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THE BOARD OF THE

INTERNATIONAL ORGANIZATION OF SECURITIES COMMISSIONS

Statement on Addressing Regulation of Crowdfunding

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Post the 2008 financial crisis, traditional credit providers have become increasingly constrained in their ability to make loans available for worthy investment projects, particularly with respect to small and medium enterprises. Policy makers and regulators have sought ways to encourage investment in small firms and start-ups. One of these ways has been through the use of crowdfunding, which seeks to leverage technology, inter alia, to provide an alternative channel for capital raising. However, when developing or investing in crowdfunding, IOSCO believes it is important for regulators and policy makers to balance the need for supporting economic growth and recovery with that of protecting investors.

IOSCO's Work on Crowdfunding

As a follow on to the Staff Working Paper,[1] the IOSCO Committee for the Regulation of Market Intermediaries (Committee 3) carried out a fact-finding survey to enhance IOSCO's understanding of developments in members' current or proposed investment-based crowdfunding regulatory programs and to highlight emerging trends and issues in this area. IOSCO has now published the survey findings from twenty-three IOSCO members in the "*Crowdfunding 2015 Survey Responses Report*" ("Survey Report").[2]

The Survey Report highlights that most regulatory regimes for crowdfunding have only recently been implemented. Therefore, IOSCO has not proposed a common international approach to the oversight or supervision of crowdfunding at this stage. However, based on the findings from the

[1] In 2014, the IOSCO Research Department developed a Staff Working Paper that provided economic analysis of crowdfunding and considered possible regulatory implications for this type of capital fundraising Kirby and Worner, *Crowdfunding: An Infant Industry Growing Fast* (2014), IOSCO Research Department Staff Working Paper, available at http://www.iosco.org/research/pdf/swp/Crowd-funding-An-Infant-Industry-Growing-Fast.pdf.

[2] Available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD520.pdf

Survey Report, IOSCO would like to raise awareness regarding some of the major risks investors face when investing in crowdfunding.

In addition to common investment risks, such as conflict of interest, data protection and fraud, IOSCO believes regulators should pay attention to the additional risks related to crowdfunding:

- *Heightened financial risks*: High risk of default or failure is often associated with start-up businesses.
- *Fraud, money laundering/terrorist financing:* The risk of fraud may be higher in the case of online private offering.
- *Platform failure:* There is risk of platform failure or closure for crowdfunding portals.
- *Illiquidity:* In most cases there is no secondary market for crowdfunding securities, which may limit investors' ability to sell or liquidate these securities.
- *Suitability/information asymmetry:* A crowdfunding offering may not be suitable for all investors, as many lack experience with these types of offerings and may not be able to carry out sufficient due diligence due to a lack of appropriate skills and/or the significant information asymmetry between the entrepreneur and the investor.

While regulatory regimes for crowdfunding are in their infancy, for the purpose of investor protection, regulators and policy makers should note some of the measures taken thus far by regulators to address these inherent risks related to crowdfunding:

- customizing entry, registration, or licensing requirements for funding portals;
- setting disclosure requirements for issuers and funding portals;
- limiting the services that may be provided by crowdfunding platforms;
- requiring investor education and/or statements signed by investors acknowledging their understanding of risks;
- limiting the size of the investments made by an individual in each offering and in a given timeframe; and
- requiring the appointment of a third party custodian to hold investor assets.

Furthermore, because crowdfunding often operates on web or mobile based platforms, regulators should take into account possible cross border implications. To mitigate cross-border risks, special crowdfunding regimes often restrict cross-border fundraising by requiring that the issuer and/or the managers running the funding portal must be incorporated locally. Nonetheless, some jurisdictions have considered exploring coordinated approaches with one another in managing both the risks and opportunities related to the cross-border aspect of crowdfunding.