Draft Capital Markets (Investment-Based Crowdfunding) Regulations, 2021

Summary through Q&A

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The draft Capital Markets (Investment-Based Crowdfunding) Regulations, 2021

The Republic of Kenya, through one of its regulatory agencies, the Capital Markets Authority (CMA), is in the process of regularising crowdfunding through the draft Capital Markets (Investment Based Crowdfunding) Regulations, 2021. The regulation is timely if well-thought-out.

There has been a grey area concerning whether corporate crowdfunding by a private limited company resulted in a model of soliciting funds beyond the scope of a private placement, which turns the status of a corporate entity from a private limited company to a public limited company. The Capital Markets Act and Capital Markets (Securities) (Public Offers, Listing and Disclosures) Regulations, 2002 provide more regulatory aspects of a private placement.

The activities that go on during crowdfunding result in interacting with various areas of law; hence, the need to look into how the regulation is going to affect crowdfunding activities – the implication not only affects the businesses but also how Software as a Service (SaaS) or Platform as a Service (PaaS) will be developed. In that regard, we share our Q&A, subject to our terms and conditions, on the draft Capital Markets (Investment Based Crowdfunding) Regulations, 2021.

Question	Answer/ Comment
Is there a cooling-off period, and what is its implication to a crowdfunding platform operator?	The implication is that crowdfunding SaaS/PaaS needs to have an option that allows an investor to back out the intended investment without restrictions or repercussions.
Does the crowdfunding platform require any assessment and approvals by CMA?	The crowdfunding platform will need to attain approval from the CMA.
Who can operate a crowdfunding platform, does one require a license to operate, and is there any share capital required different from the Companies Act bare minimum?	The regulations require a crowdfunding platform to be operated by a limited liability company with a paid-up capital of Kenya Shillings ten million, and it must obtain a license from CMA.
What type of crowdfunding do the draft regulations intend to apply?	The regulation limits its application. It only applies to crowdfunding practices that touch on investment instruments that the CMA only approves.
Who is an investor according to the draft regulations?	The definition of an investor is limited to those who place their funds with a view of achieving returns. "Achieving returns" may be vague considering the practices of crowdfunding. For instance, in instances where one provides funds and what is to be offered in return are the products or services indicated under the perks. Most of these perks do not offer investment instruments but a product or service upon production or launch.

Question	Answer/ Comment
What is a start-up according to the draft regulations?	An entity that is less than ten years and established for the sole purpose of developing a unique and scalable product or service to benefit the market.
Will the draft regulations apply to only local entities or foreign entities too?	The implication of what amounts to operating, providing, or maintaining **investment-based crowdfunding** means that other than local platforms, foreign entities allowing Kenyans to use their platforms will need to comply with CMA and adjust their platforms accordingly. Investment-based crowdfunding platforms targeting Kenyan investors will require licenses from CMA. In establishing whether there is direct or indirect promotion, there is a high chance of confusion when a subscriber signs up for certain emails that market specific products or services as per the relevant Data Protection Laws. The implication can result in some crowdfunding platforms using geofencing to block Kenyans from accessing these crowdfunding platforms.
Will an intended crowdfund platform operator require licensing?	The intended operator will be required to comply with a series of conditions to secure a license. Further, there are more measures to be observed when operational.
Does the draft regulation provide any limitations on who an issuer can be and the amounts to be raised?	The issuer must be a micro or small enterprise incorporated in Kenya with a minimum of two years' operating track record. Certain entities will not be in a position to be classified as issuers as per the regulation. In particular, public listed companies and their subsidiaries, entities with poor governance records, intend to collect funds and offer loans or invest in other entities and as CMA may deem feet. The regulations provide for three types of issuers based on funds allowed to be offered, ranging between KES. 25 million to KES. 100 million. However, there is room to have CMA remove the limits placed.
What are the classifications of eligible investors?	There are two types of investors: the sophisticated investor (high net worth and knowledgeable about the markets) and retail investor who can only invest a maximum of Kenya Shillings one hundred thousand (KES. 100,000). The platform operator may provide a capping that is lower than KES. 100,000.
What are the permitted investment instruments?	The CMA provides that the permitted investment instruments include shares, bonds or debentures, or any other as CMA will approve.

Question	Answer/ Comment
What are some of the requirements for an issuer?	The eligible issuer is required to offer its securities through a licensed crowdfunding platform, provide all the needed disclosures, and clearly outline investors' rights and ownership of investment instruments.
What are some of the requirements for an investor?	The CMA requires that investors only invest through crowdfunding platforms (approved and licensed) and will benefit from withdrawing their investment within 48 hours after the close of the offer. The issuer is required to disclose this right to the investor through its documentation.
Are there any documents to be relied on as an issuer?	The crowdfunding platform operator is obligated to develop standard documents that an issuer will utilize in submitting their intended offer. These documents must provide the bare minimum of what the regulations require.
What happens if the crowdfunding does not meet the minimum required funds from investors?	Crowdfunding offers will only last a maximum of sixty days, and in the event, the issuer fails to meet the minimum amount that is targeted, the crowdfunding platform will refund the funds to investors within 48 hours. The issuer will only commence a fresh offering after ninety days of the withdrawal of the initial offer upon its failure to meet its target.
What happens when crowdfunding is successful?	If the crowdfunding is successful, the crowdfunding operator will release the funds to the issuer within 24 hours. However, this may contradict the requirement of the cooling-off period.
Can the funds be diverted to a different project?	CMA requires the crowdfunding platform operator to adopt reasonable measures to ensure that the funds are used for the stated purpose.
Are there any requirements to provide warning statements and risk acknowledgment forms?	It is a requirement for the crowdfunding platform operator to provide various warning statements as guided by the regulations. It will include having the investor affirming the risk acknowledgment form before accepting an offer.
What are some of the obligations of the crowdfunding platform operator?	The crowdfunding platform operator has several obligations, including users rights and responsibilities, list and information relating to issuers and investors on the platform, investor education material and programs, providing disclaimers, complaints, and dispute resolution, fees charged by the crowdfunding platform, disclosures, ensuring there is the compliance of the rules, among others.

Question	Answer/ Comment
Are there any requirements for conducting due diligence?	The crowdfunding platform operator is required to conduct due diligence on the issuer. Due diligence will include background checks, verifying the accuracy of information provided, ensuring compliance with know your customer and anti-money laundering rules, and securing self-declared risk acknowledgment forms.
How will the investor funds be handled before the close of the offer period?	The crowdfunding platform operator must appoint a custodian who will establish a trust account for each funding round. The custodian must be a financial institution registered with CMA as a custodian.
Does the draft regulation provide for any data and insurance law compliance measures?	The crowdfunding platform operator must comply with the data protection laws, which translates into having credible infrastructure. Further, it is required that the crowdfunding platform operator obtains insurance against the portal.
Will CMA anticipate any reports from the crowdfunding platform operator?	CMA requires the crowdfunding platform operator to generate various reports and share the information with it every month. The reports will include offers made through the platform, use of the funds, investors and amounts invested, and any other information that CMA may request.
Will CMA conduct any inspection post approving the crowdfunding platform and licensing the crowdfunding platform operator?	CMA reserves the right to conduct any inspections to confirm compliance with the regulations and any other applicable laws or regulations. Any conviction on contravening the regulations will result in a penalty under s 34A of the Capital Markets Act and general damages where applicable.
Are there any other laws that apply to crowdfunding?	Some laws directly interact with operating a crowdfunding platform. Further, CMA also proceeds to indicate other applicable laws such as those for Market Intermediaries, the Regulations on the Prevention of Money Laundering, data protection laws, Terrorism Financing in the Capital Market, 2015, among others.

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