



9 July 2019

## **SEC APPROVES RULES ON CROWDFUNDING**

The Securities and Exchange Commission (SEC) has issued rules and regulations on crowdfunding, allowing startups and small and medium-sized enterprises (SMEs) greater access to funding while providing the public more investment options.

The Commission *En Banc* on July 4 approved the Rules and Regulations Governing Crowdfunding (CF Rules) in accordance with Republic Act No. 8799, or the Securities Regulation Code (SRC), and international best practices and standards.

Section 37 of the SRC empowers the Commission to promote national economic development by encouraging competitiveness in the market through the promulgation of rules for the registration and licensing of innovative and other trading markets for innovative securities, securities of small, medium, growth and venture enterprises and technology-based ventures.

“Information and communication technology has made a significant impact on our financial environment,” SEC Chairperson Emilio B. Aquino said.

“With the rules and regulations governing crowdfunding in place, the Commission hopes to support recent financial innovations on providing easier access to finance especially for smaller business startups or ventures while ensuring the integrity and fairness of financial systems and the protection of investors.”

### **Crowdfunding defined**

Crowdfunding is a fundraising activity typically conducted through an online platform and usually for startups and SMEs.

The fundraising approach involves three parties, namely: the entrepreneur or project initiator; the supporters or those willing to fund the entrepreneur’s business idea or project; and the platform or moderating organization that brings the entrepreneur and supporters together to realize the business idea or project.

Supporters make their contributions or donations through online platforms. Thereafter, the platforms coordinate and administer the fundraising activities.

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Generally, there are four forms of crowdfunding:

1. Donation-based crowdfunding, where individuals pool their resources to support a charitable cause;
2. Reward-based crowdfunding, where individuals give money to a company in return for a “reward,” usually a product produced by the company;
3. Lending-based crowdfunding, where individuals lend money to a company and receive the company’s legally-binding commitment to repay the loan at pre-determined time intervals and interest rate; and
4. Equity-based crowdfunding, where individuals invest in shares sold by a company and receive a share of the profits in the form of a dividend or distribution, subject to the company’s discretion.

Reward-based and donation-based crowdfunding are two prevalent forms of community crowdfunding, which are not subject to securities regulation as they do not involve offers of securities or the prospect of financial returns.

On the other hand, the financial return model includes lending-based and equity-based crowdfunding. Considering it involves the offer of securities in the form of debentures or shares, the financial return model is subject to securities regulation in most jurisdictions.

In the Philippines, Section 8 of the SRC provides that securities shall not be sold or offered for sale or distribution within the Philippines, without a registration statement duly filed with and approved by the Commission.

However, to promote capital market development and access to finance, the CF Rules provides an exemption from registration of CF securities provided the issuer, intermediary and investors comply with the CF Rules.

### **Salient rules on crowdfunding**

The CF Rules primarily govern the operation and use of equity- and lending-based crowdfunding by registered persons such as brokers, investment houses, funding portal, and issuers and investors who participate in such fundraising activities online.

Crowdfunding through means other than online electronic platform is not within the coverage of the CF Rules; hence, the usual requirements under the SRC shall apply. Here are some of the rules that issuers, intermediaries and investors must follow in equity- and lending-based crowdfunding:

*CF Transactions Must Be Done Through Registered CF Intermediaries:* The issuance of securities must be conducted through an intermediary that complies with the requirements for intermediaries and the related requirements under the CF Rules, and the issuance of securities is conducted exclusively through the intermediary’s platform.

*Registration of CF Intermediaries:* An intermediary in a crowdfunding transaction must register with the SEC as a CF intermediary. A CF intermediary may be a registered broker-dealer, an investment house or a funding portal.

A funding portal is an intermediary in transactions involving the offer or sale of only CF securities through an online electronic platform. A funding portal cannot not:

- offer investment advice or recommendations;
- solicit purchases, sales or offers to buy the securities displayed on its platform;
- compensate employees, agents, or other persons for such solicitation or based on the sale of securities displayed or referenced on its platform; or
- hold, manage, possess, or otherwise handle investor funds or securities.

In addition to its application to register as a CF intermediary, a funding portal must also submit an application to register as a funding portal to the Commission (a funding portal will be asked to provide additional requirements).

*Limit on Amount of Securities That Can Be Sold:* The aggregate amount of securities that can be offered and sold by issuer within a 12-month period shall be limited to:

- P10 million when offered and sold to any investor; and
- More than P10 million but not exceeding P50 million when offered and sold to qualified investors.

*Limit on Total Investments:* The aggregate amount of securities sold to any investor across all issuers in securities crowdfunding during the 12-month period shall not exceed the following limits:

- For retail investors with annual income of up to P2 million, a maximum value of 5% of their total income per year; and
- For retail investors with annual income of more than P2 million, a maximum value of 10% of their total income per year.

Qualified investors are not subject to the limits set forth above, provided that they comply with Rules 10.1.3 and 10.1.11 of the 2015 Implementing Rules and Regulations of the SRC.

*Expenditure- and Risk-based Minimum Capital Requirement:* A CF intermediary must, at all times, maintain a capital amount that exceeds its annual operational expenditure constituting all expenses and losses that arise in the CF intermediary's normal course of business facilitating the offer or sale of securities in reliance to the CF Rules in a 12-month accounting period.

The Commission may require additional capital in the form of cash or insurance to cover any risky activities arising from the proposed or actual operations of the CF intermediary.

*Access to Information:* A CF intermediary must disclose and display prominently on its platform, relevant information relating to its crowdfunding activities, such as issuer information, fees, charges, and other expenses, and information on investor rights.

*Educational Materials:* A CF intermediary must deliver educational materials to investors on process for the offer, purchase and issuance of CF securities and the risks associated; types of securities available for purchase on the intermediary's platform and the risks associated with each type of security, including the risk of having limited voting power as a result of dilution; any restriction on the resale of a CF security; the need for the investor to consider whether investing in a CF security is appropriate for him.

*Communication Channels:* A CF intermediary must provide on its platform communication channels through which investors and potential investors can communicate with one another.

*Cancellation of Investment:* An investor must be able to cancel an investment commitment for any reason until 48 hours prior to the deadline identified in the issuer's offering materials.

*Return of Funds if Offering is Not Completed:* If an issuer does not complete an offering, an intermediary must direct the refund of investor funds.

*Issuer Disclosures:* Issuers must submit annual reports and progress updates disclosing the issuer's development in achieving the target offering amount.

*Transition Phase:* Any person or corporation currently engaged in equity-based and/or lending-based crowdfunding (e.g. crowdfunding platforms and issuers) must comply with the CF Rules within three months upon its effectivity. This means that existing operators of crowdfunding platforms must register as a CF intermediary with the Commission in accordance with the CF Rules. Those who submit an application for registration within the three-month transition phase may continue its operations until the Commission has made a decision regarding its application. Otherwise, those who fail to submit an application during this transition phase will be regarded as carrying on crowdfunding activities in violation of SEC rules and regulations and will be penalized accordingly.

“Securities-based crowdfunding can offer an alternative source of private financing for startups and SMEs,” Mr. Aquino noted. “Further, market validation through successful crowdfunding campaigns may create more funding opportunities for businesses.”

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