



PUBLIC CONSULTATION PAPER

NO. 2/2019

PROPOSED REGULATORY FRAMEWORK

FOR PROPERTY CROWDFUNDING

The Securities Commission Malaysia (SC) invites your written comments in this consultation paper. Comments are due by **29 March 2019** and should be sent to:

E-mail : CPLAWREFORM@seccom.com.my

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OVERVIEW

1. Introduction

- 1.1 This paper is intended to generate discussion as well as obtain views and feedback from interested parties in respect of the SC's proposed regulatory framework for property crowdfunding activities in Malaysia.
- 1.2 The SC has to date embarked on various efforts to enable businesses to benefit from wider accessibility to market-based financing avenues to meet their financing needs, as well as utilising technology to enable greater investor participation.
- 1.3 In this regard, the SC has introduced the equity crowdfunding (ECF) and peer-to-peer (P2P) financing frameworks in the capital market to allow for alternative market-based financing avenues for micro, small and medium enterprises (MSMEs) to raise funds. Since the launch of ECF and P2P financing frameworks in February 2015 and April 2016 respectively, both avenues have shown good progress in meeting the financing needs of our MSMEs.
- 1.4 Currently, the SC has registered seven ECF platform operators and six P2P financing platform operators as recognised market operators. As at December 2018, a total of RM261.52 million has been raised by issuers via both market-based financing avenues.
- 1.5 The Government, in the recent Budget announcement, stated that it would leverage on the use of technology-enabled and innovative mechanisms to provide an alternative funding source for first-time homebuyers¹, through a property crowdfunding scheme.
- 1.6 The SC is supportive of innovative ideas that tap on the transformative power of technology to democratise investments and which allows greater breadth of financing options for Malaysians.

¹ Budget Speech 2019 <http://www.treasury.gov.my/pdf/budget/speech/bs19.pdf> p. 24.

- 1.7 Property crowdfunding offers the same potential as that of ECF and P2P platforms in providing an alternative source of financing for businesses but which is specifically tailored for first-time homebuyers. Property crowdfunding will enable investors, collectively as a crowd, to finance first-time homebuyers to purchase their first property. At the same time, it will enable investors to access a new type of investment product.
- 1.8 Nevertheless, the SC is of the view that there is a need to balance promoting innovation with ensuring proper safeguards to protect the integrity of the scheme and investors' interest. In this regard, the current P2P financing framework may apply, with necessary amendments made.
- 1.9 The SC is issuing this consultation paper (CP) to obtain feedback on the proposed guidelines that will facilitate property crowdfunding under the P2P financing framework.
- 1.10 The proposals discussed in this CP have taken into account feedback received from the Ministry of Finance and other relevant stakeholders including potential operators, valuers, banks and lawyers.

2. What is a property crowdfunding scheme

- 2.1 There is no legal definition for property crowdfunding but, as a concept, it refers to a form of fundraising that envisages a homebuyer obtaining funds to pay for the purchase price of a property through investments from relatively large numbers of investors, with an online platform publicising and facilitating such transactions.
- 2.2 Investors who are platform members can browse through a list of properties offered on the platform to find opportunities that meet their investment criteria (for example, the location, property type, entry level, estimated returns and the background of the proposed homebuyer). They put in their investment sum, which

is then held by the platform operator until the fundraising target is achieved.

- 2.3 Some of the benefits available to investors are that investors can take advantage of the low entry level and easy investment process to achieve a high level of investment diversification and minimise their risks. At the same time, they retain control of their investment without incurring the charges associated with fund-based investing and would be able to exit their investment by disposing their investment note² in a secondary market.
- 2.4 For homebuyers, whilst they may have the initial capital for payment of the deposit or down payment for the purchase of a property, they typically would need to secure further funding for the balance of the purchase price. Property crowdfunding has the potential to act as an alternative source of funding for first-time homebuyers.
- 2.5 As mentioned earlier, the SC is of the view that the current P2P financing framework under RMO Guidelines may apply, with necessary amendments, to the proposed property crowdfunding scheme. As such, similar to the current P2P financing framework, a property crowdfunding platform operator (platform operator) will be registered as a recognised market operator.
- 2.6 It is envisaged that, in general, a property crowdfunding scheme would be platform operator-driven. The SC does not prescribe a specific model that should be adopted to encourage ongoing innovation within the RMO framework. However, the SC proposes to set out several requirements that must be fulfilled by a platform operator and participants of the scheme. The next section of this paper will set out the key parameters of the proposed regulatory framework and the policy rationale for the same.

² Investment note is defined in SC's prescription order which can be found here.

3. The need for regulation

3.1 As with any other investment, property crowdfunding poses risks, which include—

- (a) the platform operator not being fit and proper;
- (b) the platform does not have sufficient resources to carry out the scheme;
- (c) a homebuyer failing to purchase the property or investors unable to recoup their investments;
- (d) property price fluctuations; and
- (e) a lack of understanding in the property scheme's features and associated costs.

3.2 To mitigate the risks as mentioned above, the SC proposes that several regulatory requirements be imposed on the property crowdfunding scheme and its participants, such as—

- (a) imposing requirements in relation to a platform operator, such as criteria to qualify as a platform operator, obligations of a platform operator and permissible and non-permissible activities of a platform operator;
- (b) imposing requirements in relation to a homebuyer, such as criteria for a homebuyer who can seek funding through the platform, funding limit and obligations of a homebuyer; and
- (c) specifying the criteria on the type of properties that can be hosted on the platform.

4. Proposed requirements in relation to a platform operator

4.1 It is envisaged that a platform operator will play various roles which may include—

- (i) operating a platform which hosts properties available for purchase by a first-time homebuyer;
- (ii) providing a secondary market where investors can trade their investment notes; or
- (iii) acting as a centralised point of contact or conduit between a homebuyer and the investors.

Criteria to qualify as a platform operator

4.2 Given the multi-faceted role that a platform operator plays, the platform operator must have sufficient capabilities and necessary resources to operate the platform and to facilitate the scheme without compromising the interest of both homebuyer's as well as investors' interest. The platform operator must also have the capability and capacity to ensure that any secondary market it may operate is fair, transparent and efficient.

4.3 To qualify as a platform operator, the SC proposes that the applicant must fulfil the following requirements:

(a) Registration and capital requirement

A platform operator will have to apply to the SC to be registered as a recognised market operator. For the purposes of registration, the platform operator must be a locally incorporated company.

A platform operator must also satisfy the SC that it is fit and proper³ to operate the platform at all times. Further, a platform operator must have sufficient financial, human and other resources to ensure that the market it

³ This would include among others, that the operator has not been convicted for offences relating to fraud, dishonesty or breaches of securities laws, has engaged in any business practices appearing to the SC to be deceitful or oppressive or otherwise improper or has engaged in or has been associated with any conduct that cast doubt on his ability to act in the best interest of investors.

operates will be fair and orderly.⁴ To fulfil this requirement, the platform operator must have a minimum paid up capital of RM20 million. This is to ensure that the platform operator would have sufficient capital to operate the platform and there is exit certainty⁵ for the homebuyers and investors at the end of the scheme's tenor.

Given the nature of the scheme, it is also proposed that the SC have power to impose additional financial requirements on the platform operator should the need arise (at the point of registration and/or post registration).

(b) Governance

A platform operator will also be required to appoint a responsible person who will be the contact point for the SC. The responsible person must be a senior member of management and his duties should include, among others, identifying and reporting to the SC any breach of the platform rules or material change in relevant circumstances relating to its operation or the scheme.

In addition, a platform operator would also be required to have in place a conflict of interest, risk management, business continuity management and cyber-resiliency frameworks as well as an internal audit function.

Obligations applicable to a platform operator

4.4 Once registered by the SC, a platform operator is required to carry out various obligations to ensure that the platform operates in a fair and efficient manner. Some of the obligations to be imposed are—

(a) Disclosure and due diligence during fundraising period

A platform operator is obliged to carry out the necessary due diligence on a

⁴ These requirements are also imposed on applicants who wish to operate an ECF or P2P platform.

⁵ Please refer to the discussion relating to exit certainty in paragraph 4.16-4.17 below.

prospective first-time homebuyer, such as verifying his general personal and credit profile. In addition, a platform operator will be required to disclose to the investors, during the fundraising period, the verified general personal and credit profile of the homebuyer. This may include the homebuyer's gender, age band, occupation and salary band.

A platform operator should have the right to deny any prospective first-time homebuyer's access to its platform if the platform operator is of the view that the homebuyer does not fulfil the eligibility criteria⁶ or other requirements that the platform operator may impose.

A platform operator is also obliged to carry out due diligence on the properties to be hosted, including verifying the accuracy of information relating to the properties and assessing any potential limitations on the subsequent sale of these properties in the future. In this respect, the platform operator is required to appoint an independent qualified property valuer to perform a valuation of the property before hosting it on its platform and once more before expiry of the scheme's tenor. The valuation will be disclosed to the homebuyer and the investors through the platform. This will provide transparency in the pricing of the property at the point of hosting and at the exit point.

A platform operator will also be required to disclose all relevant information regarding the property during the fundraising period for a homebuyer and the investors to assess.

(b) Continuous education and awareness programs

An important obligation on the part of a platform operator would be to carry out continuous education and awareness programs about the features and risks of property crowdfunding, both from the perspective of a homebuyer as well as investors. This will contribute to the homebuyer's and investors'

⁶ Please refer to the discussion relating to homebuyer eligibility criteria in paragraph 5.3 below.

understanding of the scheme and is therefore critical to the scheme's success.

(c) Disclosure of fees, charges and incentives

The SC is of the view that there should be no hidden fees or charges imposed on a homebuyer and the investors. Thus, a platform operator will be required to disclose all applicable fees and charges that are to be borne by a homebuyer and the investors.

Such fees and charges may include legal fees relating to the transaction i.e. stamp duty, lawyers' fees, real property gain tax (if the property is sold at the end of the scheme's tenor), cost of the appointment of a valuer, trustee or property manager (if any), quit rent, maintenance fees, utility bills, fire insurance, platform fees etc.

In addition, the platform operator will also need to disclose how these fees and charges will be paid and the party/parties responsible for making these payments. Similarly, incentive schemes that a platform operator may have with property developers must also be disclosed.

Permissible and non-permissible activities of a platform operator

4.5 The SC proposes that a platform operator be permitted to do the following:

- (a) host various properties on the platforms;
- (b) operate a secondary market for the investors participating in the scheme;
- (c) provide an avenue that will facilitate discussions about the offerings on the platform; and

- (d) provide ancillary services such as–
 - (i) property management services;
 - (ii) preparing and reviewing standardised documentation relating to the scheme; or
 - (iii) acting as a centralised point of contact or conduit between a homebuyer and the investors.

4.6 The SC proposes that a platform operator be prohibited from carrying out the following activities:

- (a) Provide funding or financial assistance to a homebuyer and/or the investors;
- (b) Offer investment advice; and
- (c) Negotiate terms for and on behalf of individual third parties i.e. financial advisers, lawyers, banks, moneylenders etc.

General ongoing obligations

4.7 In addition to the above, it is proposed that a platform operator be required to–

- (a) ensure fair treatment of users of its platform;
- (b) provide fair, clear and accurate information relating to the platform and the property crowdfunding scheme;
- (c) prominently display risk warnings and obtain a homebuyer’s and the investors’ acknowledgements of their understanding of the risks involved in participating in the scheme;
- (d) disclose any material adverse change relating to the scheme and/or to the scheme’s participants;
- (e) comply with relevant laws such as anti-money laundering requirements, Personal Data Protection Act 2010 any other applicable regulations;
- (f) put in place an effective complaints and dispute resolution mechanism; and

- (g) put in place an effective resolution plan or arrangement to ensure participants' interests are safeguarded in the event of cessation of operations.

Consultation question 1:

- (a) **Given the fact that a platform operator will be playing a key role in ensuring that the investors have confidence in participating in property crowdfunding activities, would the proposed platform operator's obligations as listed out above be sufficient? If not, what other obligations should be imposed on a platform operator?**
- (b) **As mentioned earlier, the SC does not prescribe a specific model that should be adopted and would leave it to the platform operator to decide the appropriate property crowdfunding model. In this regard, please provide some examples of a suitable property crowdfunding model that may be offered and its relevant features.**
- (c) **To what extent should a platform operator be responsible to carry out background checks ("due diligence") on a prospective homebuyer?**
- (d) **Should the regulator specify parameters for background checks? If you are of the view that the regulator should specify the parameters, what should those parameters include?**
- (e) **Do you agree with the list of permitted and non-permitted activities of a platform operator as proposed above? If you do not agree, what are your suggestions?**

All-or-Nothing approach

4.8 The SC is proposing to adopt the all or nothing approach (AON model) for the property crowdfunding scheme. Under the AON model, a homebuyer will not be entitled to any part of the proceeds raised on the platform unless the homebuyer has successfully raised 100% of the balance amount required to purchase the property. If he is not able to raise the amount, all the monies received will be returned to investors.

Trust account

4.9 Similar to the requirement placed on ECF and P2P platform operators, the SC is also proposing that a platform operator be required to deposit all funds raised through the platform in a separate trust account with a licensed bank until the fundraising period is completed. The trust account must be maintained by a trustee that is

registered with the SC for carrying out capital market activities.

- 4.10 If the offering is successful, the funds will be released to the property developer. A platform operator will also be required to have in place processes to ensure that if the offering is unsuccessful, the investments will be returned to the respective investor as per the AON model.

Consultation question 2:

Do you agree that the AON model should be maintained for the reasons discussed in paragraphs above? If you do not agree, please state your reasons.

Material adverse change

- 4.11 A platform operator must always be mindful that during the fundraising period, situations that lead to a material adverse change may arise in relation to a homebuyer or the property for which the funding was sought. A material adverse change concerning the homebuyer or property may include any of the following:
- (a) The discovery of a false or misleading statement in the disclosure in relation to the homebuyer or the property;
 - (b) The discovery of a material omission of information relating to any disclosure made on the platform; or
 - (c) Material adverse change or development in the circumstances relating to the property or homebuyer which may include wrongful or material omission of information relating to the property, death of the homebuyer, the occurrence of an irreparable damage to the property or confiscation of the property by local authorities.
- 4.12 In this regard, the homebuyer or the property developer is responsible for communicating the occurrence of a material adverse change to the platform operator in a timely manner. The platform operator, in turn, is responsible for notifying all relevant investors of the said change. A platform operator is also

required to have in place policies and procedures to deal with material adverse changes.

- 4.13 A platform operator may adopt the opt-out approach, namely, where the investors are deemed to have agreed to the change unless they elect to withdraw from the investment within a period of two weeks from the date of notification of the material adverse change. This is to ensure that the offering does not fail simply because there is a lack of response from investors after being notified of the material adverse change.

Consultation question 3:

- (a) Do you agree that material adverse change should include the circumstances discussed above?**
- (b) What other circumstances, if any, should be considered as a material adverse change?**

Proposed condition precedent for release of funds to the developer

- 4.14 The SC proposes that the funds raised and maintained in the trust account shall only be released by a platform operator to the property developer⁷ after the following conditions are met:

- (a) The targeted amount sought to be raised has been achieved; and
- (b) There is no material adverse change relating to the offer during the fundraising period.

Consultation question 4:

- (a) Do you agree with the proposed conditions precedent for release of funds to the property developer provided above? If you do not agree, please state your reasons.**
- (b) Do you think that there should be other conditions precedent imposed before the funds are released? If yes, what are the other condition precedents that should be imposed?**

⁷ As will be discussed below, the property to be hosted on the platform must be a newly completed property which is being sold by a property developer.

Complaints and dispute resolution mechanism

- 4.15 The SC proposes that a platform operator, being the conduit between a homebuyer and the investors, should have in place an internal dispute resolution mechanism to deal with any dispute that may arise between both parties throughout the fundraising process and during the scheme's tenor.

Exit certainty at the end of scheme's tenor

- 4.16 It is envisaged that regardless of the model adopted by a property crowdfunding scheme, at the end of the scheme's tenor, the investors should have an avenue to exit their investment. Some of the exit options may include—
- (a) the sale of the property at a price determined by an independent valuer. The returns to the investors, if any, will be the difference between their initial investment and the amount of money raised from the sale of the property;
 - (b) a platform operator providing a warehousing facility, where a homebuyer may sell the property to the platform operator based on a market value determined by an independent valuer; or
 - (c) having in place an underwriting arrangement with a bank to provide a loan to pay off the amount due to the investors.
- 4.17 A platform operator will be required to ensure that the exit terms including how returns, if any, will be distributed to the scheme's participants are disclosed and agreed to before the participants enter the scheme.

Illustrations:

The property crowdfunding model used for the illustrations below requires the homebuyer to purchase the property or repay the investors, at the end of the

scheme's tenor. Further, in the event the property is not purchased by the homebuyer or a third party, the platform operator agrees to warehouse the property at a 20% discounted rate from the market price.

The property price is RM100,000 during the fundraising period. Mr A as the homebuyer, paid RM20,000 and Melanie, the sole investor in the scheme, invested RM80,000. Under the scheme, it was agreed that Mr A and Melanie will share any profit in the ratio of 20:80.

Scenario 1: The homebuyer purchases the property

At the end of the scheme's tenor, the property is now valued at RM120,000. Exit certainty means that Mr A will have to purchase the property at RM120,000 and pays Melanie RM96,000 (principal investment RM80,000 + RM16,000 profit).

Scenario 2: The homebuyer sells the property

At the end of the scheme's tenor, the property is now valued at RM120,000. Exit certainty means that Mr A will sell the property to a third party and pays Melanie RM96,000 (principal investment RM80,000 + RM16,000 profit).

Scenario 3: The platform operator provides a warehousing facility

In the event the property is not sold under scenario 1 or 2, the scheme provides that the platform operator will purchase the property at a 20% discounted rate from the current market price. Premised on the same figures used in the scenarios above, the "warehousing price", to be paid by the operator, would be RM96,000 (RM120,000 – 20%). In this regard, Mr A will be required to pay the amount as agreed under the scheme.

Consultation question 5:

Do you agree that a platform operator should be required to have in place an exit certainty mechanism at the end of the scheme's tenor? If yes, what should the exit certainty mechanism comprise of? How do we ensure that exit certainty mechanism is fair to all parties?

5. Proposed requirements in relation to a homebuyer

Permitted homebuyers

- 5.1 As discussed, the property crowdfunding scheme is to enable a first-time homebuyer to access funding to purchase his first residential property.
- 5.2 Whilst there is no definition of the term “first-time homebuyer”, the SC is guided by the various government incentives relating to a first-time homebuyer. For example, under My First Home Scheme⁸, the government has defined a first-time homebuyer to be an individual Malaysian citizen up to the age of 40 years and purchasing his first home. Under PRIMA Special Financial End Financing Scheme⁹, to be a homeowner of a PRIMA house, the person must be a Malaysian citizen who is above 21 years old and owns no more than one property between the person and his spouse.
- 5.3 Set against this backdrop and to ensure consistency with other government initiatives, the SC is proposing to define a first-time homebuyer as–
- (a) an individual Malaysian only;
 - (b) who is at least 21 years old; and
 - (c) has never owned a property whether solely or jointly.

Funding limit

- 5.4 The scheme must operate on the basis that a homebuyer will not be able to obtain 100% financing from investors under the scheme. It is expected that the homebuyer must put up the initial amount for the property to show his commitment to the scheme. In this regard, the SC is proposing that a homebuyer must put up a minimum of 10% or maximum 20% of the property price as the initial amount.

⁸ <http://www.srp.com.my/en/criteria.html>

⁹ <http://www.prima.my/spef.php?lang=en>

Correspondingly, it is also proposed that a homebuyer will only be able to raise funding up to 90% of the property price.

Eligible property

5.5 The SC is proposing that only properties with the following criteria are eligible to be hosted:

- (a) Properties purchased directly from a developer;
- (b) Newly completed properties¹⁰ with a valid certificate of completion and compliance;
- (c) Valued at not more than RM500,000.00, when it is first hosted on a platform; and
- (d) Limited to properties situated in Malaysia.

Obligation of a homebuyer

5.6 The SC is proposing to impose obligations on a homebuyer to ensure that the property will not be used for speculative purposes. In this regard, the SC is proposing that–

- (a) a homebuyer is not allowed to sell or transfer the property during the scheme's tenor;
- (b) the property must be occupied by the homebuyer at all times. A homebuyer, however, will be permitted to rent out rooms in the property during the scheme's tenor;
- (c) the homebuyer should use his best endeavour to maintain the property in good condition during the scheme's tenor; and

¹⁰ Newly completed properties refer to new properties which are completed within 24 months prior the date of the property being hosted on the platform.

- (d) the homebuyer must inform the platform operator of any material adverse change during the period of the scheme, for example, any irreparable damage to the property, confiscation of the property by any authorities or the inability of a homebuyer to fulfil his obligations.

5.7 It is expected that a platform operator will set out the consequences that a homebuyer will bear in the event there is a breach of the above obligations. For example, where a property has been damaged during the scheme's tenor, the homebuyer may be required to pay for the cost of repair.

Consultation question 6:

- (a) Do you agree that for the first stage of property crowdfunding, only newly completed properties be allowed to be hosted on the platform? Do you agree that properties completed within 24 months prior to being hosted on the platform are deemed to be "newly completed" for the purposes of the scheme? If you do not agree, how would you define "newly completed"?**
- (b) Do you agree with the criteria for a first-time homebuyer as listed above? If you do not agree, what other criteria must be imposed bearing in mind that the policy intention is to help a first-time homebuyer?**
- (c) Do you agree with the proposed maximum initial payment by a homebuyer and the maximum fund-raising limit as discussed in the above paragraph 5.4? If you do not agree, what is your suggestion?**
- (d) Do you agree with the eligibility criteria for properties to be crowdfunded hosted on the platform? If you do not agree, what other criteria should be imposed?**
- (e) Do you agree that a homebuyer who has participated in a property crowdfunding scheme and has exited the scheme without exercising his option to purchase the property, should not longer be considered as a n eligible first-time homebuyer for any other property crowdfunding scheme?**
- (f) Do you agree with the continuous obligations imposed on a homebuyer? What other obligations should be imposed?**

6. Proposed requirements in relation to secondary trading

6.1 As discussed in section 4 of this paper, a platform operator will also be allowed to

offer secondary trading of investment notes relating to scheme on its platform. This would enable the investors to sell their investment notes and cash out their position without the need to wait for the scheme's tenor to end.

6.2 The SC proposes that any platform operator who wishes to offer a secondary market must comply with the following requirements:

- (a) There must be transparency of pre-trade and post-trade information; and
- (b) There must be clear and transparent disclosures on the structure of the secondary market that it is operating.