

Hong Kong proposes regulations on crowdfunding

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On 19 December 2022, the Hong Kong SAR government published proposals to enhance regulation of crowdfunding activities¹ and launched a three-month public consultation exercise.

In this article, we will discuss what crowdfunding is, the existing regulations on fundraising activities, risks of the limitations in the current regime and the proposed measures in respect of crowdfunding.

What is crowdfunding?

Crowdfunding generally refers to activities conducted by an individual, a group or an organisation for openly appealing to a large number of individuals or organisations to each contribute a small amount of money for a specific fundraising purpose, so that the fundraiser may have sufficient funding to carry out a project, a business or meet a purpose. Crowdfunding has increased considerably due to the use of communications technology and online platforms.

The following are major common types of crowdfunding activities conducted in recent years:

- Equity or debt crowdfunding: Fund contributors invest in a specific project or business (such as a start-up) in return for equities or debts issued by a company, or profits or income of a collective investment scheme.
- Peer-to-peer lending: Fund contributors provide unsecured loans through online platforms that match them with borrowers, from which interests are earned.
- Donation-based crowdfunding: Fund contributors make donations to charitable or non-charitable causes (such as political campaigns, personal or social values) they support to help realise such causes without getting any specific returns.

¹ https://www.fstb.gov.hk/fsb/en/publication/consult/doc/Crowdfunding_consultation_paper_Eng_final.pdf

- Reward/pre-sale crowdfunding: Fund contributors provide funds to fundraisers to help them develop or produce specific physical goods or services, while receiving in some form the goods or services in return.

Existing regulations of fundraising activities

Currently, Hong Kong has regulatory and administrative measures over certain activities that invite contribution of funds from the general public, such as charitable fundraising, non-charitable fundraising activities conducted in public places, and sale of lottery tickets. Also, equity or debt crowdfunding invitations are subject to authorisation from the Securities and Futures Commission of Hong Kong (SFC) unless it fulfils the exemption conditions. Where any peer-to-peer lending amounts to a money-lending business, the statutory licensing regime applies. If the lending platform issues notes or debentures, such instruments may be regarded as “securities” or interests in a collective investment scheme and therefore the platform may be regulated by the SFC.

Risks of the limitations in the current regime

With the increasing use of technology as well as the diverse nature of crowdfunding nowadays, many aspects of crowdfunding activities are not covered by the existing regulatory regime. For example, donation-based and non-charitable crowdfunding conducted online are not subject to the existing regulatory controls which cover mostly fundraising in public places. Besides, Hong Kong does not have specific regulatory measures over rewards/pre-sale crowdfunding activities, and currently the

rights of fund contributors can only depend on whether a valid purchase-and-sale contract exists.

The absence of adequate supervision over such crowdfunding activities may bring about risks to fund contributors, such as:

- concealment by fundraisers of their identity and/or the arrangements and purposes of the crowdfunding
- losses to fund contributors if the fundraising platform suddenly ceases operation
- lack of protection to safeguard personal and financial data submitted by fund contributors
- inaccurate information and descriptions provided by fundraisers resulting in losses to fund contributors
- fundraising outcome not being in line with purported purpose
- funds being used on illegal purposes, such as to endanger national security or to support terrorist activities

Proposed measures to regulate crowdfunding activities

The government's key proposed measures include:

- A Crowdfunding Affairs Office (CAO) will be set up to centrally process and coordinate regulatory and administrative matters related to crowdfunding activities.
- All fundraising activities, online or offline, that raise funds “publicly” from individuals or entities of Hong Kong, or individuals or entities located in Hong

Kong, are required to apply in advance to the CAO, regardless of their purpose or location of the activities.

- When processing applications, the CAO will consider factors including the honesty, reputation and reliability of the applicant; proportionality of the purpose of the crowdfunding activity to its scale; as well as risks brought about by the activity to public interests, public safety and national security.
- The CAO will co-ordinate with relevant government departments with a view to streamlining procedures for fundraising activities which are subject to the existing regulation, such as donation invitations held physically in public places, or lottery sales.
- The new regulatory regime will not apply to commercial fundraising activities in the market which are already well regulated by financial regulators (including the SFC) under existing legislation.
- Exemptions and facilitation measures are proposed to facilitate smooth operation and timely commencement of crowdfunding activities which are widely recognised by the society and charitable crowdfunding projects which address sudden and urgent needs such as in a natural disaster. Certain activities will be excluded, including call for donations from religious bodies on religious grounds.
- Fundraisers are required to disclose objectives and arrangements of their crowdfunding activities, use bank account in Hong Kong, keep proper records of fund movements, and obtain information on fund contributors' identities.

- Public views are invited to consider whether a registration system for online crowdfunding platforms should be established and the operational practicality of such system given that many platforms are set up outside Hong Kong.
- Law enforcement agencies will be empowered to cease unlawful crowdfunding activities (such as the issue of prohibition orders) and prosecute offenders.

Key takeaway

The proposed regulations affect wide groups of participants. While the safeguards can provide additional protection to fund contributors, they also imply enhanced compliance by fundraisers, platforms, media and financial institutions involved in the crowdfunding activities.

If the proposals are adopted, any individual or organisation (whether or not based in Hong Kong) intending to raise funds publicly from Hong Kong must seek the green light from the CAO beforehand, unless otherwise exempted or excluded. Such procedure is mandatory even if the crowdfunding initiative targets many other jurisdictions in addition to Hong Kong.

More importantly, crowdfunding activities which jeopardise Hong Kong's public safety or China's national security will be taken as unlawful even if they are conducted outside Hong Kong.

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