

▶ Hong Kong Regulation of Crowd-funding



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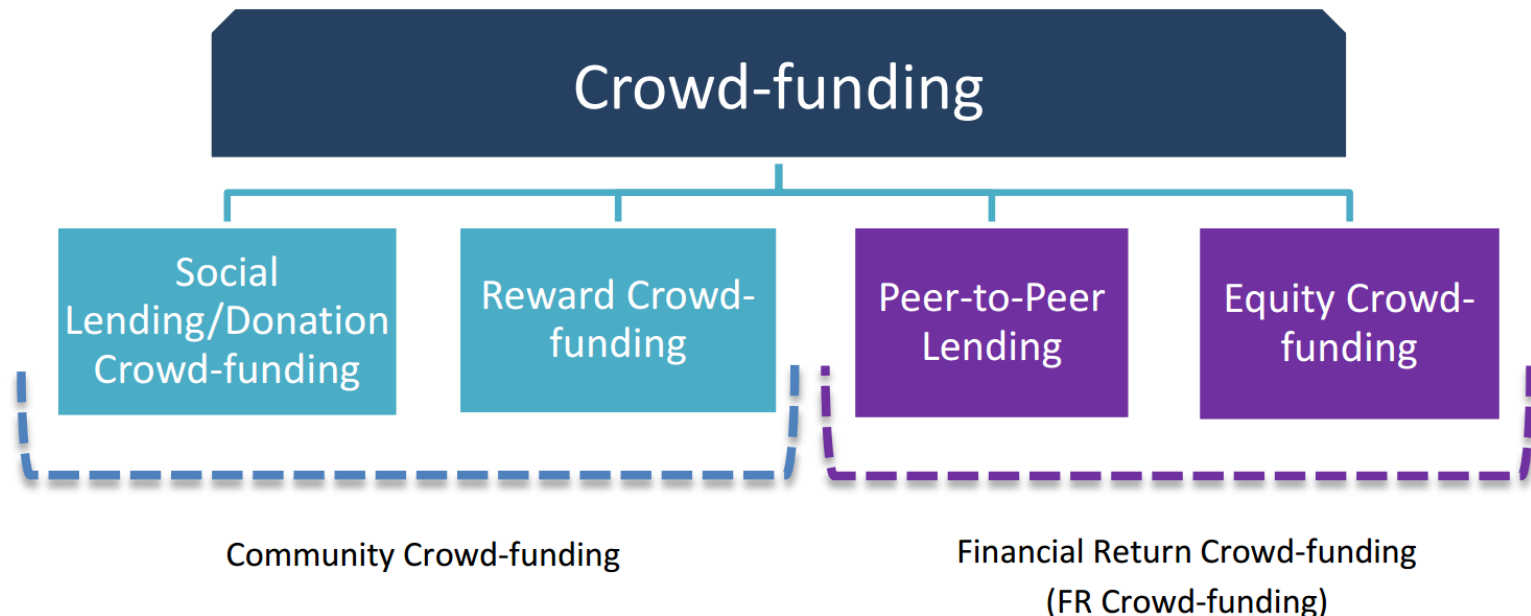
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Crowd-funding Regulation

- ▶ In his 2015-16 budget speech, HK Financial Secretary John Tsang Chun-wah set out the government's intention to set up a steering group to study how to develop Hong Kong into a financial technology hub which will also looking into issues relating to crowd-funding in Hong Kong.
- ▶ Hong Kong has yet to introduce specific regulation to lighten the regulation of crowd-funding in order to improve financing for start-ups and tech companies.
- ▶ In the UK, specific regulations have been introduced to facilitate loan-based crowd-funding platforms which are perceived to be less risky than other types of crowd-funding.
- ▶ Online crowd-funding platforms operating in Hong Kong are governed by Hong Kong's existing regulatory regime for offering securities, conducting business in regulated activities (as defined in the Securities and Futures Ordinance) and money lending and the opportunities are thus fairly limited.

What is Crowd-funding?

- ▶ Definition: use of small amounts of money, obtained from a large number of individuals or organisations, to fund a project, a business or personal loan, and other needs through an online web-based platform*.
- ▶ 4 main sub-categories:



Source: IOSCO Research Department

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* Definition used in the OICU-IOSCO Research Paper "[Crowd-funding: An Infant Industry Growing Fast](#)" by Eleanor Kirby and Shane Worner (March 2014)

Approaches to Crowd-funding Regulation (Cont'd)

Peer-to-peer lending (P2P Lending)

- ▶ Online platforms match lenders (investors) with borrowers (issuers) to provide unsecured loans to individuals or projects.
- ▶ Borrower
 - either be a business or an individual
- ▶ P2P Lenders
 - typically involves a number of lenders providing money for small parts of the overall loan required by the borrower
 - loan parts are then aggregated by the online platform
 - when there is enough to cover the required loan, the loan is originated and paid to the borrower
- ▶ interest rate
 - usually set by the platform and the borrower will repay the loan with interest
 - typically higher than the savings rate available to the lender but lower than a traditional loan available to the borrower, depending on the borrower's evaluated risk
 - paid to the lender until the loan matures, or the borrower repays early or defaults.

Approaches to Crowd-funding Regulation (Cont'd)

P2P Lending (cont'd)

- ▶ Smaller P2P Lending platforms cater to niche markets
 - E.g. platforms specialising in real estate transaction financing, venture capital, business-to-business, graduate financing, art project financing, tech start-ups or consumer to consumer loans for transactions such as eBay purchases.
- ▶ 2 key types of P2P Lending business models: notary model & client segregated account model

Notary Model

- ▶ Operation
 - The crowd-funding platform acts as an intermediary between the lender and the borrower, matching them to each other
 - The loan is originated by a bank and the platform issues a note to the lender for the value of their contribution to the loan
- ▶ In many jurisdictions, this note is considered to be a security which shifts the risk of non-repayment of the loan from the bank to the lenders
- ▶ Fee
 - Both lenders and borrowers pay a fee to the crowd-funding platform.

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Approaches to Crowd-funding Regulation (Cont'd)

P2P Lending (cont'd)

Client Segregated Account Model

▶ Operation

- The crowd-funding platform matches an individual lender with an individual borrower and a contract is entered into between them with little involvement by the intermediary platform.
- Lenders can bid on loans in an auction style and all funds of the lenders and borrowers are separated from the crowd-funding platform's balance sheet and go through a legally segregated client account, over which the platform has no claim in the event that the platform collapses.
- The contractual obligations between borrower and lender thus continue despite any collapse or failure of the crowd-funding regulation.

▶ Fee

- Both lenders and borrowers pay a fee to the platform.
- The platform provides the service of collecting loan repayments and performing preliminary assessments of borrowers' creditworthiness.

Approaches to Crowd-funding Regulation (Cont'd)

P2P Lending (cont'd)

Client Segregated Account Model (cont'd)

- ▶ A variation on this model uses a trust fund
 - lenders purchase units or shares in a trust structure, with the platform acting as the trustee who manages the fund
 - the platform uses the fund to match borrowers and lenders and the platform administers the loan repayments
 - as it is a trust, it is legally separate from the platform itself which prevents the investors suffering loss if the platform fails.

Approaches to Crowd-funding Regulation (Cont'd)

Equity crowd-funding

- ▶ Investors:
 - invest in a project or business (normally a start-up); and
 - in return receive an interest in shares or debt instruments issued by a company or a share of the profits or income generated from the relevant crowd-funding arrangement managed by 3rd party
- ▶ Enables a number of investors to invest through an online platform and gain an interest in the business
- ▶ Normal Use: early stage small start-ups with limited access to other funding sources due to their small size and maturity
- ▶ Investments involve a number of risks, particularly
 - a relatively high risk of failure;
 - dilution of initial shareholdings through further issues; and
 - the absence of a secondary market making equity stakes illiquid.
- ▶ Currently a small sector, often with many regulatory impediments preventing small public equity raisings or strict limits on the size of retail investments.

Approaches to Crowd-funding Regulation (Cont'd)

Reward/ pre-sale crowd-funding

- ▶ Payer receives returns in the form of physical goods or services in return for sums paid.

Donation crowd-funding

- ▶ Sums are raised for charitable causes.
- ▶ Regulatory perspective: reward/pre-sale crowd-funding and donation crowd-funding differ from the first two types.
- ▶ They do not provide a financial return in the form of a yield or return on investment.

Approaches to P2P Lending Regulation

- ▶ Regulation of crowd-funding activities varies across jurisdictions
- ▶ Currently 5 key regulatory approaches to P2P Lending:
 - Activities are either exempt or unregulated due to lack of definition;
 - Crowd-funding platforms are regulated as intermediaries;
 - Crowd-funding platforms are regulated as banks;
 - The US model under which there are two levels of regulation: Federal regulation through the Securities and Exchange Commission and state level regulations, where platforms must apply on a state-by-state basis; and
 - Prohibition of P2P lending.
- ▶ Other possible form of regulation:
 - regulation as a collective investment scheme (**CIS**) where a platform actively manages investors' money and automatically invests their money while providing them with a limited choice.

Approaches to Equity Crowd-funding Regulation

- ▶ There are 3 main approaches to regulation:
 - Regulation that prohibits crowd-funding completely;
 - Regulation that permits crowd-funding but creates high barriers to entry; and
 - Regulation allowing the industry to exist within strict limits.
- ▶ Some have sought to treat equity crowd-funding as exempt, or lighten the regulation of the issuing of shares in return for crowd-funding investment in order to provide funding for SMEs
- ▶ Some consider P2P Lending in particular to be an efficient vehicle for funding start-ups and SMEs
- ▶ Some are seeking to encourage the practice but without compromising investor protection through specific, targeted regulation
 - e.g. UK

Hong Kong Regulation of Crowd-funding

- ▶ Has not introduced specific laws or regulations in relation to crowd-funding.
- ▶ Crowd-funding activities such as peer-to-peer lending in Hong Kong and equity crowd-funding are potentially subject to the following Hong Kong regulatory provisions:*
 - restrictions on offers of shares or debentures to the public under the Companies (Winding Up and Miscellaneous Provisions) Ordinance (**C(WUMPO)**);
 - prohibition on the issue of Unauthorised Invitations to the Public under s.103(1) of the SFO;
 - prohibition on carrying on a “regulated activity” under the SFO without being licensed/registered to do so by the SFC; and
 - prohibition on carrying on a money lending business without a money lender’s licence under s.7 of the Money Lenders Ordinance (**MLO**) (Cap. 163).

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* Securities and Futures Commission’s (SFC) May 2014 “[Notice on Potential Regulations Applicable to, and Risks of, Crowd-funding Activities](#)”

Hong Kong Regulation of Crowd-funding (Cont'd)

Restrictions on Offers of Shares or Debentures to the Public under the C(WUMP)O

- ▶ The offer of shares or debentures to the “public” is regulated by C(WUMP)O
- ▶ For Hong Kong incorporated companies, any prospectus issued (s.38 C) by or on behalf of the company, and in the case of overseas companies, any prospectus distributed in Hong Kong (s.342) must:
 - comply with the detailed contents requirements of C(WUMP)O (notably the Third Schedule); and
 - be registered with the Registrar of Companies.
- ▶ A “prospectus” is defined as any prospectus, notice, circular, brochure, advertisement or other document which:-
 - offers any shares or debentures of a company to the public for purchase or subscription; or
 - is calculated to invite offers by the public to subscribe for or purchase any shares or debentures of a company.

Hong Kong Regulation of Crowd-funding (Cont'd)

Restrictions on Offers of Shares or Debentures to the Public under the C(WUMP)O (cont'd)

- ▶ A company which issues a prospectus which does not comply with the disclosure and registration requirements, and every person who is knowingly a party to the issue, commits an offence under C(WUMP)O.
- ▶ The provision of information on the internet in relation to investment-based crowd-funding (involving investment in equity or debt securities) is likely to constitute the issue of a prospectus in breach of C(WUMP)O.
- ▶ Exemptions (17th Schedule to C(WUMP)O):
 - Consider whether these exemptions are available and suitable for particular crowd-funding platforms
 - Most require access to the information to be restricted which poses difficulties for online crowd-funding platforms in practice

Hong Kong Regulation of Crowd-funding (Cont'd)

Restrictions on Offers of Shares or Debentures to the Public under the C(WUMP)O (cont'd)

▶ Exemptions (17th Schedule to C(WUMP)O) (cont'd)

a) **Offers to not more than 50 persons**

- Limitation is on the number of offers made (not offers accepted) thus the exemption would only apply to an online crowd-funding platform if access could be restricted to 50 persons.
- Upper limit of 50 takes into account offers by the same person in reliance on the same exemption made in the preceding 12 months which prevents offers being staggered to make offers to larger numbers of investors.

b) **Offers only to professional investors** (as defined in SFO)

- Professional investors under the SFO fall into two main categories:
 - 1) **institutional investors** – e.g. regulated banks, investment intermediaries, funds, insurers, pension schemes etc.; and
 - 2) **“high net worth investors”** as defined under the Securities and Futures (Professional Investor) Rules (the **PI Rules**).

Hong Kong Regulation of Crowd-funding (Cont'd)

Restrictions on Offers of Shares or Debentures to the Public under the C(WUMP)O (cont'd)

▶ Exemptions (17th Schedule to C(WUMP)O) (cont'd)

b) Offers only to professional investors (as defined in SFO)(cont'd)

• High net worth investors include:

- 1) an individual, who either alone or with any of his or her associates on a joint account, has a portfolio of \geq **HK\$8 million** or its equivalent in any foreign currency at the relevant date (an “associate” in relation to an individual, means the spouse or child of the individual);
- 2) a corporation or partnership with:
 - a portfolio of \geq **HK\$8 million** or its equivalent in any foreign currency; or
 - total assets of \geq **HK\$40 million** or its equivalent in any foreign currency;
- 3) a trust corporation with total assets of \geq **HK\$40 million**; and
- 4) a corporation whose principal business at the relevant date is to hold investments and which at the relevant date is wholly owned by any one or more of the following:
(i) an individual within the description in (1); (ii) a corporation or partnership within the description in (2); a trust corporation within (3); and professional investors w/in paras (a), (d) and (e) to (h) of the “professional investor” definition in Part 1, Sch.1 SFO
- 5) a corporation which wholly owns a corporation within (2)

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Hong Kong Regulation of Crowd-funding (Cont'd)

Restrictions on Offers of Shares or Debentures to the Public under the C(WUMP)O (cont'd)

- ▶ Exemptions (17th Schedule to C(WUMP)O) (cont'd)
 - c) **Offers for which the total consideration payable is HK\$5 million or less**
 - reliance is likely to be problematic
 - restriction is on the number of offers made (which is potentially unlimited where the information is available on the internet) rather than the number of offers accepted
 - upper limit of HK\$5 million takes into account offers by the same person in reliance on the same exemption made in the preceding 12 months.
 - d) **Offers where the minimum consideration payable (for shares) or the minimum principal amount to be subscribed (for debentures) is HK\$500,000**
 - exemption requires a minimum investment amount of HK\$500,000

Hong Kong Regulation of Crowd-funding (Cont'd)

Prohibition on the Issue of Unauthorised Invitations to the Public under s.103(1) SFO

- ▶ s.103(1) SFO prohibits the issue, or possession for the purposes of issue, of an advertisement, invitation or document containing an invitation to the public (together “investment advertisement”):
 - a) to enter into or offer to enter into:
 - an agreement to acquire, dispose of, subscribe for or underwrite securities; or
 - a regulated investment agreement; or
 - b) to acquire an interest in or participate in, or offer to acquire an interest in or participate in, a collective investment scheme (CIS),

unless the issue is authorised by the SFC.

Hong Kong Regulation of Crowd-funding (Cont'd)

Prohibition on the Issue of Unauthorised Invitations to the Public under s.103(1) SFO (cont'd)

- ▶ s.103(10) contains deeming provisions whereby:
 - any advertisement, invitation or document which consists of or contains information likely to lead, directly or indirectly, to the doing of any act referred to in s.103(1)(a) or (b) is regarded as an advertisement, invitation or document which is or contains an invitation to do such act; and
 - any advertisement, invitation or document which is or contains an invitation directed at, or the contents of which are likely to be accessed or read (whether concurrently or otherwise) by, the public is deemed to be or contain an invitation to the public.
- ▶ Information inviting investment in equity or debt securities or in a CIS available on a website is likely to be regarded as an “invitation to the public” requiring SFC authorisation in the absence of an available exemption.

Hong Kong Regulation of Crowd-funding (Cont'd)

Prohibition on the Issue of Unauthorised Invitations to the Public under s.103(1) SFO (cont'd)

Exemptions

a) Offers exempt under the Seventeenth Schedule to C(WUMP)O

- Offers of shares or debentures which fall within any of the exemptions in the 17th Schedule to C(WUMP)O are exempt from the s.103(1) SFO prohibition under s.103(2)(ga) SFO.

b) Offers only to professional investors

- ▶ The issue of investment advertisements in respect of securities, structured products or interests in a collective investment scheme only to professional investors are exempt under s.103(k) SFO.
- ▶ Reliance on this exemption raises the same issues as the professionals exemption under C(WUMP)O (see Slide 13)

c) Offers not to the public

- although not strictly an exemption, since the prohibition is of invitations to the *public*, an offer would not contravene this provision if it is structured not to be a public offer.
- no bright line test set as to how many offerees are considered to constitute the public.
- reliance would require access to the information to be restricted.

Hong Kong Regulation of Crowd-funding (Cont'd)

Unlicensed Carrying on of a Regulated Activity under the SFO

- ▶ Even where an exemption is available in respect of an offer or invitation of investment products under C(WUMP)O or the SFO, operators of crowd-funding platforms may commit an offence for conducting “regulated activities” as defined in the SFO without being licensed or registered to do so.
- ▶ Types of regulated activities potentially involved in crowd-funding which require licensing include:
 - Type 1: Dealing in Securities
 - Type 4: Advising on Securities
 - Type 6: Advising on Corporate Finance
 - Type 7: Providing Automated Trading Services
 - Type 9: Asset Management

Hong Kong Regulation of Crowd-funding (Cont'd)

Unlicensed Carrying on of a Regulated Activity under the SFO (cont'd)

- ▶ Consideration how and whether operators of crowd-funding platforms would need to be licensed or registered with the SFC
- ▶ There are few, if any exemptions, currently available
 - e.g. the regulated activity of “dealing in securities” is widely defined.
 - A person “deals in securities” if he, whether as principal or agent, makes or offers to make an agreement with another person, or *induces or attempts to induce* another person to enter into or offer to enter into an agreement to acquire, dispose of, subscribe for or underwrite securities.
- ▶ Information posted in relation to investment-based crowd-funding is likely to be within that definition.
- ▶ Exemption for dealing with professional investors in paragraph (v) A of the definition of dealing in securities in Schedule 5 SFO would not be available:
 - available only to a person who acts as principal in the transaction (this would not cover a crowd-funding platform)
 - applies only to dealings with institutional investors (the definition of professional investors applicable to the exemption does not apply to professional investors under the PI Rules (i.e. high net worth investors).

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Hong Kong Regulation of Crowd-funding (Cont'd)

Unlicensed Carrying on of a Regulated Activity under the SFO (cont'd)

- ▶ Exemption where a person as principal, acquires, disposes of, subscribes for or underwrites securities (para. (v) B of the definition of dealing in securities in Schedule 5 SFO) would not apply as:
 - requires the person to act as principal; and
 - there is doubt that “disposes of” would extend to cover marketing activities.

Code of Conduct Requirements

- ▶ Where a crowd-funding platform carries on a regulated activity for which a licence is required, the platform would also be required to:
 - comply with the requirements of the SFC’s Code of Conduct for Persons Licensed by or Registered with the SFC which contain provisions requiring licensed intermediaries to establish clients’ financial situation and investment experience etc.; and
 - ensure that investment products recommended to the client are suitable for the particular client.

Hong Kong Regulation of Crowd-funding (Cont'd)

SFC Licensing of AngelHub Limited

- ▶ AngelHub became Hong Kong's first SFC-licensed equity crowdfunding platform on 1 April 2019
- ▶ It is licensed for regulated activities Type 1 (dealing in securities) and Type 4 (advising on securities)
- ▶ Its licence is subject to the following restrictions:
 1. it can only provide services to professional investors;
 2. its business scope is limited to providing equity crowdfunding through its online platform
 3. there is a limit (which is subject to SFC approval from time to time) on the aggregate amount invested by each “specified professional investor” in all active equity crowdfunding projects on AngelHub's online platform at any point in time;
 - **“Specified professional investors”** are individual professional investors and corporate professional investors defined in para 15.2 of the SFC's Code of Conduct but (a) cannot meet the requirements of para 15.3A of the Code of Conduct and/or (b) in respect of which the procedures set out in paragraph 15.3B of the Code of Conduct have not been complied with by AngelHub;
 4. the total number of investment projects which are offered concurrently on AngelHub's online platform at any time is subject to a limit approved by the SFC;

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Hong Kong Regulation of Crowd-funding (Cont'd)

SFC Licensing of AngelHub Limited (Cont'd)

- ▶ Its licence is subject to the following restrictions:
 5. it must comply, and implement systems and controls adequate for complying with the Guidelines on Online Distribution and Advisory Platform and should deem investment projects on offer on its online platform as complex products for the purposes of those Guidelines. AngelHub is required to provide the minimum information and warning statements on complex products (where applicable) on its online platform as specified in guidance issued by the SFC from time to time;
 6. it must provide monthly reports to the SFC on its business activities in a format agreed upon by the SFC within 2 weeks after the end of the relevant month or upon request; and
 7. after being licensed for 24 months, it must engage an independent professional firm (e.g., an accountancy or law firm) acceptable to the SFC to review its activities and operations and prepare a report confirming that AngelHub has complied with the licensing conditions, relevant provisions of the SFO, and the applicable rules, codes, guidelines and circulars issued by the SFC (with specific reference to the Guidelines on Online Distribution and Advisory Platforms). The report is required to be submitted to the SFC within 30 months after licensing.

Hong Kong Regulation of Crowd-funding (Cont'd)

Money Lending

- ▶ Crowd-funding activities may constitute the carrying on of a money lending business requiring a money lender licence under s.7 of the MLO.
- ▶ In Hong Kong, the WeLend platform facilitates online lending but is not a pure P2P Lending platform.

Hong Kong Regulation of Crowd-funding (Cont'd)

Money Lending (cont'd)

▶ Welend

- founded in July 2013
- describes itself as an online lender rather than a pure P2P Lending platform as it only accepts loans from lenders in the company's private network
- has a number of big-name investors including Allianz, China Construction Bank International, International Finance Corporation, Malaysian sovereign wealth fund Nasional Berhad, CK Hutchison's TOM Group and US-based Sequoia Capital
- Welend's online platform (<https://www.welend.hk/en/about-us>) enables borrowers to apply for loans online
- loans which can be applied for include personal loans, debt consolidation loans to allow the clearing of credit card debt and property owner loans
- Welend is a licensed money lender so that the loans made to borrowers are regulated by the MLO.

Hong Kong Regulation of Crowd-funding (Cont'd)

Money Lending (cont'd)

- ▶ Bestlend (formerly licensed as a money lender)
 - previously the internet financing platform of Haitong International Securities Group Limited
 - matched borrowers in need of funding with licensed money lenders in Hong Kong
 - borrowers could choose their preferred offer among the loan quotes provided
 - nearly 30 licensed money lenders apparently collaborated with Bestlend.com
- ▶ Reason sites do not operate as true P2P Lending platforms matching borrowers and lenders appears to be concern that P2P Lending by individuals or businesses might constitute the carrying on of business as a money lender, which requires the person or business to be a licensed money lender under the MLO.

Hong Kong Regulation of Crowd-funding (Cont'd)

MoneySQ.com and Bridgeway Prime Shop Fund Management Limited

- ▶ Online lending platform MoneySQ partnered with SFC-licensed asset management firm Bridgeway Prime Shop Fund Management Limited (**Bridgeway**)
- ▶ Funds are raised by Bridgeway from professional investors only (its licence restricts it to providing services to professional investors).
- ▶ Bridgeway is licensed for Regulated Activities Types 1, 4 and 9, but its Type 1 licence is restricted to dealing in collective investment schemes.
- ▶ The platform, MoneySQ is a licensed money lender which allows it to onlend the funds raised by Bridgeway

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Hong Kong Regulation of Crowd-funding (Cont'd)

The Money Lenders Ordinance

- ▶ The MLO requires that anyone wishing to carry on business as a money lender must apply to a licensing court for a licence.
- ▶ The term “money lender” is defined in s.2 MLO:
 - “every person whose business (whether or not he carries on any other business) is that of making loans or who advertises or announces himself or holds himself out in any way as carrying on that business”.
- ▶ Certain persons and loans specified in Schedule 1 to the MLO are excluded from the definition.
- ▶ Examples of exempted loans:
 - i. a loan made bona fide by an employer to his employee;
 - ii. a loan made to a company secured by a mortgage, charge, lien or other encumbrance: (a) which is registered, or to be registered, under the Companies Ordinance; or (b) which would, in the case of a company incorporated by any other Ordinance or incorporated or established outside Hong Kong, be able to be registered under the Companies Ordinance if it were a company incorporated under that Ordinance;

Hong Kong Regulation of Crowd-funding (Cont'd)

The Money Lenders Ordinance (cont'd)

- ▶ Examples of exempted loans (cont'd):
 - iii. a loan made by a company under a bona fide credit-card scheme operated by the company to any holder of a credit-card issued under that scheme; and
 - iv. a loan made bona fide for the purchase of immovable property on the security of a mortgage of that property and a loan made bona fide to refinance such a mortgage; and
 - v. a loan made by a company, firm or individual whose ordinary business does not primarily or mainly involve the lending of money, in the ordinary course of that business.
- ▶ Exempted category (v) (loans by a company, firm or individual whose ordinary business does not primarily or mainly involve the lending of money in the ordinary course of that business) may be an exemption on which P2P lenders are able to rely.
- ▶ It will however be difficult in the case of any individual lender to determine at what point the lender is “carrying on a business of lending money”.

Hong Kong Regulation of Crowd-funding (Cont'd)

Regulation of Money Lenders Transactions

▶ Money lenders' transactions are regulated under Part III MLO

I. Form of Agreement

- In order for a loan agreement entered into by a money lender and any security given in respect of it to be enforceable the agreement must be in writing and signed personally by the borrower and a copy of the agreement must be given to the borrower at the time of signing.
- Any such agreement or security will be unenforceable if it is proved that the agreement was not signed by the borrower before the money was lent or the security given.
- The agreement is required to contain all the terms and must in particular set out:
 - a) the name and address of the money lender;
 - b) the name and address of the borrower;
 - c) the name and address of the surety, if any;
 - d) the amount of the principal of the loan in words and figures;
 - e) the date of the making of the agreement;
 - f) the date of the making of the loan;

Hong Kong Regulation of Crowd-funding (Cont'd)

Regulation of Money Lenders Transactions (cont'd)

I. Form of Agreement (cont'd)

- The agreement is required to contain all the terms and must in particular set out:
 - g) the terms of repayment of the loan;
 - h) the form of security for the loan, if any;
 - i) the rate of interest charged on the loan expressed as a rate per cent per annum, or the rate per cent per annum represented by the interest charged as calculated in accordance with Schedule 2; and
 - j) a declaration as to the place of negotiation and completion of the agreement for the loan.
- A court may however give effect to an agreement which does not comply with the provisions of s.18 if it considers that it to do so would be equitable in the circumstances.

Hong Kong Regulation of Crowd-funding (Cont'd)

Regulation of Money Lenders Transactions (cont'd)

II. Duty to Provide Information

- A money lender has a duty to provide specified information to any borrower upon receipt of a written demand from the borrower and payment of its expenses.
- In respect of any loan for which security is provided, a money lender must also provide to the surety within 7 days of the making of the agreement:
 - a copy of the loan agreement;
 - a copy of the security instrument (if any); and
 - a written statement signed by the money lender showing the total amount payable by the borrower under the agreement and the various amounts comprised in that total sum with the date, or the mode of determining the date, when each becomes due.
- A surety may also make a written request to receive a statement of the amounts payable under the agreement at any time during its continuance.

Hong Kong Regulation of Crowd-funding (Cont'd)

Regulation of Money Lenders Transactions (cont'd)

III. Early Payment by Borrower

- A borrower must be allowed to repay early on giving written notice to the money lender and on payment of all amounts payable as principal together with interest computed up to the date of such payment.
- The effective rate of interest paid must not exceed the effective rate of interest which would have been payable under the agreement if the borrower had not exercised his right to repay early.

Hong Kong Regulation of Crowd-funding (Cont'd)

Regulation of Money Lenders Transactions (cont'd)

IV. Illegal Agreements

- A loan agreement will be illegal if it provides directly or indirectly for:
 - a. the payment of compound interest;
 - b. prohibiting the repayment of the loan by instalments; or
 - c. the rate or amount of interest being increased by reason of any default in the payment of sums due under the agreement.
- A loan agreement may however provide that if default is made in the payment of any sum due, the money lender may charge simple interest on that sum from the date of the default until the sum is paid at an effective rate not exceeding the effective rate payable in respect of the principal.

Hong Kong Regulation of Crowd-funding (Cont'd)

Regulation of Money Lenders Transactions (cont'd)

v. *Charges for Expenses not Recoverable*

- A loan agreement may not provide for the payment by the borrower of any sum for or on account of costs, charges or expenses (other than stamp duties or similar duties) incidental to or relating to the negotiations for or the granting of the loan or any guarantee or security to be given in respect of the loan.
- It is also illegal for any person to receive any sum for or on account of such costs, charges or expenses or to demand or receive any remuneration or reward whatsoever from a borrower for or in connection with a loan (s.27).

Hong Kong Regulation of Crowd-funding (Cont'd)

Regulation of Money Lenders Transactions (cont'd)

vi. Restriction on Money-lending Advertisements

- Any advertisement, circular, business letter or other similar document published by a money lender must show the name of the money lender as specified in his licence in a manner which is no less conspicuous than any other name (s.26).
- Where any such document purports to show the rate of interest at which the money lender is willing to make loans, the proposed rate of interest must be shown as a rate per cent per annum and in a manner which is no less conspicuous than any other matter mentioned.
- Any advertisement must clearly show the number of the money lender's licence.

Hong Kong Regulation of Crowd-funding (Cont'd)

Regulation of Money Lenders Transactions (cont'd)

vii. Applying for a Licence

- Licence applications are, initially, submitted to the **Registrar of Companies** as Registrar of Money Lenders (who is appointed by the Chief Executive).
- A **copy** is also sent to the **Commissioner of Police** who may carry out an investigation in respect to the application and object to the application if appropriate (s.9 MLO).
- The application is **advertised**, and any member of the public who has an interest in the matter has the right to object.
- Licences are granted for a period of 12 months and must be renewed annually.

Hong Kong Regulation of Crowd-funding (Cont'd)

Consequences of Failure to Comply with the Money Lenders Ordinance

- ▶ It is an offence punishable by a fine of \$100,000 and imprisonment for 2 years for a person to carry on business as a money lender without a licence.
- ▶ Any loan agreement entered into by a money lender and any security taken in respect of such loan will not be enforceable if the money lender was not licensed at the date of the loan agreement or the taking of the security (s.23 MLO).

Hong Kong Regulation of Crowd-funding (Cont'd)

Anti-Money Laundering and Counter-Terrorist Financing Regulation

- ▶ In Hong Kong, legislation dealing with money laundering and terrorist financing includes:
 - [Anti-Money Laundering and Counter-Terrorist Financing Ordinance \(AMLO\)](#);
 - [Drug Trafficking \(Recovery of Proceeds\) Ordinance \(DTROP\)](#);
 - [Organized and Serious Crimes Ordinance \(OSCO\)](#); and
 - [United Nations \(Anti-Terrorism Measures\) Ordinance \(UNATMO\)](#).
- ▶ AMLO
 - came into effect on 1 April 2012
 - imposes on financial institutions requirements regarding customer due diligence and record-keeping
- ▶ DTROP, OSCO and UNATMO
 - require reporting of suspicious transactions regarding money laundering or terrorist financing.

Hong Kong Regulation of Crowd-funding (Cont'd)

Anti-Money Laundering and Counter-Terrorist Financing Regulation (cont'd)

- ▶ Financial institutions (for the purposes of the AMLO) include banks and other types of “authorised institutions” under the Banking Ordinance and entities which are licensed corporations under the SFO (e.g. licensed securities deals, asset managers etc.)
- ▶ Although money lenders are not financial institutions for the purposes of the AMLO, Hong Kong’s Licensed Money Lenders Association Ltd. has issued a [guideline on Anti-Money Laundering and Counter-Terrorist Financing](#) which members of the association are recommended to follow in order to maintain the same regulatory standard against money laundering and terrorist financing.

The United Kingdom

- ▶ The first Financial Services Authority (now the Financial Conduct Authority (“FCA”)) regulated crowd-funding platform launched in the UK was Abundance Generation, approved in July 2011 and launched to the public in the spring of 2012.
- ▶ Abundance Generation provides debt finance to UK-based renewable energy developers.
- ▶ 6 July 2012: Seedrs Limited launched as the first equity crowd-funding platform to have received regulatory approval anywhere in the world, from the FCA.
- ▶ February 2013: CrowdCube which launched in 2011, became FCA authorised.
 - prior to obtaining FCA authorisation, Crowdcube apparently operated by taking advantage of a loophole for offers to the same group of existing shareholders
 - when an investor signed up to Crowdcube’s website it becomes a “shareholder” without the standard rights
 - Crowdcube also takes shares in companies looking to raise capital
 - therefore when the investment “opportunities” were advertised they were targeted at the same group of existing shareholders
 - this is a legal promotion under FCA regulations.

The United Kingdom (Cont'd)

UK Regulation of Crowd-funding

- ▶ The FCA regulates firms providing the following types of crowd-funding:
 - Loan-based crowd-funding
 - where people and institutions lend money directly to consumers or businesses in return for interest payments and a repayment of capital over time; and
 - Investment-based crowd-funding:
 - where investors invest directly or indirectly in businesses by buying shares or debt securities, or units in an unregulated collective investment scheme.
- ▶ These are regulated activities under the Financial Services and Markets Act 2000.

The United Kingdom (Cont'd)

Investment-based Crowd-funding

- ▶ The FCA confirmed in its 2014 Policy Statement* that firms operating investment-based crowd-funding platforms are regulated by the FCA if, in doing so, they carry on a regulated activity.
- ▶ Firms will need to be authorised if they:
 - arrange (bring about) deals in relation to equity or debt securities or units in a collective investment scheme;
 - agree to carry on a regulated activity; or
 - establish, operate or wind up an unregulated collective investment scheme.

Restriction on Direct Offer Financial Promotions to Retail Clients

- ▶ The Policy Statement also sets out rules which impose restrictions on providing direct offer financial promotions (being a promotion which contains an offer or invitation and specifies the manner of response or provides a form by which a response can be made) in respect of “non-readily realisable securities” (i.e. equity or debt securities for which there is no secondary market).

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* Policy Statement PS14/4 on the “FCA’s Regulatory Approach to Crowdfunding over the Internet and the Promotion of Non-readily Realisable Securities by other Media”

The United Kingdom (Cont'd)

Investment-based Crowd-funding (cont'd)

Restriction on Direct Offer Financial Promotions to Retail Clients (cont'd)

- ▶ Under the rules, direct offer financial promotions in respect of such securities can only be provided to the following types of retail clients:
 - those who are certified or self-certify as sophisticated investors;
 - those who are certified as high net worth investors;
 - those who confirm that, in relation to the investment promoted, they will receive regulated investment advice or investment management services from an authorised person; or
 - those who certify that they will not invest more than 10% of their net assets in non-readily realisable securities.
- ▶ Where no advice is provided to retail clients, an appropriateness test applies which requires firms to check that clients have the knowledge or experience to understand the risks involved.

The United Kingdom (Cont'd)

Loan-based Crowd-funding (cont'd)

- ▶ Consumer credit market, including loan-based crowd-funding (both peer-to-peer (**P2P**) and peer-to-business lending) has been regulated by the FCA since 1 April 2014.
- ▶ Rules set out in the Policy Statement created a new regulated activity of “operating an electronic system in relation to lending” (i.e. operating a loan-based crowd-funding platform)
 - Aim: to enhance the regulation of peer-to-peer lending platforms which were not regulated under the previous Consumer Credit Act regime.
- ▶ Firms entering the market are required to obtain FCA authorisation before commencing operations.

The United Kingdom (Cont'd)

Loan-based Crowd-funding (cont'd)

Scope of Application of the New Rules

- ▶ Under Article 36H of the Financial Services and Markets Act 2000, a regulated electronic system includes one that:
 - facilitates lending by providing a complete service that enables individuals to lend; from finding borrowers and checking their credit status, to collecting or arranging for the collection of repayments; and
 - is able to determine the agreements for lenders and borrowers to enter into, taking account of any parameters set by them.
- ▶ The new regulations apply to loans meeting certain criteria, including that the investor and/or borrower must be:
 - an individual;
 - a partnership consisting of two or three persons not all of whom are bodies corporate; or
 - an unincorporated body of persons which does not consist entirely of bodies corporate and is not a partnership.
- ▶ These criteria mean that business-to-business loans are not FCA-regulated.
- ▶ Only principal firms (and not their appointed representatives) can perform the new regulated activity.

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The United Kingdom (Cont'd)

Loan-based Crowd-funding (cont'd)

Regulations

- ▶ The FCA considers loan-based crowd-funding activities to be generally less risky than investment-based crowd-funding activities.
- ▶ The regime is primarily disclosure-based and includes:
 - minimum capital requirements;
 - a requirement for firms to take reasonable steps to ensure that existing loans continue to be managed in the event of platform failure;
 - rules that firms must follow when holding client money, to minimise the risk of loss due to fraud, misuse and poor record-keeping and to provide for the return of money in the event of firm failure;
 - rules on dispute resolution to allow users first to complain to the firm before complaining to the Financial Ombudsman Service; and
 - reporting requirements for firms to send information to the FCA in relation to their financial position, client money holdings, complaints and loans they have arranged.

The United Kingdom (Cont'd)

Loan-based Crowd-funding (cont'd)

Regulations (cont'd)

i. Disclosure

- To address the risk of non-repayment and lenders' potential ineligibility for the statutory compensation scheme*, peer-to-peer agreements are categorised as “designated investment business” in the FCA Handbook so that key parts of the handbook apply.
- In addition to the rules on financial promotions which require all communications to be fair, clear and not misleading in order to ensure that platform providers are providing a balanced view and sufficient information, peer-to-peer agreements are also required to disclose information allowing lenders to make an informed lending decision including but not limited to:
 - expected and actual default rates based on past and future performance;
 - a description of how loan risk is assessed;
 - details of the creditworthiness assessment;
 - details of likely actual rates of return;
 - exit options for investors; and
 - impact of the failure of the firm, including the lack of FSCS cover.

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* Financial Services Compensation Scheme (FSCS) set up under the Financial Services and Markets Act 2000: <http://www.fscs.org.uk/>
The FSCS currently does not cover loan-based crowd-funding unless the P2P firm operating the platform in question is in default.

The United Kingdom (Cont'd)

Loan-based Crowd-funding (cont'd)

Regulations (cont'd)

ii. Capital Requirements

- P2P firms are required to hold a minimum of the higher of:
 - £50,000 as capital; or
 - 0.2% of the first £50 million of total value of loaned funds outstanding; 0.15% of the next £200m of total value of loaned funds outstanding; 0.1% of the next £250m of total value of loaned funds outstanding; and 0.05% of any remaining balance of total value of loaned funds outstanding above £500m*.
- If the total value of loans outstanding increases by 25%, firms are required to notify the FCA.

The United Kingdom (Cont'd)

Loan-based Crowd-funding (cont'd)

Regulations (cont'd)

iii. Client Money

- P2P firms are also required to comply with the client money rules in terms of monies received from lenders and in terms of acting as a conduit for borrower repayments to ensure proper administration of loans in the event of platform failure.
- This latter function is important particularly since lenders often do not know the actual identity of the borrower and the amount of their investment may not be large enough to justify them seeking repayment.

The United Kingdom (Cont'd)

Loan-based Crowd-funding (cont'd)

CONC

- ▶ Peer-to-peer agreements which involve individual or relevant persons borrowers are subject to more stringent regulation under the new Consumer Credit sourcebook (**CONC**) which provides enhanced protections to borrowers.
- ▶ If the platform is captured by CONC, it must:
 - provide an adequate explanation of the key features of the credit agreement to borrowers;
 - assess the creditworthiness of borrowers;
 - comply with the financial promotions rules;
 - allow the borrower 14 days to withdraw from the agreement; and
 - provide post-contract information where the borrower is in arrears or default.

The United Kingdom (Cont'd)

Loan-based Crowd-funding (cont'd)

New Rules for Loan-based Crowdfunding Effective 9 December 2019

The FCA published its Policy Statement (PS19/14) in June 2019 setting out new rules for loan-based crowdfunding platforms (P2P platforms) which came into effect on 9 December 2019. The updated rules (among others):

- ▶ Impose restrictions on Direct Offer Financial Promotions to Retail Clients similar to those applicable to investment-based crowd funding. P2P platforms can only make direct offer financial promotions to retail clients who:
 - are certified or self-certify as sophisticated investors;
 - are certified as high net worth investors;
 - confirm that, in relation to the investment promoted, they will receive regulated investment advice or investment management services from an authorised person; or
 - will certify that they will not invest more than 10% of their net assets in P2P agreements in the following 12 months;
- ▶ Require platforms to conduct an appropriateness assessment to assess an investor's knowledge and experience of P2P investments, where no advice is given to the investor;

The United Kingdom (Cont'd)

- ▶ Require P2P platforms to review the value of each P2P agreement at least in the following circumstances:
 - When a P2P agreement is originated;
 - When it is considered that the borrower is unlikely to pay its obligations under the P2P agreement in full without the platform enforcing any security or taking similar steps;
 - Following a default; and
 - When the platform facilitates an exit for a lender before the agreement's maturity date;
- ▶ Require platforms offering a target rate of return to be able to demonstrate that they have appropriate access to data and the modelling capability and governance arrangements to do so effectively;
- ▶ Require platforms (depending on the nature, scale & complexity of their business and the nature/range of services they provide) to have an independent risk management and internal audit function. They must also maintain a permanent and effective compliance function which operates independently;
- ▶ Require an individual performing a senior management function to have overall responsibility for establishing and maintaining the platform's risk management framework;

The United Kingdom (Cont'd)

- ▶ Require P2P platforms to disclose to investors sufficient information about the risks they are exposed to, the nature of the investment opportunity, the role of the platform and the fees and charges for the services provided;
- ▶ Require platforms to provide investors with sufficient information to help them understand their tax obligations and the potential impact on their investment returns;
- ▶ P2P platforms are required to have wind-down plans and to notify investors of their wind-down arrangements and changes to those arrangements. The FCA clarified that P2P platforms should have arrangements in place to ensure that the P2P agreements they facilitate would have a reasonable likelihood of being managed and administered on an ongoing basis and in accordance with the contract terms even if the platform ceased to conduct those functions itself; and
- ▶ Require P2P platforms to maintain an up-to-date P2P resolution manual setting out information on their operations that would assist in resolving the platform in the event of its insolvency.

The United Kingdom (Cont'd)

Unregulated and Exempt Activities

- ▶ The FCA does not regulate firms that only operate donations-based, pre-payment or rewards-based crowd-funding platforms.
- ▶ Activities or organisations which fall within the scope of statutory exemptions from the FCA authorisation requirement or regulation (e.g. Enterprise Schemes) are also not regulated by the FCA.

About Charltons



- ▶ Charltons' extensive experience in corporate finance makes us uniquely qualified to provide a first class legal service
- ▶ Charltons have representative offices in Shanghai, Beijing and Yangon
- ▶ Charltons was named the **"Corporate Finance Law Firm of the Year in Hong Kong"** in the Corporate Intl Magazine Global Award 2014
- ▶ **"Boutique Transactional Law Firm of the Year"** was awarded to Charltons by Asian Legal Business in 2017 and 2020
- ▶ **"Boutique/Specialist Law Firm of the Year"** was awarded to Charltons by Asian Legal Business for the years 2002, 2003, 2006, 2007, 2008, 2009, 2010, 2011, 2012, 2013 and 2014, 2015 and 2016
- ▶ **"Hong Kong's Top Independent Law Firm"** was awarded to Charltons in the Euromoney Legal Media Group Asia Women in Business Law Awards 2012 and 2013
- ▶ **"Equity Market Deal of the Year"** was awarded to Charltons in 2011 by Asian Legal Business for advising on the AIA IPO

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