



was shipped from France as a gift of friendship from the people of France to the people of the United States. However, the US government was unable to raise the funding of \$250,000 for the construction of its granite plinth even though a special committee was set up to raise the fund. The shortfall of more than a third of the amount needed for the construction prompted the crowdfunding campaign that eventually materialised in the standing of the statue.<sup>4</sup> This success story occurred without the Internet.

In 1997, the Internet helped the British rock band, Marillion, to collect US\$ 60,000 from their fans to fund their concert tour.<sup>5</sup> Since then, Internet-mediated crowdfunding platforms have started to mushroom in many countries, particularly in the United States (US) and the United Kingdom (UK), and recently in other parts of the globe. The emergence of these platforms since early 2000 such as Kickstarter, Kiva.org GlobalGiving, ArtistShare, Prosper.com, Lending Club, SliceThePie, IndieGoGo, Spot.us, GoFundMe, Funding Circle and RocketHub have proven the viability of crowdfunding as an effective platform for soliciting funding for brilliant business ideas or social projects.

As at 2014, the value of the crowdfunding industry worldwide has reached \$16.2 billion.<sup>6</sup> The figure was predicted to increase to \$34.44b in 2015.<sup>7</sup> In comparison, the venture capital (VC) industry is recorded to have an average of \$30 billion each year.<sup>8</sup> Crowdfunding has developed based on two major categories; community-based crowdfunding or financial return crowdfunding. The first category can be further divided into two, namely donation-based and reward-based crowdfunding while the latter can either be peer-to-peer (P2P) lending or equity crowdfunding<sup>9</sup> or royalty-based crowdfunding.<sup>10</sup> GlobalGiving, GoFundMe, and DonorsChoose are examples of donation-based crowdfunding platforms while ArtistShare, SliceThePie, IndieGoGo, and Kickstarter are known for their reward-based platforms. Examples of P2P lending platforms are Prosper.com, Kiva.org, Lending Club, Funding Circle, and Micro Ventures while CircleUp is for equity crowdfunding. [Quirky](#), [TubeStart](#), [AppsFunder](#), [RoyaltyClouds](#), [Lendpool.com](#), and [Gideen.com](#) are for royalty-based crowdfunding platforms. The number of crowdfunding platforms is increasing from

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<sup>4</sup> “The Statue of Liberty and America's crowdfunding pioneer”, *BBC News*, <<http://www.bbc.com/news/magazine-21932675>> (accessed 25 December 2015).

<sup>5</sup> Joachim Hemer, “A Snapshot On Crowdfunding”, Working papers firms and region, No. R2/2011, (2011):1-2, <<http://hdl.handle.net/10419/52302>> (accessed 25 December 2015).

<sup>6</sup> Liao, Y-Sing, “Islamic Crowdfunding Takes Root in Asia in Boon to Entrepreneurs”, *Bloomberg Business*, <<http://www.bloomberg.com/news/articles/2015-11-08/islamic-crowdfunding-takes-root-in-asia-in-boon-to-entrepreneurs>> (accessed 25 December 2015)

<sup>7</sup> Anthony Zeoli, “Crowdfunding: A Look at 2015 & Beyond!”, (December 31, 2015), <<http://www.crowdfundinsider.com/2015/12/79574-crowdfunding-a-look-at-2015-beyond/>> (accessed 10 November 2016)

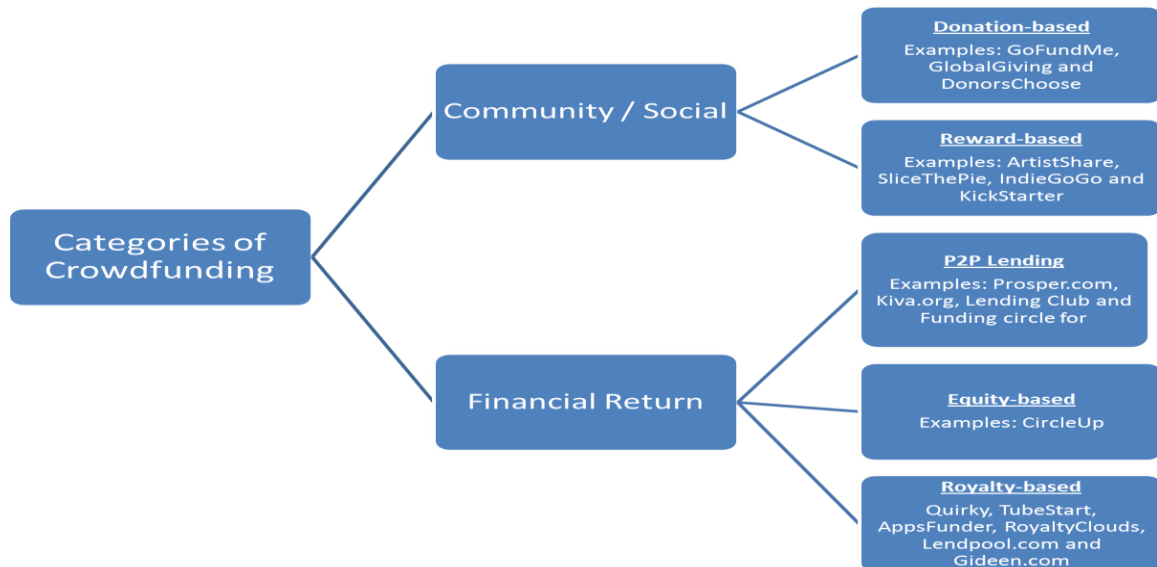
<sup>8</sup> [Chance Barnett](#), “Trends Show Crowdfunding To Surpass VC In 2016”, (June 9, 2015), <<http://www.forbes.com/sites/chancebarnett/2015/06/09/trends-show-crowdfunding-to-surpass-vc-in-2016/#1a647331444b>>, (accessed 10 November 2016)

<sup>9</sup> See, Apnizan Abdullah, “Crowdfunding as an emerging fundraising tool: With Special Reference to Malaysian Regulatory framework”, *Islam and Civilisational Renewal*, Vol. 7, No 1, (2016): pp. 198-119.

<sup>10</sup> “[Cf 101: Part Two-Different Types Of Crowdfunding Platforms](#)”, (September 24, 2015), <<http://www.startupcrowdfunding.com/blog/cf-101-part-two-different-types-of-crowdfunding-platforms>> (accessed 10 November 2016).

year to year, signalling its tremendous potential in the next phase of the financial technology world.

Figure 1: Categories of Crowdfunding



## Types of Crowdfunding

Essentially, crowdfunding rides on two categories. The first category is community or social-based crowdfunding which could either be donation-based or reward-based, and the second category is financial return crowdfunding which could either be P2P lending or equity or royalty-based crowdfunding.

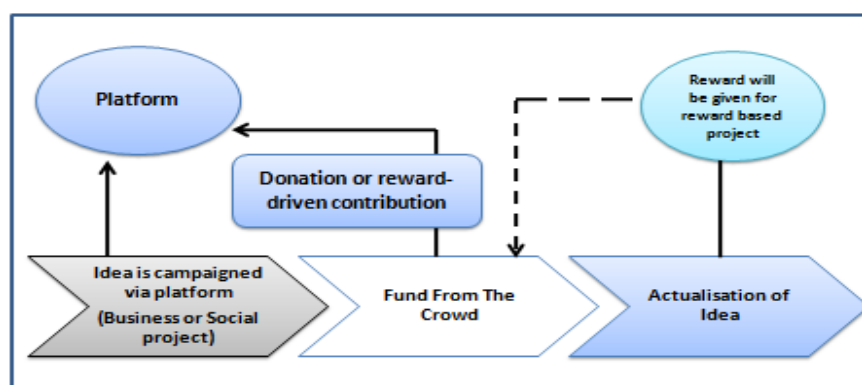
In donation-based crowdfunding, the funders or donors give away some portion of their contributions to the idea or project campaigned by the platform but do not expect any returns. GoFundMe, for example, is a crowdfunding platform that runs based on this structure. One of its beneficiaries was Farrah Soudani who was critically injured in a US movie theatre shooting in November 2012. Her medical expenses were paid for from the funds raised through this platform.<sup>11</sup>

On the other hand, reward-based crowdfunding works as follows; the funders or contributors expect something in return for the contributions or donations made to the project campaigned by the platform. These rewards could be in the form of acknowledgement as a token of appreciation like T-shirts advertising the project or group funded, thank-you mail, an artist's autograph or mentioning the crowdfunder's name on the cover of a film DVD or music CD. The Maria Schneider's jazz album project in 2004 was one of the successful projects campaigned via ArtistShare, a reward-based crowdfunding platform. In this project, the

<sup>11</sup> Freedman, David M and Nutting, Mathew R, "A brief of Crowdfunding: Including Rewards, Donations, Debt and Equity Platforms in the USA", (2015):5, <<http://www.freedman-chicago.com/ec4i/History-of-Crowdfunding.pdf>> (accessed on 25 December 2015)

funders were allowed to download the album upon release for a \$9.95 contribution.<sup>12</sup> This type of crowdfunding exercise is also referred to as crowd-sponsoring or crowd pre-selling.<sup>13</sup>

Figure 2: Structure of Community/Social Based Crowdfunding (Donation & Reward-based Crowdfunding Platforms)



The structure of financial return crowdfunding, crowd lending or P2P lending crowdfunding platforms work as follows; first, the platforms become the intermediaries between funders and borrowers. They generate revenue by way of imposing specified percentage over the loan amounts (a one-time charge) from the borrower and a loan servicing fee (either a fixed annual fee or a one-time percentage of the loan amount) from investors or funders. The funders will receive their income on each loan.<sup>14</sup>

In addition, for crowd equity or equity crowdfunding, the investors will contribute their funds to the project campaigned by the platforms with an expectation of financial returns from the project based on the terms specified in the campaigns. Since this structure involves investment solicitation, regulatory requirements of the relevant jurisdictions on the exercise must be adhered to since each jurisdiction has its laws pertaining to investments.<sup>15</sup>

<sup>12</sup> *Ibid*, 1.

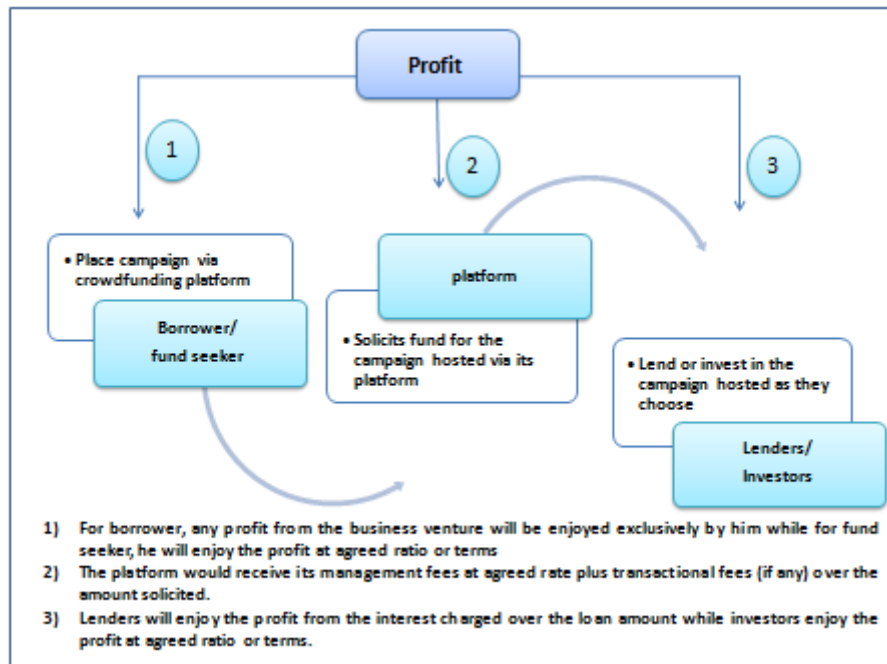
<sup>13</sup> Hemer, 13-14.

<sup>14</sup> *Ibid*., 3.

<sup>15</sup> CASI, "Crowdfunding in sustainable innovation", *CASI Policy Brief*, CASI-PB-6.2015 (June, 2015): 2, <<http://www.casi2020.eu/app/web1/files/download/casi-pb-6-2015.pdf>> (accessed 25 December 2015).

Royalty-based crowdfunding, on the other hand, offers the funders or backers with royalties or percentage of the revenue when the project begins to generate sales or profits. Under this structure, the platforms will generate income on the fee charged for the campaign made via their platforms. The allotted portions of the issuer’s or fundseeker’s cash flow to the investors are intended as consideration for the financial support rendered by the funders.

Figure 3: Structure of Financial Return Crowdfunding (P2P Lending, Equity & Royalty-based Crowdfunding Platforms)



Recognising its tremendous potential to the financial market and economic ecosystem, countries such as the US, the UK, China, Australia, Singapore have taken initiatives at providing necessary adjustments to their regulatory regimes to accommodate the operation of crowdfunding, including Malaysia. Currently, the focus of the regulatory adjustments in most of the countries responding to the development of crowdfunding exercises is more on the financial return crowdfunding. The reason behind it is that it directly involves the act of fund solicitation or investment from the public that triggers securities laws’ attention. Thus, this article delineates the development of regulatory response towards financial return crowdfunding in Malaysia and highlights the loopholes in its current framework.

### **Regulatory Response towards Financial Return Crowdfunding: Malaysian Experience**

The Securities Commission of Malaysia (SC) issued the Public Consultation Paper No. 2/2014, “Proposed Regulatory Framework for Equity Crowdfunding” on 21<sup>st</sup> August 2014. In pursuant to the paper, *Guidelines on Regulation of Markets under Section 34 of the Capital*

*Markets and Services Act 2007* was successfully released on 10 February 2015 which aimed at introducing new regulatory requirements for the registration of equity crowdfunding (ECF) platforms and providing governance arrangement for the operator of such platforms. It replaced the *Guidelines on Regulation of Markets* which was issued on September 2007 (CASI, 2016).<sup>16</sup>

As a result of such issuance, the SC made an open call for registration of equity crowdfunding (ECF) operators in February 2015. Consequently, 27 applications from the ECF operators were received by the regulator, but six platforms were approved to run the ECF platforms. They are Alix Global, Ata Plus, Crowdonomic, Eureeca, pitchIN and Propellar Crowd+. The approval was aimed at providing small businesses and entrepreneurs with greater access to capital. Since ECF is relatively new to our Malaysian financial market, there would commonly be new developments in the legal framework. Eventually, on 11 December 2015, a new guideline was issued viz. the Guidelines on Recognised Markets (the Guideline) which came into force on 15 December 2015. It is worth noting that as at December 2015, as far as crowdfunding is concerned, the provisions of the Guidelines cover only equity crowdfunding. On 13 April 2016, the SC issued a revised version of the Guidelines which incorporates the additional provisions on P2P lending platforms.

Currently, the regulator essentially recognises both equity and P2P lending as a method of eligible crowdfunding exercises by adopting the US approach in dealing with its development, which permits the exercise with securities laws framework, with certain limitations. Such limitations include the restrictions on the eligible issuers (fund seekers) as stipulated in Article 12.14 to 12.17, funds limits and investment limits as mentioned in Article 12.18 and Article 12.22 and on the type of investors for the micro-funding entity as prescribed in Article 12.17 of the Guideline. It also restricts the eligible P2P lending platform operators to those with a minimum paid-up capital of RM5 million.

Essentially, Chapter 12 and 13 of Part F of the Guidelines provide general provisions on the registration of the ECF and P2P lending platforms, its conduct and operational requirements. The provisions act as additional requirements relating to the registration of the ECF and P2P lending platforms in addition to the general provisions for the recognised market which include the registration eligibility, terms and conditions, directions and obligations of the recognised market, cessation, withdrawal and review process and disclosure requirements. The provisions of Chapter 12 and 13 of the Guidelines seem to be equally applicable to both conventional equity and Islamic equity crowdfunding except the latter is subjected to the requirement of the appointment of Shariah advisor as stipulated in Chapter 11 of Part E of the Guidelines

In conclusion, Malaysia is very proactive in adapting its regulatory environment to the latest development in the global financial system. However, it should be highlighted to the regulator that the current spectrum of the Part F and E is still insufficient to cater the rapid changes in the sphere of crowdfunding since it does not cater the necessary provisions for

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<sup>16</sup>[http://www.sc.com.my/post\\_archive/sc-releases-new-guidelines-to-facilitate-equity-crowdfunding/](http://www.sc.com.my/post_archive/sc-releases-new-guidelines-to-facilitate-equity-crowdfunding/) (accessed on 25 December 2015).

royalty-based crowdfunding, which has gained the world attention since 2014. Since Part E of the Guidelines only stipulates the requirement on the appointment of a Shariah adviser for the recognised market (including ECF and P2P platforms) that intend to ride on Islamic approach, it is therefore proposed that additional provisions especially on the Shariah governance aspect should also be included into the Guidelines to support the emergence of Islamic investment/financial return crowdfunding.