

A framework for crowdfunding capital in India

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Outline of the presentation

- ▶ Market profile
- ▶ Risks of crowdfunding
- ▶ Global regulatory framework
- ▶ Proposed framework
- ▶ Hurdles with the existing framework

What is Crowdfunding?

*“A term describing the 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**.”*

- ▶ Types of Crowdfunding:
 - ▶ Social/Donation
 - ▶ Reward
 - ▶ P2P lending
 - ▶ Securities-based
 - ▶ Other Investment based models

Characteristics of Issuer

Feature	Finding
No. of offerings	163
Median offering size (in \$)	53,000
Average offering size (in \$)	110,000
Percentage of equity securities offerings	36%
Percentage of debt securities offerings	20%
Percentage of convertible and other securities offerings	44%
Average issuer age (months since incorporation)	28.7
Average employees	4.6
Average assets (\$000)	327
% of issuers in the pre-revenue phase	60%

Source: SEC 2017

Investors

Share of retail investors in equity based crowdfunding:

Region	2016	2017
Asia Pacific (excl. China)	85%	94%
UK	75%	51%
EU	87%	-
India	-	26%

Source: Cambridge Centre for Alternative Finance

Market size

Country	Market Type	2013	2014	2015	2016	2017
US	-	3,660	10,910	33,900	35,973	-
UK	-	1,140	3,070	4,500	6,030	8,150
EU	-	1,270	3,200	6,140	8,670	-
China	-	5,560	24,300	102,000	243,000	358,000
India	P2P(Consumer)	3.21	4.73	18.79	42.52	92.32
	Equity-based	0.40	6.25	18.50	17.22	17.62
	P2P(Business)	0.63	0.39	0.99	2.42	28.76
	Balance Sheet	-	-	-	45.50	104.65
	Reward-based	0.85	0.71	1.64	1.45	0.64
	Social/Donation	-	-	-	15.05	20.83

Note: All figures in USD million

Source: Cambridge Centre for Alternative Finance

Platforms

Number of investment based crowdfunded platforms in 2013

Country	No.	Country	No.
US	377	UK	87
France	53	Netherlands, Canada	34
Spain	27	Germany	26
Brazil	17	Australia	12
India	10	Russia, South Africa	4
Belgium, Hong Kong	1	China, UAE, Estonia	1

Source: infoDev 2013

Potential problems for crowdfunding marketplaces

- ▶ Information asymmetry
- ▶ Adverse selection and moral hazard
- ▶ Risks involved
 - ▶ Default risk
 - ▶ Operational risk
 - ▶ Systemic risk

Global regulatory framework

Restriction	US	UK	EU
Regulator	SEC	FCA	ESMA
Restrictions on:			
- Borrowers	Yes	Yes	None
- Lender	No	Yes	No
- Maximum issuance (Annual)	\$1,070,000	No limit	€8,000,000
- Hosting a secondary market	Yes	Yes	No
- Investment by platform	No	No	Yes
- Platform's shareholding	No	No	No

Global regulatory Framework

Restriction	US	UK	EU
Disclosures:			
- By Issuer	Yes	Self-regulated	No
- Of platform's fees	Yes	Self-regulated	Yes
- Of default rate	No	No	Annually
Mandatory suitability assessment	Yes	Self-regulated	No
Platform's prudential requirements	No	Yes	Yes
Business continuity requirement	No	Self-regulated	No

Takeaways from global jurisdictions

- ▶ No distinction between regulation of debt and equity markets.
- ▶ **Regulator:** Same as the securities regulator of the particular jurisdiction.
- ▶ **Eligibility of Issuer:** Limited. Restriction is primarily by way of offer size.
- ▶ **Eligibility of Investor:** Restricts exposure. Greater protection for unsophisticated investors.
- ▶ **Disclosures:** Proportional to size of the company.
- ▶ **Regulation of Platforms:** Focal point of crowdfunding regulation.

Current regulatory landscape

Type of crowdfunding	Regulation
Social/Donation	No specific regulations
Reward	No specific regulations
P2P lending	RBI Master Directions (2017)
Securities-based	SEBI working Paper (2014)

Potential framework

Specification	Suggestion
Regulator	SEBI
Registration of platforms	Mandatory registration with SEBI
Capital adequacy of platforms	Must be proportionate to the risks posed
Secondary Trading	To be permitted
Eligibility criteria for investors	The platform must facilitate investment by all kinds of investors, including non-residents
Restrictions on issuance	Should limit exposure of unsophisticated lenders.
Grievance redressal	Mandatory but non-prescriptive
Data protection	Mandatory but non-prescriptive
Business plan continuity	Mandatory but non-prescriptive
Ancillary services	To be permitted except undertaking counter-party risk

Potential framework

Specification	Suggestion
Disclosures by platform	<ul style="list-style-type: none"> -Conflict of interests of the board, KMPs and majority shareholders; -Investments by the platform; -Tasks that the platform will outsource; -Disclosure of fees by the platform; -Defaults by borrowers.
Disclosures by issuer	<ul style="list-style-type: none"> -Management and shareholding of the issuer; -audited financial statements, with appropriate exemptions for small-sized issuers; -key attributes of the security being issued; -information relating to defaults on securities issued through the platform; -ongoing information about defaults, if any, committed towards other creditors.

Regulatory hurdles

Problem	Possible solution
Issue of securities to more than 200 persons qualifies as a public offer	-Cap number of investors -Allow exception for sophisticated lenders and restrict exposure of retail investors -Cap issue size
Platform may qualify as an NBFC	SEBI should have exclusive jurisdiction
Investments by institutional investors are currently restricted	Appropriate exceptions should be made
Lenders on P2P platforms may qualify as 'money lenders'	Specific exceptions should be made
Certain instruments attract compliance with the Acceptance of Deposits Rules	Definition of deposit should provide suitable exception

Conclusion

- ▶ Balance between innovation and risk management needs to be achieved
- ▶ Platform is the best unit of governance
- ▶ Regulatory hurdles to be removed to develop the crowdfunding market