaricom a letter of no objection allowing Safaricom to launch M-Pesa, as the BA at that time did not provide a basis to regulate mobile payments that M-Pesa sought to offer.
 - b. The CMA can issue a letter confirming that a crowdfunding model does not need to be regulated under the Capital Markets Act. From experience parties are able to contact the proposed finance model does not require a licence and this is something that the CMA has in the past been able to confirm in writing.
 - c. The CAK may issue a letter confirming that a firm does not require a telecommunications licence to provide or operate a crowdfunding model. From experience, parties are able to contact the Communications Authority of Kenya to obtain confirmation, and make written submissions that their particular proposed operations do not require a licence and this is something that the Communications Authority of Kenya has in the past been able to confirm in writing.
104. <http://www.fsdafrica.org/knowledge-hub/documents/funding-the-frontier-the-crowdfunding-landscape-in-east-africa/>
105. Potentially relevant legislation for crowdfunding in Uganda includes:
- a. Financial Institutions Act 2004.
 - b. Microfinance Deposit Taking Institutions Act 2003, to regulate and oversee credit issuance.
 - c. The Capital Markets Authority Act (Cap 84) defines securities to include debentures, stocks, shares, bonds or notes issued or proposed to be issued by a body corporate.
 - d. Money Lenders Act (Cap 273).
 - e. Uganda Communications Act 2013.
 - f. The Anti-Money Laundering Act 2013.
106. http://www.finance.go.ug/index.php?option=com_doman&Itemid=7&task=doc_download&gid=497
107. https://www.bou.or.ug/bou/bou-downloads/acts/supervision_acts_regulations/Fl_Act/Fin-Amendment-Act-2016.pdf
108. Data from the AlliedCrowds report on the East African crowdfunding landscape, commissioned by FSD Africa, 2016.
109. Law No11/2011 of 18/05/2011 establishing the Capital Market Authority (CMA) and determining its mission, powers, organisation and functioning; law N°01/2011 of 10/02/2011 regulating Capital Market in Rwanda.
110. Law N° 55/2007 of 30/11/2007 governing the Central Bank of Rwanda; law N°03/2010 of 26/02/2010 concerning the payment system.
111. Article 6 of Law N°01/2011 of 10/02/2011 regulating Capital Market in Rwanda.
112. Organic Law N°01/2012/OL of 02/05/2012 instituting the penal code.
113. Money laundering under this law constitutes the performance of any one of the following acts:
- a. the conversion, transfer or handling of property whose perpetrator knows that they derive from a misdemeanour or a felony, or from an act of participation in such offences, for the purpose of concealing or disguising the illegal origin of the property or of assisting any person involved in the commission of such an offence to escape justice.
 - b. the concealment, or disguise of the true nature of the origin, location, disposition, donation, the owner of the property or the person having rights on it, knowing that such a property is derived from a misdemeanour or a felony or from an act of participation in such offences.
 - c. acquisition, possession or use of property, knowing, at the time of reception, that such a property is derived from a misdemeanour or a felony or from an act of participation in such offences.
 - d. participation in, association to commit, attempts to commit, aiding, inciting, abetting, facilitating or counselling the commission of any of the acts mentioned in this article.

114. Law N°47/2008 of 09/09/2008 on prevention and penalising the crime of money laundering and financing terrorism. This law was enacted with the aim of preventing, detecting, fighting and eradicating:
- the use of the financial system or the other economic sectors for the purpose of money laundering.
 - the financing of acts of terrorism whether related to money laundering or not.
115. Reporting entities must disclose customer information:
- prior to establishing a business relationship.
 - when they execute occasional transactions exceeding the threshold set by the Financial Investigation Unit.
 - when they receive a wire transfer that does not contain full information about the originator.
 - when there is suspicion of money laundering.
 - when they have doubts about the veracity or accuracy of the customers' previously obtained identification data.
116. Using the trade finance model, this company is linking entrepreneurial businesses (SMEs) within Rwanda to foreign investment capital through an innovative technology platform.
117. Article 5 of Law N° 55/2007 of 30/11/2007 governing the Central Bank of Rwanda.
118. Data from the AlliedCrowds report on the East African crowdfunding landscape, commissioned by FSD Africa, 2016.
119. Potentially relevant legislation for crowdfunding in Tanzania includes:
- The Bank of Tanzania Act, 2006 (BOTA).
 - The Capital Markets and Securities Act, Authority (CMS Act).
 - The Banking and Financial Institutions Act, 2006 (BAFIA).
 - The Banking and Financial Institutions (Microfinance Activities) Regulations, 2014 (the Microfinance Regulations).
 - National Payment Systems Act, 2015 (the NPS Act).
 - National Payment Systems Regulations, 2015 (the NPS Regulations).
 - National Payment Systems (Electronic Money) Regulations, 2015 (the Electronic Money Regulations).
120. Platforms providing the following services need a license from the Bank of Tanzania:
- clearing of payment instructions between financial and non-financial institutions.
 - settling of obligations arising from the clearing of payment instructions.
 - transfer of funds from one account to another using any electronic device.
 - transfer of electronic money from one electronic device to another.
 - provision of technological services to facilitate switching, routing, clearing or data management for, or on behalf of, a payment system provider.
 - facilitation of interoperability of payment systems and services between payment systems providers and consumers.
 - provision of electronic payment services to the unbanked and under-banked population.
 - establishing a payment clearing house.
 - provision of a financial communication network.
 - any other objects as may be prescribed by the BOT.
121. The Act defines this class as follows: 'a body corporate, acting alone or under an arrangement with another body corporate to provide electronic payment services licensed under the Act'.
122. Section 2 of the Electronic Money Regulations defines electronic money as: 'monetary value as represented by a claim on its issuer, that is electronically stored in an instrument or device, issued against receipt of funds of an amount not lesser in value than the monetary value issued, accepted as means of payment by persons or entities other than the issuer and can be redeemed in cash.'
123. It is prudent to be aware of the regulatory and supervisory powers of the BOT with respect to related areas such as payment, clearance and settlement systems. Needless to say, it is also advisable to keep abreast of any developments that may occur – these that may be in the form of BOT circulars, rather than new pieces of legislation and/or regulation.
124. There are added provisions where the persons

- in question are deemed to be ‘politically exposed persons’, defined under the AMLA. In addition to performing normal due diligence measures, there will be a requirement to have appropriate risk management systems in place to determine whether the customer is a politically exposed person. These include obtaining senior management approval for establishing a business relationship with such a customer, taking reasonable measures to establish the source of wealth and source of funds, and conducting enhanced ongoing monitoring of the business relationship.
125. Sustaining Momentum, UK Alternative Finance Benchmarking Report, Cambridge Centre for Alternative Finance, 2016.
 126. It is HMT that sets forth the definitions for taxable crowdfunding activities, yet it is the FCA that is responsible for supervising and regulating the area.
 127. CP13/13: The FCA’s regulatory approach to crowdfunding (and similar activities): <https://www.fca.org.uk/publications/consultation-papers/cp13-13-fca%E2%80%99s-regulatory-approach-crowdfunding-and-similar>
 128. UK Crowdfunding Association (<http://www.ukcfa.org.uk/code-of-practice-2/>) and the P2P Finance Association (www.p2pfa.co.uk).
 129. As of June 2016, based on research conducted by the Cambridge Centre for Alternative Finance.
 130. www.ukcfa.org.uk
 131. www.p2pfa.co.uk
 132. The UKCFA and the P2PFA have ‘rules of conduct’ which member platforms must abide by. Some of the key rules are:
 - a. Segregated client accounts.
 - b. Transparency with respect to firm operations and the services provided by the firm.
 - c. Explicit ‘cooling off periods’, when users may rescind their investment or monetary commitment.
 - d. Advice is only given if appropriate authorisation has been granted by the regulating authority.
 - e. All firms, regardless of authorisation status, will act according to the law and will not knowingly allow for fraud to occur on their platform.
 133. <http://p2pfa.info/rules>
 134. CASS 7.10 Application and Purpose, CASS Client Asset – CASS Client Money Rules, FCA Handbook, Financial Conduct Authority, 2 January 2015: fshandbook.info
 135. CP16/4: Loan-based Crowdfunding Platforms and Segregation of Client Money, Financial Conduct Authority, 21 January 2016: <https://www.fca.org.uk/your-fca/documents/consultation-papers/cp16-4>
 136. Within the context of the FCA, a social promotion is defined as ‘any form of communication (including through social media) which can constitute a financial promotion, depending on whether it includes an invitation or inducement to engage in financial activity’. Section 1.9 – Finalised Guidance: Social Media and Consumer Communications.
 137. Article 36H RAO establishes that P2P platforms are carrying out a regulated activity if they are facilitating lending and borrowing between two individuals, or between individuals and businesses under an article 36H.
 138. A Review of the Regulatory Regime for Crowdfunding and the Promotion of Non-readily Realisable Securities by Other Media, Financial Conduct Authority, February 2015: <http://www.fca.org.uk/static/documents/crowdfunding-review.pdf>
 139. A Review of the Regulatory Regime for Crowdfunding and the Promotion of Non-readily Realisable Securities by Other Media, Financial Conduct Authority, February 2015: <http://www.fca.org.uk/static/documents/crowdfunding-review.pdf>
 140. Though prudential rules are not easy to generalise, as they are based upon the individual permissions and activities of each platform, P2P lending firms do have a base capital requirement of £50,000, with a £20,000 requirement during the transition period. At present, firms are obliged to meet minimum capital requirements only upon authorisation, with a transitional period until April 2017. See ‘A Review of the Regulatory Regime for Crowdfunding and the

- Promotion of Non-readily Realisable Securities by Other Media', Financial Conduct Authority, February 2015: <http://www.fca.org.uk/static/documents/crowdfunding-review.pdf>
141. Reporting Requirements: Consumer Credit, Financial Conduct Authority: https://www.the-fca.org.uk/reporting-requirements-consumer-credit?field_fcasf_sector=226&field_fcasf_page_category=unset
 142. A Review of the Regulatory Regime for Crowdfunding and the Promotion of Non-readily Realisable Securities by Other Media, Financial Conduct Authority, February 2015, pp. 2-3: <http://www.fca.org.uk/static/documents/crowdfunding-review.pdf>
 143. Regulatory Sandbox, FCA, September 2016: <https://www.fca.org.uk/firms/project-innovate-innovation-hub/regulatory-sandbox>
 144. <https://www.fca.org.uk/firms/project-innovate-innovation-hub/regulatory-sandbox>
 145. <http://www.growthbusiness.co.uk/news-and-market-deals/business-news/2137011/funding-circle-and-zopa-revealed-as-peertopeer-lenders-receiving-portion-of-business-finance-partnership-cash.shtml>
 146. London Co-Investment Fund: www.lcif.co
 147. <https://www.fca.org.uk/news/press-releases/fca-launches-call-input-crowdfunding-rules>
 148. <https://innovativefinanceisa.org.uk/>
 149. <https://www.gov.uk/topic/business-tax/investment-schemes>
 150. For an explanation of Social Investment Tax Relief, see: <http://www.socialenterprise.org.uk/news/social-investment-tax-relief-explained>
 151. Data from the AlliedCrowds report on the East African crowdfunding landscape, commissioned by FSD Africa, 2016.
 152. 2016 South Africa FSD Bulletin First Quarter: <https://www.fsb.co.za/Departments/communications/Documents/2016%20FSB%20Bulletin%20First%20Quarter.pdf>
 153. Potentially relevant legislation in South Africa includes:
 - a. The Banks Act, where activities could be seen as deposit-taking.
 - b. The Companies Act, where the business in question is a company and activities fall within the definition of public offerings facing certain disclosure requirements.
 - c. The Collective Investment Schemes Control Act, where investments are pooled and invested.
 - d. The Financial Advisory and Intermediary Services Act, where the platform provides an intermediary service or advice of some sort relating to a financial product as defined in the Act.
 - e. The Financial Markets Act, where the online platform matches investors with issuers, and securities are traded on an over-the-counter basis.
 - f. The National Credit Regulation Act, where the platform matches lenders with borrowers in order to provide unsecured loans.
 - g. The Protection of Personal Information Act – this comes into play given that platforms collect data from the individuals that are using their services, and it is very important that this data is protected and that individuals understand how this data is being used.
 154. <http://africancrowd.org/>
 155. Data from the Asia Pacific Benchmarking Report, Cambridge Centre for Alternative Finance, 2016.
 156. List of Registered Market Operators for ECF: <https://www.sc.com.my/digital/equity-crowdfunding/list-of-registered-market-operators-for-ecf/>
 157. Chapter 13 in these guidelines outlines the duties and responsibilities of a P2P platform, as well as the type of issuances and classes of investors that can participate.
 158. Key duties are as follows:
 - a. Platforms must determine the suitability of issuers hosted on their platform, i.e. through background checks, verification of business propositions and credit checks.
 - b. Platforms must ensure investor funds are placed in a trust account until the minimum target is met.

- c. Issuer-to-investor repayments must be placed in a trust account – i.e. not in the platform.
 - d. Platforms must manage issuer defaults and recover funds where possible.
 - e. Platforms must make available their risk scoring mechanisms, criteria for determining defaults, processes to manage defaults, information on late payments and default rates of issuers.
 - f. All fees, charges and expenses relating to the investment must be disclosed by the platform.
 - g. Complaints and dispute resolution – platform must have processes for handling complaints or resolving disputes. Such information must also be made accessible to all investors.
 - h. If the matter cannot be resolved by the platform, the investor may refer the matter to the MSC.
159. Malaysian loan-based crowdfunding platforms must adhere to the following duties:
- a. Investors/funders are entitled to all relevant information to be published on P2P platforms, i.e. i) key characteristics of the issuers, ii) purpose of the fundraising and iii) business plan.
 - b. No funding limits on issuers imposed on by the MSC.
 - c. 80% minimum threshold – issuers can keep funds raised, provided 80%+ of the target is raised.
 - d. No overfunding – issuers not allowed to keep any amount which exceeds the target amount.
 - e. Listing on different platforms – issuers can only list concurrently for different purposes on multiple P2P platforms if they disclose their intention to the platform.
160. https://www.sc.com.my/faq_p2p/
161. Malaysian platforms must also:
- a. Carry out due diligence on prospective issuers and verify the proposition of the issuer.
 - b. Ensure compliance of its rules and take action against non-compliance by the issuer.
 - c. Carry out investor education programmes.
 - d. Ensure issuer's disclosure documents are verified for accuracy and made accessible to investors.
 - e. Inform investors of any material or adverse changes to the issuer's proposal.
 - f. Ensure fundraising and investment limits are not breached.
- g. Obtain and retain the investors' self-declared risk acknowledgement forms prior to investing.
 - h. Have in place processes to monitor anti-money laundering requirements.
 - i. Conduct background checks on the issuer and issuer's board of directors, officers and owner.
 - j. Conflict of interests – platforms must publicly disclose any controlling shares in any of the issuers.
 - k. Platforms must disclose if they pay any referrer or introducer, or receive payments from issuers.
 - l. Platforms' shareholding in any issuer hosted on their platform shall not exceed 30%.
 - m. Platforms located outside Malaysia are considered to be actively targeting Malaysian investors if they promote directly or indirectly in Malaysia, e.g. via direct mail or email to Malaysian addresses.
 - n. Equity platforms are prohibited from giving advice about, soliciting or advertising securities.
 - o. Equity platforms are prohibited from providing any financial assistance to investors to help them invest.
 - p. Equity platforms are prohibited from having directors or officers with financial interests in an issuer, and from compensating introducers for providing information about potential investors.
162. Malaysian equity crowdfunding platforms have a number of restrictions placed upon them:
- a. Financial information relating to issuers must also be disclosed according to company size.
 - b. An issuer can only use an equity platform to raise a maximum amount of circa \$1,250,000, excluding the issuer's own capital contribution or any funding obtained through private placement.
 - c. An issuer shall submit to the equity platform information to include.
 - d. Fifty shareholders per issuance.
 - e. Equity crowdfunding platforms are not intended to be secondary markets, however existing shareholders may dispose of their shares outside the platform.
 - f. Permitted share classes: only common shares, excluding options and convertible securities.

- g. An issuer may only offer one class of shares in any one offering and that class of shares must be offered at the same price and carry the same rights.
163. <http://www.sc.com.my/digital/afinitysc-industry-call-for-participation/crowdfunding/programme/>
164. Interview with Leo Shimada, CEO Malaysia equity crowdfunding platform.
165. <http://www.mban.com.my/>
166. http://www.bnm.gov.my/guidelines/50_others/dp_regulatory%20sandbox_July2016.pdf
167. Data from the Asia Pacific Alternative Finance Benchmarking Report, Cambridge Centre for Alternative Finance, 2016.
168. New Zealand peer-to-peer lending platforms have a number of requirements and duties:
- Platforms must have fair, orderly, and transparent systems and procedures for providing the service.
 - The service must be designed primarily for offers by persons other than the platform and its associated persons.
 - Platforms must have adequate systems and procedures for checking the identity of each issuer, and associated directors and senior managers, before the issuer is authorised to use the service.
 - Platforms must have adequate systems and procedures to assess the risk of investors not being repaid in full or not receiving the interest or other returns that will be offered.
 - Platforms must disclose information about their checking and assessment criteria to investors.
 - Platforms must have adequate policies (a fair dealing policy) for excluding issuers if the platform has information regarding the unfit nature of the issuer.
 - Platforms must have adequate systems and procedures for implementing the fair dealing policy.
 - Platforms must have adequate arrangements for ensuring the orderly administration of the debt securities in the event that they cease to operate the service.
 - Platforms must have adequate systems and procedures for ensuring that each issuer does not raise more than \$1.5 million in any 12-month period via their service.
- j. Platforms must have adequate systems and procedures for handling conflicts between the commercial interests of the platform (and associated persons).
- k. Platforms must have a fair dealing policy and a clear process for conducting background checks on borrowers and providing transparent information to lenders.
169. New Zealand equity-based crowdfunding platforms have a number of duties and responsibilities including:
- Directors and senior managers of platforms must be fit and proper, and background checks must be carried out. They must have good character and capabilities.
 - Disclosure arrangements – investors must receive information on offers to assist them with investment decisions, e.g. eligibility criteria, a clearly outlined due diligence process.
 - Conflicts of interest – platforms must identify these and deal with them in a fair, orderly and transparent way.
 - Platforms must ensure issuers don't exceed fundraising limits.
 - Secondary markets – platforms must be operate in a fair, orderly and transparent way.
 - Platform failure – platforms must have a business termination plan to protect clients' interests.
 - Complaints and dispute resolution – platforms must have effective processes and procedures.
 - Staffing and supervision – platforms must have suitable, professional staff.
 - Platforms must maintain adequate records and provide information to the FMA on time.
 - IT systems used to deliver licensed services must be secure and reliable.
 - Platforms must have adequate financial resources to effectively perform the licensed service.
 - Platforms must have an appropriate level of professional indemnity insurance.
 - Platforms must have a high-level body responsible for overseeing compliance obligations and risk.
 - Platforms must have fair, orderly and transparent systems and procedures for

- service provision.
- o. Platforms must have policies and processes for identifying and managing the risk of fraud by issuers using the service (the anti-fraud policy).
 - p. Platforms must make checks against information of the identity of the issuer.
 - q. Platforms must have adequate systems and procedures for implementing the anti-fraud policy.
 - r. Platforms must have adequate systems and procedures for handling conflicts between the commercial interests of the provider (or of its associated persons) and the need for the provider to have fair, orderly and transparent systems and procedures for providing the service.
 - s. AML and CFT regulation – the Anti-Money Laundering and Countering Financing of Terrorism Act 2009 and its regulations place obligations on New Zealand’s financial institutions to detect and deter money laundering and the financing of terrorism.
170. The rules for those raising capital on New Zealand equity-based crowdfunding platforms are as follows:
- a. Fundraisers/issuers must not engage in conduct that is misleading or deceptive.
 - b. Fundraisers must not make false or misleading representation against section 22 of the Financial Markets Conduct Act (see: <http://www.legislation.govt.nz/act/public/2013/0069/latest/DLM4090952.html#DLM4090952>).
 - c. Fundraisers must not make unsubstantiated representation contravening section 23 of the Financial Markets Conduct Act (see: <http://www.legislation.govt.nz/act/public/2013/0069/latest/DLM5155241.html#DLM5155241>).
 - d. Each issuer must not raise more than \$1.5 million in any 12-month period under the service.
 - e. There should be no specific, prescribed disclosure requirements for issuers.
 - f. Fundraisers can issue shares without supplying a Product Disclosure Statement.
 - g. A fundraiser’s directors or senior managers must be of good character.
 - h. Fundraisers must comply with the obligations imposed on them by the platform.
 - i. Fundraisers must provide readily obtainable, timely and understandable information to assist investors to decide whether to acquire the shares (for example, through initial disclosure, or question and answer forums, or other information that is made available).
171. Data from the Asia Pacific Alternative Finance Benchmarking Report, Cambridge Centre for Alternative Finance, 2016.
172. <http://www.livemint.com/Industry/Vx9iwySoYwxHxfIsPq2r1L/RBI-proposes-regulatory-framework-for-P2P-lending-platform.html>
173. Potentially relevant legislation for crowdfunding in India includes:
- a. The Companies’ Act, 2013.
 - b. The SEBI Act, 1992.
 - c. The Securities Contracts (Regulation) Act, 1956.
 - d. The Depositories Act, 1996.
174. The activities that regulators in India will undertake include:
- a. Recognition of the crowdfunding platforms.
 - b. Oversight and regulation of the crowdfunding market in India.
 - c. Issuance of guidelines/circular regarding information required to be disclosed in Private Placement Offer Letter or on an ongoing basis, or requirements of due diligence and screening.
 - d. Periodic inspections or audits of crowdfunding platforms and enforcement of regulations.
175. Reserve Bank of India, Consultation Paper on Peer to Peer Lending, 2016: https://www.rbi.org.in/scripts/bs_viewcontent.aspx?Id=3164
176. There are a range of highly prescriptive proposed rules in India governing peer-to-peer lending:
- a. P2P companies can act only as intermediaries, and their role must be limited to bringing the borrower and lender together, i.e. P2P lenders cannot take on the functions of a bank and seek and keep deposits.
 - b. Funds must move directly from the lender’s account to the borrower’s account to prevent risk of money laundering.

- c. P2P platforms cannot assure returns to lenders.
 - d. The companies must have minimum capital of Rs.2 crore.
 - e. The platforms may have to adhere to a leverage ratio so that they do not expand indiscriminately.
 - f. Since lenders may not be sophisticated, there may be limits on the maximum contribution by a lender to a borrower/segment of activity.
 - g. Promoters, directors and chief executive officers of P2P platforms will have to meet 'fit and proper' criteria.
 - h. Some proportion of the board members of such platforms may need to have a background in finance.
 - i. P2P platforms are required to have a 'bricks-and-mortar' presence in India.
 - j. Platforms will need to submit regular reports on their financial position (loans arranged each quarter, complaints etc.) to the Reserve Bank of India.
 - k. Platforms will have to guarantee confidentiality of customer data.
 - l. The loan-recovery practices of the P2P platforms will need to adhere to existing guidelines on recovery practices.
 - m. The guidelines prohibit platforms being used for any cross-border transaction in view of FEMA provisions relating to transactions between residents and non-residents.
 - n. The RBI regulator is silent on credit risk profiling of borrowers.
 - o. Funders - Only offered to accredited investors who are registered with the platform .
 - p. Fundraisers - Enables the issuers to raise up to circa \$1.5 million online by issuing debentures or debt securities through a recognised crowdfunding platform.
 - q. Section 45S of the RBI Act prohibits an individual, a firm or an unincorporated association of individuals from accepting deposits.
 - r. Platforms will be limited to bringing the borrower and lender together without the lending and borrowing being reflected on their balance sheets.
 - s. Platforms will be prohibited from giving any assured return either directly or indirectly.
 - t. Platforms will be allowed to opine on the suitability of lenders and creditworthiness of borrowers.
 - u. Adequate regulations on advertisements will also be put in place.
 - v. Funds will have to move directly from the lender's bank account to the borrower's bank account to obviate the threat of money laundering.
 - w. The guidelines would also prohibit platforms being used for any cross-border transaction in view of FEMA provisions relating to transactions between residents and non-residents.
 - x. The prudential requirements will include a minimum capital requirement of \$300,000.
 - y. Management and operational personnel of the platform need to be stationed in India.
 - z. Platforms need to put in place adequate risk management systems for its smooth operations.
 - aa. Data protection systems needs to be put in place since the platform also acts as a custodian of the agreements/cheques etc.
177. The 2014 review of equity crowdfunding in India encompassed the following rules and requirements:
- a. The Companies' Act – any offer that is not in compliance with section 42 of the Act will be deemed to be a private offer, and would have to fulfill all the requirements for such an offer laid down by the SEBI and the Companies' Act, 2013 and Rules.
 - b. The Companies (Prospectus and Allotment of Securities) Rules, 2014 – private offers cannot be made to more than 200 people in the aggregate of a financial year.
 - c. Companies listed on crowdfunding platforms will not be treated as 'listed companies', and there will be no secondary market liquidity.
 - d. It is proposed that these entities are allowed to set up a crowdfunding platform.
 - e. Background and regulatory checks must be conducted on the issuers, whole-time directors, promoters and shareholders holding more than 20% of equity shares in the company.
 - f. The information presented by the issuer setting out the structure of the security, issuer-specific risks, parties involved, conflicts of interest and intended use of funds must be reviewed.
 - g. Due diligence of investors (such as net worth requirements and KYC requirements, if any)

- must be conducted, while maintaining the privacy of the investors.
- h. Access to an issuer must be denied, if there is reason to believe they are fraudulent.
 - i. A record of all the issues brought by the companies and subsequently the disclosures of the issuing companies must be maintained, and made accessible to the investors.
 - j. Information, as may be called for, must be collected and transmitted to SEBI.
 - k. The domain ID/website/URL should be owned, for recognition with SEBI, and platforms should have adequate systems and procedures to manage daily operations as well as emergency situations.
 - l. Platforms should have adequate human, technology and risk management capabilities.
 - m. Platforms should have fair, orderly and transparent processes.
 - n. Platforms should have procedures to address possible conflicts which may arise between issuers and the platform.
 - o. Platforms should ensure a seamless operation in the event of closure or financial distress.
 - p. Platforms should not offer investment advice, solicit or manage funds or securities, incentivise employees for such sale of securities displayed on the platform, or make recommendations to investors.
 - q. Only accredited investors registered with a platform can invest through that platform.
 - r. Only Indian start-up companies, SMEs or funds can raise funds through these platforms.
 - s. Platforms should provide a grievance redressal mechanism for the investors as well as the issuers.
 - t. Platforms should have a 'screening committee', with a variety of experience from different domains and sectors.
 - u. Companies offering securities through private placement shall not release any public advertisements or utilise any media, marketing or distribution channels to the general public.
 - v. The Ministry of Corporate Affairs has also drawn attention the the Companies (Prospectus and Allotment of Securities) Rules, 2014. As per the said Rules, a private placement offer letter shall be accompanied by an application form serially numbered and addressed specifically to the person to whom the offer is made, and no person other than the person so addressed in the application form shall be allowed to apply through such an application form.
 - w. The value of such an offer or invitation per person shall be with an investment size (face value of the securities) of not less than circa \$300.
 - x. Investment in an investee company by an angel fund shall not be less than circa \$75,000 or more than \$750,000. Such conditions are expected to ensure that investments are genuine investments in startups/early-stage companies in India.
 - y. The minimum investment from each investor shall be circa \$40,000.
178. Restrictions are as follows:
- a. Fundraisers can only raise up to circa \$1.5 million a year using these mechanisms.
 - b. Entities will be allowed to raise funds through crowdfunding only if they are not associated with businesses having a turnover of over circa \$3.75 million.
 - c. Entities involved in the real estate and financial sector would be barred from crowdfunding.
 - d. Issuers cannot directly or indirectly advertise their offering in public.
 - e. In a given period of 12 months, issuers shall not use multiple crowdfunding platforms.
 - f. The maximum oversubscription amount to be retained should not exceed 25% of the actual issue size. The total amount retained, including the actual issue size and oversubscription, shall not exceed the limit of circa \$1.5 million.
 - g. Companies intending to raise funds through crowdfunding platforms must submit an private placement offer letter to the crowdfunding portal, which inter alia may contain the following
 - h. It is proposed that the issuing companies submit biannual disclosures to the crowdfunding platform, which, inter alia, may contain the following
179. The Asia-Pacific Alternative Finance Benchmarking Report, Cambridge Centre for Alternative Finance, 2016, page 30: https://www.jbs.cam.ac.uk/fileadmin/user_upload/research/centres/alternative-finance/downloads/harnessing-potential.pdf
180. Data from the Americas Alternative Finance Benchmarking Report, Cambridge Centre for

Alternative Finance, 2016.

181. Breaking New Ground, Americas Alternative Finance Benchmarking Report, Cambridge Centre for Alternative Finance , 2016, page 34: https://www.jbs.cam.ac.uk/fileadmin/user_upload/research/centres/alternative-finance/downloads/2016-americas-alternative-finance-benchmarking-report.pdf
182. Blue sky laws are state laws regulating the offering and sale of securities to protect the public from fraud. All securities offerings and sales, as well as the firm or broker organising the sale, must be registered.
183. For a comprehensive list of which states have crowdfunding exemptions, please see here: <https://crowdfundinglegalnews.files.wordpress.com/2015/01/int-summary-enacted-full5.pdf>
184. The crowdfunding portal must register as a funding portal or broker, and become a member of FINRA. The funding portal must complete 'Form BD Light' in order to become registered. Form BD Light is a 'lighter touch' version of the registration form that brokers of securities must complete when registering. Information required of the platform includes (for more details, see: <http://www.seyfarth.com/publications/MA103013CORP>):
- a. Legal name and principal place of business.
 - b. Disciplinary history as applicable.
 - c. Business activity, including the types of compensation it would receive.
 - d. Control affiliates and disciplinary history as applicable.
 - e. Website address or other means of access.
 - f. Confirmation of FINRA membership.
185. Overarching regulation for crowdfunding activities is known as 'Regulation Crowdfunding' within Jumpstart Our Business Start-ups Act, Title III.
- a. Offer and Sale of Securities which adhere to Section 4(a)(6) of the Securities Act of 1933.
 - b. Registration requirements and exemptions from Section 12(g) of the Securities Act of 1934.
186. Regulation A/A+, annotated within JOBS Act, Title IV has been readily applied to equity-based crowdfunding activities, as Regulation CF had yet to be implemented. Regulation A A+ provides guidelines on how small entities may issue securities via brokers and funding portals. Regulation D, annotated in Title II within the JOBS Act, allows for general solicitation of accredited investors, and is used by both equity and debt-based real estate platforms.
187. A crowdfunding portal must adhere to a number of requirements. They include:
- a. Registering as a funding portal, becoming a member of FINRA and completing 'Form BD Light' (explained in previous endnote).
 - b. Filing annual reports, depending upon the security on offer.
 - c. Abiding by several overarching disclosure and compliance frameworks, as outlined by the SEC, referred to as the 'Compliance Guide for Intermediaries'. Key themes of these are as follows:
 - i. The funding portal must have a clear plan in the event of insolvency or bankruptcy (this is especially relevant to debt platforms, which issue their own notes).
 - ii. The funding portal may not provide investment advice, nor solicit the sale of securities.
 - iii. The funding portal and product sold on the platform must be transparent, and adhere to full disclosure before it can be purchased by an investor.
- For more details, see: <https://www.sec.gov/news/pressrelease/2015-249.html>
188. USA investor or funder regulation for equity and loans stipulates the following:
- a. The investor cannot make a purchase exceeding \$2,000 (or 5% of their annual income or net worth, if their net worth is less than \$100,000).
 - b. The investor cannot exceed 10% of their annual income or net worth, if their net worth is equal to or greater than \$100,000.
 - c. The transaction must be conducted on the funding portal, or through a registered broker that complies with SEC and applicable federal and state rules.
 - d. The funder must allow the issuer and the funding portal to provide information to the investor directly through the use of the

- electronic platform.
- e. The funder must also allow for key communications to be channeled via the website.
 - f. The funder must purchase the security, either entirely or in part, via the electronic platform.
189. Key restrictions for crowdfunding fundraisers (within Regulation CF) include:
- a. The issuer cannot sell more than \$1 million of their offered security in a 12-month period.
 - b. Business issuers must register with the SEC before pursuing a crowdfunding round.
 - c. The issuer must abide by advertisements rules, which ban solicitation prior to SEC registration.
 - d. The issuer must maintain communications via the funding portal, and ensure communications remain on the electronic portal.
190. Key applicable USA laws include:
- a. JOBS Act – Regulation A/A+, Regulation CF, Regulation D.
 - b. Truth in Lending Act – uniform method for computing cost of credit, disclosure and issues underlying notes held by the issuer (which can be the funding portal).
 - c. Blue Sky Laws – <https://media2.mofo.com/documents/150129p2plendingbasics.pdf>
191. Key loan-based crowdfunding laws include:
- a. Equal Credit Opportunity Act – prohibits discrimination against issuer applicants, and requires fairness when evaluating credit information.
 - a. Fair Credit Reporting Act — sets rules around obtaining credit information, including anti-fraud and identity theft protections.
 - a. Gramm-Leach-Bliley Act — restricts disclosure of credit information to third-party or non-public persons. Protects the issuer from unfair information sharing.
 - a. Bank Secrecy Act — includes AML, customer identification and general risk prevention and due-diligence requirements.
192. Key USA equity issuer identifying information includes (as well as legal name, status, etc.):
- a. Business plan and purpose for fundraise.
 - b. Ownership structure and disclosure of key participants.
 - c. Valuation and methodology for deriving offered value of securities.

About FSD Africa

FSD Africa is a non-profit company funded by the UK Government which aims to increase prosperity, create jobs and reduce poverty by bringing about a transformation in financial markets in SSA and in the economies they serve. It provides know-how and capital to champions of change whose ideas, influence and actions will make finance more useful to African businesses and households.

Through access to finance initiatives, it seeks to build financial inclusion. Through capital market development, it looks to promote economic growth and increase investment. As a regional programme, it seeks to encourage collaboration, knowledge transfer and market-building activities – especially in fragile states.

Where there are opportunities to drive financial market transformation more quickly and intensively through capital investment, FSD Africa will deploy equity, loans or guarantees as the situation requires.

About the FSD Network

- Comprises two regional FSDs in South Africa (est. 2002) and Kenya (est. 2013) and seven national FSDs in Kenya (est. 2005), Mozambique (est. 2014), Nigeria (est. 2007), Rwanda (est. 2010), Tanzania (est. 2005), Uganda (est. 2014) and Zambia (est. 2013);
- Is a world-leading proponent of the ‘making markets work for the poor’ approach;
- Specialises in a number of themes from agriculture finance and savings groups to payments, SME finance and capital market development;
- Represents a collective investment of \$450+ million by DFID; Bill & Melinda Gates Foundation; SIDA; DANIDA; Foreign Affairs, Trade and Development Canada; RNE (Netherlands) and World Bank;
- Spends \$55+ million per year, predominantly through grant instruments;
- Employs over 120 full time members of staff and a uses wide range of consultants.



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