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Superintendência de Desenvolvimento de Mercado
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à Superintendência de Desenvolvimento de Mercado:

The principals of our firm, Crowdfund Capital Advisors (CCA), wrote the framework to legalize securities-based crowdfunding in the United States. They were invited by the White House and attended the Bill signing ceremony on April 5, 2012. CCA wrote the World Bank Report Crowdfunding's Potential for the Developing World and the IDB Report Creating a Crowdfunding Ecosystem in Chile. The principals are successful entrepreneurs that have raised millions of dollars in the private capital markets for their own firms and for many others. They are also authors of the how to book on debt and equity crowdfunding. CCA has consulted in over 40 countries with governments, regulators, policy-makers and stakeholders on creating crowdfunding ecosystems. CCA created the first global database to collect information on online public offerings and hosted the first comprehensive Analysis of the Modern Private Markets in the USA. In short, there is no other firm that has the depth of knowledge or understanding about how securities-based crowdfunding operates, what are best practices and how ecosystems can either flounder or flourish.

Background

The Internet is transforming nearly all industries globally. The disruption of these industries was funded in most cases by private capital markets (angel investors, venture capital, private equity). Now, the Internet and mobile technologies, combined with market demand and regulatory changes, are unleashing a similar type of disruption in the private capital markets themselves with online finance (i.e. equity and debt crowdfunding) driving the change. This is because online finance or crowdfunding is a nascent segment of private capital markets and at this stage of market development the speed and degree of innovation is high. Market participants are innovating as rapidly as possible to gain market share, revenue, and relevance. As these markets grow, several innovations in these new markets will be adopted by other, more traditional parts of private capital markets (angel investing, venture capital, private equity).

A similar pattern of rapid innovation and adoption by traditional players can be seen in the way that online trading of public securities has been adopted. It was once being thought to be impossible but is now the primary way retail investors trade securities. More recently, the rise of robo-advisors, even among high net worth clients of major financial institutions (e.g. JP Morgan Chase's announcement in March 2016 to move private clients with less than US$10 million in capital into a robo-advisor product). Economies and institutions that understand and support the growth of the online finance industry will succeed. Governments and development institutions that create customized policy solutions based on global best practice can increase job creation, successful entrepreneurship and innovation in their countries. Investors and technology/financial services companies that look upon these new online finance markets to grow their customers and market share will improve their market positions over time. Countries and companies contemplating this new fintech market should understand that it is already past the "early adopter phase". This market is now in the "fast follower" phase. Now is the time for action to secure competitive advantage in the new private capital markets that will fund an increasing portion of the global economy.

Goldman Sachs's (May, 2015) report on *The Future of Finance* describes this "socialization of finance" as a US$4.7 trillion market disruption opportunity. This disruption will be driven by equity crowdfunding, debt crowdfunding (also known as marketplace lending), real estate crowdfunding, wealth management and robo-advisors.

To build a transparent, efficient, and effective market for debt and equity crowdfunding, a full ecosystem of products and services is being created in countries where crowdfunding is developing. Some of the services are like those that were required to be created by the public stock markets decades ago. Others will be required because of the central role that social media, mobile, and the traditional Web play in crowdfunding.

Entrepreneurship, Innovation and Jobs are Critical Parts of a Healthy Economy and a By-Product of a Crowdfunding Ecosystem

In our comment letter, we will discuss the rise of different types of crowdfunding and how a crowdfunding ecosystem typically evolves. The elements in a successful crowdfunding ecosystem are then explored with examples of the kinds of companies and services that will emerge to support a crowdfunding ecosystem. Drawing on CCA's experience in advising multilateral organizations and governments around the world, this letter outlines best practice in crowdfunding policy, best practice for governments in fostering crowdfunding, and the key elements in building a stable crowdfunding ecosystem. This letter highlights the important role of education and training, as well as how entrepreneurs and SMEs can choose the most appropriate form of crowdfunding for their needs.

Evolution of a Crowdfunding Ecosystem

The crowdfunding ecosystem within a country typically evolves through four phases on the path to maturity

- **Pre-launch**: Countries in this category have a strong opportunity to be successful with crowdfunding and potential need for crowdfunding to advance other job creation and economic development goals. These countries possess a high utilization of social media but may need to expand or enhance capacities in one or more of the following areas: financial regulation, technology infrastructure development, expanding entrepreneurship skills, and deploying financial technology innovations (examples include Hong Kong, Saudi Arabia, and Jamaica).
- **Experimentation**: Early innovators build crowdfunding services based on successful models in other countries. These usually are either rewards-based (unregulated) crowdfunding or involve working around existing regulation or operation in an area that is not currently explicitly regulated. This can demonstrate the product/market fit of services and motivate governments and regulators to adopt a balanced stakeholder framework to bring these activities within commonsense regulation (recent examples include Singapore, Chile, Mexico, and Thailand).
- **Launch/Early Growth**: Following the authorization of all forms of crowdfunding, typically the market experiences an initial slow start. Given the magnitude of the change in how markets operate (enabling public solicitation and use of social media to raise money from retail and sophisticated investors), time is needed for all parties to build experience and adopt best practice, and for successful cases to emerge (recent examples include Malaysia and the United States).
- **Scaling/Hybridization**: As the market grows, a tipping point is reached that accelerates growth rates to 100-300% per year. This tipping point is a convergence of factors including: growing awareness of crowdfunding; successful cases of exit; active engagement by stakeholders in communication, collaboration, and creation of trusting relationships among themselves that leads to viable markets for crowdfunding; and, most importantly, a rise of companies that build the infrastructure that solves challenges in the market that impede scalability (for example, the United Kingdom).

The Five Sectors in a Successful Crowdfunding Ecosystem

A successful crowdfunding ecosystem comprises technology companies and service providers that support the individuals and companies raising funds. As each market develops further, these ecosystems, which may be categorized into five sectors, grow and localize to solve individual market challenges (for example, offline-to-online transactions, credit scores, monetary flows using mobile communications, and so on):

1. *Crowdfunding platforms and secondary markets* to enable transactions to take place and improve liquidity. Crowdfunding platforms are typically the first part of this sector to develop, well ahead of secondary markets.

2. *Trust and transparency tools* to scale the size and frequency of successful offerings. Examples of these types of tools in the public markets include: investor relations, escrow, transfer, settlement, legal services, accounting, and so on.
3. *Data and analytics services* to scale the size and scope of markets: Who will be the Bloomberg and Thomson Reuters of these markets? How will investors convert terabytes of data into actionable information?
4. *Money transfer*: The ability to move money between individuals and across borders. This is where blockchain technologies intersect with crowdfunding.
5. *White space opportunities*: These are the innovative or disruptive new business models and technologies that will almost certainly occur during the formation of this new industry that cannot be anticipated.

Underlying Companies to Support a Crowdfunding Ecosystem

As a crowdfunding industry develops, different kinds of companies will emerge to support the ecosystem. The following is a non-comprehensive list of examples of the types of companies that should evolve:

- *Donation, rewards and accredited (sophisticated) investor and/or non-accredited investor crowdfunding platforms*: Beginning with unregulated donation and rewards platforms, with the passage of policy and regulation that enables debt and equity crowdfunding, many equity-based and lending-based crowdfunding platforms will appear. These platforms will be both all-encompassing and within vertical sectors. Within the verticals, crowdfunding platforms may emerge that are based on: industry (for example, real estate, high tech, farming); gender; ethnic origin (for example, African-American, Asian-American); affinity (for example, veterans, medical doctors); geography (for example, local town chamber of commerce sponsored funding platforms); and diaspora (for example, Ethiopian, Latin American immigrants). Some crowdfunding platforms may take a more passive approach to managing the transactions and simply act as a listing service for entrepreneurs and issuers (for example, AngelList).
- *Traditional broker-dealers*: Broker-dealers will play a major role in the crowdfunding ecosystem. They can provide follow-on revenue in the secondary markets where these emerge. Not only can they align with crowdfunding platforms that wish to be more than a funding platform but they can also act as their own funding platform. Furthermore, regional broker-dealers will work on strategies for a “funding runway” that incorporates both accredited and unaccredited crowdfund investing into a product suite that could be delivered via one platform. For example, US-based North Capital Private Securities, which serves as the principal broker-dealer for over 20 online funding portals, launched 99 fundings in February 2015 to interconnect all the deals on their client sites. This partnership allows technology companies to partner with regulated securities dealers to tackle a sector of the market that institutional banks have vacated owing to regulatory limits.

- *Crowdfunding technology-enabled angel network services*: Technologies may be deployed to reduce friction and increase transactions and transparency in angel groups and networks that are nascent in countries. This assists in bringing offline-fragmented processes online. An example is the partnership between angel network Gust and equity platform SeedInvest, where SeedInvest acts as the technology backend of Gust deals.
- *Integrated data/analytics feeds*: Service providers will create the "Thomson Reuters" of a country's crowdfunding industry that can expand to offer similar services to the rest of the private capital markets, including both reporting on private capital market transactions, trends and analytics for investors interested in the space. An example is the partnership between data analytic company, Crowdnetic, our firm Crowdfund Capital Advisors and financial reporting firm Thomson Reuters, whereby Crowdnetic will be publishing crowdfunding data from Reuter's feed.
- *Accounting firms*: Accounting firms will play an important role in the crowdfunding ecosystem where legislation may mandate that a certified public accountant provide a review of a company's financial accounts. In certain circumstances accounting firms may be necessary to perform audits on financials. For instance, under Title IV of the U.S. JOBS Act, audits are required for capital raises of over US$20 million. Hence, accounting firms are expanding to provide services to the crowdfunding industry to develop streamlined processes for issuers, crowdfunding websites and regulators. For example, CrowdfundCPA entered the market to handle the audit requirements for private companies seeking to use the regulations under the U.S. JOBS Act.
- *Escrow, title, and transfer services built for crowdfunding*: Existing companies or new entrants will create products and services to support these new funding structures. This may also create different or new products in other parts of the private capital markets over time. CrowdBouncer is an example of a company that has entered this space to handle these backend requirements. Escrow may be a challenge in regions of the world where banks are the only permitted escrow providers. Crowdfunding may be an opportunity to introduce innovation and new players into this part of private company transactions.
- *Facilitation of mobile-based offerings or transactions*: In many markets the "mobile first" development approach is the initial focus. This is particularly true in developing nations where mobile is the primary access point for Internet connectivity. Vivify Investments is an example of a platform with a mobile first technology to engage high net worth families on teaching wealth creation.
- *Cross-border money transfer*: This issue is one of the most challenging in creating diaspora capital flows. Crowdfunding may contribute to a "tipping point" along with the development of mobile banking and other online technologies, to create solutions to these issues. Governments need to work closely with policymakers and regulators to encourage rather than inhibit capital inflows. This may include cutting back on taxing incoming capital as well as facilitating external capital gains flows where there are company exits.
- *White space opportunities*: As the various types of crowdfunding develop within a country or region, there will be additional businesses that emerge to support this new industry. This is because, for an entirely new business process (fundraising online), new services will be required and demanded by the market. These services may include:

- *Education*: Companies will emerge to train entrepreneurs in how to crowdfund (as well as their responsibilities with investors' money) within the law. The same providers will develop courses for investors to be informed on how to make a crowdfund investment, the associated risks and what the law (if any) restricts on their participation. An example of this is an online education series called [Success with Crowdfunding], which educates entrepreneurs and investors about the opportunities and risks with crowdfunding.
- *Investor/Issuer fraud detection services*: Fraud is the paramount concern of regulators. Companies that wish to enter the crowdfunding ecosystem to help detect fraud before it can be committed may have potential. EarlyIQ is an example of a platform developed by a former FBI securities fraud agent to tackle the issue of fraud (www.earlyiq.com).
- *Credit card and online payment fraud prevention services:* New services must be created to enhance protection against online payment and credit card fraud so that platforms and investors can have trust in these transactions. CashRun is an example of a machine learning platform that guarantees 100% of all cleared transactions and assumes all risk for any fraud (www.cashrun.com).
- *Cybersecurity*: As in any industry with a Web presence, cybersecurity plays a critical role. Companies that provide a "seal of approval" for investors on crowdfunding platforms, to assure them that a platform meets minimum criteria and that their private information is safe, are likely to have growth potential.
- *Regulatory compliance services*: Regulations may create non-trivial and, in some cases, significant compliance and reporting requirements for companies raising money. Services should be created to remove the administrative burden from companies, ease compliance and provide greater transparency for all market participants. Companies such as Crowd Check (www.crowdcheck.com), Crowdentials (www.crowdentials.com) and iDisclose (www.idisclose.com) are examples of best practice.
- *Data analytics services*: Opportunities to create actionable dashboards, metrics, measurements, and analytics opportunities may be significant. One potential comparable would be to consider the growth and success of these services in the online advertising market. Crowdnetic (www.crowdnetic.com) is a leader already in this field.
- *Investor relations' tools*: Another area where services are likely to emerge to support best practice is investor reporting and relations. Companies should emerge to offer streamlined reporting tools that both allow entrepreneurs and issuers to record and transmit what is taking place within their businesses and ease year-end reporting. Companies that provide tools that not only streamline the communication channel between entrepreneur and investor but also allow investors to play a more active role in the growth of the business will present attractive opportunities. KoreConx is one example of a company that is building a technology to communicate with investors in a secure fashion.

- *Shareholder rights' services for crowdfunded shares*: A subset of this would include services required to represent crowdfund investors when venture capital or private equity firms invest at a later stage.
- *Campaign management/marketing services*: Service companies will be created to assist entrepreneurs in branding, marketing, and successfully executing entrepreneurs crowdfund investing campaigns as well as providing additional social marketing reach.
- *Gamification and social connectivity*: A subset of this includes services that enhance the crowdfunding experience, strengthen the wisdom of the crowds, and better connect market participants.
- *Accelerator and incubator-focused services*: As accelerators and incubators begin to incorporate crowdfund investing and crowdfunding, these entities may either be customers for, or foster the creation of, crowdfunding technologies. Not only do accelerators and incubators offer good deal flow for crowdfunding platforms and investors but they are also a good starting point for entrepreneurs who might lack business acumen. This is particularly true for emerging markets or developing economies with nascent startup ecosystems.
- *Media*: The stories that relate to this industry will be significant, ranging from covering local technology companies being built to support the industry to innovative entrepreneurs who were successful with a campaign. Media companies may enter the space to develop television programs around funding winning ideas. Magazines and other forms of media will appear to cover these innovations.
- *Traditional and online entertainment*: There are several television programs, such as The Startup Hour (www.thestartuphour.com), currently under development that focus on crowdfund investing. Companies will emerge to provide related products and services to tie-ins to such shows.
- *Insurance*: Some governments, like Chile, are providing guarantee programs to encourage investors to make limited risks. These insurance endeavors increase market participation and create opportunities for insurance companies to create policies directed at the crowdfunding ecosystem. Such policies include directors' and officers' liability (D&O) insurance for emerging companies and fraud insurance. Global player AIG has also launched their own line of crowdfund related insurance products.
- *Secondary markets*: Secondary market players, like NASDAQ Private Market (www.nasdaqprivatemarket.com), may be formed to create liquidity for securities purchased in accordance with regulations created. These market participants stand to earn commissions on sales. In the United States, several existing primary issuance crowdfunding platforms are considering adding a secondary market feature. In other smaller markets, there may be a role for the stock market in a country to provide a market for secondary trades of crowdfunded shares. The challenge and opportunity, however, is that these stock markets must take a "crowd-enabled" approach to setting up and regulating these markets, rather than expecting these

markets to function effectively by just taking the same regulation and requirements from the main stock board and cutting and pasting it on the new "crowd-board".
  - *Business processing and facilitation services*: Some of these crowdfund investing focused services will have spillover opportunities in other more traditional investment markets, for example, services that facilitate the transactions and create new business process or refine existing process.

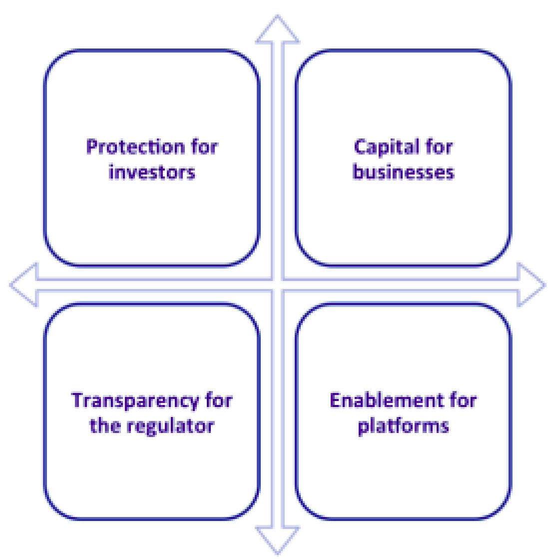
Best Practice in Crowdfunding Policy

Traditionally, creating new financial regulations is a process with limited outside consultation. Creating an industry for equity and debt crowdfunding in a country is a significant undertaking that requires increased collaboration among stakeholders. Regulators, governments, investors, and industry can collaborate to form a balanced framework upon which legislation and regulations can be enacted. An open dialogue provides an opportunity for leaders from government and key sectors to build a consensus around a framework that results in a rational process to form legislation and regulation for securities-based crowdfunding.

The CCA Balanced Stakeholder Framework™ has been designed to assist the ecosystem of government, regulators, investors, and entrepreneurs to balance each group's needs to reach the ultimate goal: to foster innovation, enable access to capital for entrepreneurs and SMEs, and the creation of jobs. This framework has been applied in several countries around the world and has helped groups to answer key questions in creating a crowdfunding industry that is transparent, efficient, and scalable. The framework also offers the flexibility that enables it to be used by both large and small countries across the spectrum of development.

The CCA Balanced Stakeholder Framework™ addresses the needs of each audience in policy and regulation:

- *Protection for Investors*: This is a core tenet in all securities regulation globally, to protect investors via adequate disclosure of relevant information to enable them to make informed decisions. If constructed properly, crowdfunding has the potential to better provide investor protection because the data is online in databases and can be standardized and reported more easily than data from traditional securities filings that are not easy to understand or use.



- *Capital for Entrepreneurs and SMEs*: The goal in developing crowdfunding is to create opportunities for SMEs and entrepreneurs to gain access to capital not available before. If the regulations and processes to access this capital are too expensive, difficult, or unmanageable, then the time spent creating the regulation and infrastructure will fail because businesses and entrepreneurs will not use it. They will continue to do without access to capital and will not be able to reach their full potential.
- *Transparency for Regulators*: Crowdfunding cannot function without transparency. Technology creates the transparency that enables transactions to be completed and trust to form. Crowdfunding offers the possibility to provide regulators with greater access to data and information on offerings than has been available in the past. That transparency can support effective decision making by regulators, to modulate best practice and regulations more rapidly than was possible before.
- *Viability for the Crowdfunding Industry*: If crowdfunding platforms are not allowed to be profitable, self-sustainable businesses, the ecosystem will fail because the platforms will cease to operate. Stakeholders and decision makers can work to provide adequate oversight of platforms, but in a way, that leverages the technology to make it lightweight and efficient for platforms to comply.

Drivers that inform the implementation of the CCA Balanced Stakeholder Framework™

Successfully implementing the CCA Balanced Stakeholder Framework™ requires the presence of a number of key drivers:

- Internet access for a majority of the population
- Mobile communications and social media in the country
- Business formation laws & bankruptcy laws
- Money transfer laws
- Securities and lending regulations, and
- Cultural issues (trust, entrepreneurship as an acceptable career, transparency, risk tolerance in business transactions)

Important Issues to be considered within the CCA Balanced Stakeholder Framework™

In addition, there are many important issues and key questions that must be considered for successful implementation. Some of the important issues and questions are:

<u>Protection for Investors</u>

- Should there be individual investment limits for investors?
- Should there be transfer restrictions for securities?
- Should there be limits on the number of shareholders per issue?
- Is there a need for “educationally accredited investors” in crowdfunding, and reassessing the requirements to be an accredited investor?
- Should there be investor education needs/requirements/available tools?

Capital for Entrepreneurs and SMEs

- What types of businesses entities will use crowdfunding?
- What should be the maximum offering size?
- How important is closing speed for offerings?
- What should be the offering documents and prospectus requirements? What online tools are available?
- What should be the financial disclosure requirements?

Transparency for Regulators

- What Investor verification (Including “know your customer,” anti-money laundering and anti-terrorist verification) services exist or need to be created?
- What pre-filing and “testing the water” provisions for issuers may be allowed?
- What Diaspora investor specific communication/education/pilot programs can be developed to strengthen regional financial engagement?
- What can be done to resolve money transfer/exchange control issues to enable cross-border investment?
- What should be ongoing disclosure and filing requirements, including termination of reporting requirements?
- What should be the data monitoring and communication methods with the crowdfunding industry and industry trade association?

Viability for the Crowdfunding Industry

- Does a crowdfunding professional association exist or does it need to be created?
- What should be the is the advertising and general solicitation guidelines (including via the Web and social media)?
- What should the Crowdfunding platform requirements be for a common data standard for the industry?
- What should the crowdfunding platform liability preemption be? (Equivalent to a safe harbor that exists for traditional offerings)?
- What consideration should be given to secondary markets for securities?
- What kind of liability limits for platforms should be created?

Best Practice for Governments in Fostering Crowdfunding

Governments have a critical role to play in fostering a crowdfunding ecosystem, including:

- Identifying and convening key individual stakeholders within the government to become government champions of crowdfunding. Ideally these individuals will be former entrepreneurs themselves and hence will be familiar with the challenges of starting, scaling, funding, and dissolving corporations. These stakeholders should become part of a larger group of industry advocates and private sector stakeholders to create a simple and consensual framework for crowdfunding based on the CCA Balanced Stakeholder Framework™.

- Developing modernizing incorporation and bankruptcy laws. This may include policies that encourage the formation of corporations (preferably online) without undue time, bureaucracy, or cost, as well as policies that foster the dissolution of corporations in the event that they fail or go out of business.
- Developing policies that foster the enablement of both the crowdfunding association and the ecosystem. This includes encouraging the development and funding of ecosystem enablers such as incubators, accelerators, and coworking spaces, and providing incentives for mentors to engage in these. In addition, governments should allocate the relatively small amount of funding needed to support and sustain the crowdfunding association and ecosystem from relevant technology, entrepreneurship, innovation and economic development ministries and agencies.
- Crafting balanced legislation (based on the CCA Balance Stakeholder Framework™) that balances the interests of entrepreneurs who need capital, with investors who need protection, with regulators who need oversight, and with crowdfunding intermediaries who need enough freedom to operate without being burdened by bureaucracy and costs.
- Policies that encourage risk taking by investors and assist in the mitigation of those risks by offering:
    - Government/crowd co-investment schemes in which the government creates funds to invest both alongside investors or acts as a top-up fund (where investors have shown a certain degree of interest).
    - Investment guarantees and insurance policies that protect a proportion of an investor's investment should a company be fraudulent.
    - Tax incentives that either waive capital gains for investments that are held over a certain period of time or allow for the write off of losses for investments made into qualified small businesses that fail.
    - Other policies that support the utilization of crowdfunding as a tool for additional distribution of capital already allocated to entrepreneurship and SME development that may not be fully utilized today.
- Policies that enable new market entrants to emerge, especially where existing financial market participants are not serving this new market. One potential example of this is allowing the creation of third party escrow agents to serve crowdfunding platforms that are not tied to existing financial institutions. These escrow agents could operate at a lower cost and with regulatory oversight and government backing.
- Connecting the different parts of the government such that the branches work together and communicate with each other regarding relevant activities. An example of good practice would be to have the policymakers and regulators discuss with the Chamber of Commerce the rules on crowdfunding; the Chamber of Commerce discusses the impact of crowdfunding with the tax authorities; and the Ministry of Science and Technology talks with the Development Banks on where they need support and assistance.

Important Dynamics in Building a Stable Crowdfunding Ecosystem: Regulator–Industry Relationship: Trust Building and Transparency to Create a Solid Foundation

Trust lies at the core of all financial transactions, including crowdfunding. Building a foundation for a successful crowdfunding industry requires trust between the crowdfunding industry and the financial regulatory authority. This trust does not happen overnight, nor does it happen without a concerted effort from all parties. It is crucial that as a crowdfunding industry emerges that they form an alliance and speak with one voice. This is important because it provides a forum for everyone interested in crowdfunding to convene as well as representing the industry with a unified voice when speaking with the media, governments, or regulators.

Nearly every industry (financial and non-financial) forms some kind of trade association to help create a strong, successful, and ethical industry that can function within whatever regulatory regime exists, and advocate for favorable regulations to enable the industry to grow. Emerging best practice includes the creation of a national crowdfunding association to help the crowdfunding industry to grow and succeed. The association should be kept simple and should not require enormous infrastructure or time commitments, the focus of its activities should be the:

- Creation of an initial statement of principles that all members agree to as part of their membership of the association. These principles should be common sense items like the following that form the foundation of a strong and ethical industry that endorses The Balanced Stakeholder Framework™ approach to enabling crowdfunding:
    - Establish strong protection for investors in the form of an Investor's Bill of Rights, including tests to assess investors' understanding of risk, criminal background checks on issuers, and adequate disclosures by issuers;
    - Ensure confidentiality of investors' personal financial information;
    - Ensure that investors do not exceed statutory investment limits, by implementing standardized reporting and communication among platforms;
    - Establish standard communication processes for transparent flow of information between the issuer, the investor, the intermediary, and the regulatory agency;
    - Develop a code of conduct for crowdfunding platforms, with enforcement mechanisms to punish bad actors;
    - Create a recognizable brand common to trustworthy intermediaries (akin to VeriSign or BBB).
- Definition of standards on how member platforms should operate and conduct their business and with which members agree to adhere to as a condition of membership in the association. These guidelines set minimum standards for operation and a level playing field for members.
- Registration of crowdfunding platforms with the securities regulator – only members of the association should be able to apply to be registered. Such a check-and-balance system helps to significantly reduce the likelihood of fraudulent platforms and unites industry and regulator in a common cause.

- Construction of data standards so that all platforms can send key data elements to the regulator on a regular basis. Transmitting this data on a periodic basis enables crowdfunding platforms to have ongoing dialogue with the regulator based on data regarding the market and how it is functioning. This data will increase opportunities for the regulator to agree to an annual review of funding rules to make commonsense modifications that can help improve market dynamics while maintaining a balance among the stakeholders. Relevant data elements will vary to some degree depending on a number of factors. These elements should be created and evaluated on a country specific basis. Possible data elements may include:
    - Number of companies funded in the period
    - Names of companies listed in the period
    - Names of companies funded in the period
    - Amount funded by company in the period
    - Type of funding closed (equity, debt, and so on)
    - Number of employees at the close of funding
    - Other data that both the crowdfunding association members and securities regulator agree are helpful in promoting the growth of the industry and better transparency for the regulator.
    - This data will increase opportunities for the regulator to participate in an annual review of crowdfunding rules allowing modifications to help improve market dynamics while maintaining a balance among the stakeholders.

The Role of Education and Training

Education and training has a key role to play in protecting both investors and companies seeking funding. Relevant entrepreneurship training organizations must add crowdfunding training to their curriculum to enable them to master the art and science of crowdfunding. While there is nothing new about raising money to support an entrepreneurial endeavor, there is a need to raise awareness about crowdfunding to avoid confusion. Education will play a critical role in markets where crowdfunding is emerging because although the process is old the system is new.

Best practice in education include the following key elements:

1. Explaining the different methods of crowdfunding (that is, donation, rewards, equity, debt).
2. Reviewing the benefits and risks of each type for the entrepreneur, the investor, and the government under which the ecosystem is emerging.
3. Determining which type of crowdfunding best matches a particular company's or initiative's need.
4. Detailing the journey an entrepreneur must take to move from idea to campaign to funding.
5. Instilling in entrepreneurs the role of capital, how to be responsible with investor's capital, and how to communicate with investors and backers after funding.
6. Teaching entrepreneurs how important it is to carefully plan their crowdfunding campaigns to significantly increase their chances of success.

7. Helping entrepreneurs understand the requirement to build their social network both offline and online prior to the launch of their campaign to increase the likelihood of success.
8. Teaching entrepreneurs the importance of "give, give, give, ask" when engaging their social network. It is vital that entrepreneurs give to their social networks before they ask for money and support to demonstrate that they are good members of the community.
9. Where debt and equity crowdfunding initiatives begin to gain traction, engaging government officials, policymakers, and regulators in a dialog and educating them on the economic benefits of job creation, entrepreneurship development, and innovation.

Education and training is crucial because it teaches entrepreneurs how to raise money online as well as teaching investors how to make informed decisions and not risk more money than they can afford to lose. When done properly, education programs built to support crowdfunding extol entrepreneurship, innovation, job creation, and gender inclusivity. For governments, more new businesses mean more tax revenue. Economies that develop policies to support securities-based crowdfunding address major economic detriments that may include funding gaps, poor economic output, brain drain, and inequality. Educating entrepreneurs and investors can be done online or delivered in person via partnerships with accelerators, incubators, and universities. Emerging markets, that have fewer skilled entrepreneurs, have been using crowdfunding education as a filtering mechanism. For instance, entrepreneurs in Kenya that wish to raise funds on equity platform LeLepa must take and pass an education program in order to be eligible to raise funds on their platform. Requiring entrepreneurs to educate themselves about the process before they embark upon it forces them to expend time, energy, and sometime even enrollment fees. This shows that they have significant commitment before applying to platforms for funding. There are also ways to leverage technology not only to educate but also to make sure entrepreneurs are compliant. Traklight is an example of a company that assists entrepreneurs raise funds by making sure they have all the diligence and documentation that investors, lawyers, or certified public accountants would need.

One of the critical components of skilling entrepreneurs in the use of crowdfunding is in their understanding and experience regarding the time commitment required to be successful in a crowdfunding campaign. Entrepreneurs who understand that raising funds is a full-time job and are willing to dedicate the time and resources to doing so are not only more likely to succeed but make for better entrepreneurs once funded. Entrepreneurial training should highlight the value of simple "social contracts" between the entrepreneur and organization hosting the crowdfunding training to keep entrepreneurs accountable to meeting milestones and deliverables during the process of creating a crowdfunding campaign.

How Entrepreneurs/SMEs Can Best Use Crowdfunding

One of the biggest issues for entrepreneurs is to understand which type of crowdfunding is the most appropriate for their needs. If entrepreneurs fail to select the right kind of crowdfunding model for their campaign (that is, donation, rewards, debt, or equity) they are unlikely to reach their funding target.

To assist answering this complex question, Crowdfund Capital Advisors has conducted extensive research and analysis into the factors resulting in successful campaigns, based on the type of business, the stage of business, and the individuals backing the campaigns.

Entrepreneurs need to answer the following questions to the best of their abilities to help them decide which form of crowdfunding is likely to be most appropriate for their needs:

1. *What type of business do you have*? To what degree does it provide a service like a restaurant or hair salon or provide a product that you sell to customers?
2. *At what stage is your business*? Is it just an idea, does it have a business plan with a proof of concept, or is it established with customers and sales?
3. *What is the growth potential for your business*? Is it a traditional type of business that will have slow or moderate growth or is it a tech company that has high growth potential?
4. *What is the risk profile of your likely investors*? Are they likely to be risk takers or conservative?

Thus, a startup at the idea stage or a nonprofit is most likely to seek backers who are giving their money to support an entrepreneur or a cause and so donation-based crowdfunding is likely to be most appropriate. A startup with proof of concept, on the other hand, may seek investors with a higher risk profile, and so a rewards-based crowdfunding model may be pursued. An established and traditional SME seeking conservative investors is likely to find that debt-based crowdfunding is the right approach because it can provide an immediate return via payment of principal and interest, while an established SME in the technology sector with higher potential for growth is a possible candidate for equity-based crowdfunding where investors see the potential for an exit.

The Funding Void in Brazil

Brazil has a number of similarities to the rest of the world when it comes to funding startups, small or medium enterprises (SMEs). These business owners either have to fund their businesses themselves, seek capital from close friends or family, Angels, VCs, or for some very lucky medium-sized businesses with very strong financials, they may be able to find loans from banks or other institutions (usually at very unfavorable rates/terms). However, none of those are a one-size-fits-all solution and each have their very limited sweet spot and funding size. In most cases, the answer is "there is no capital for your business". This is why the funding void exists. The funding void is the area where capital doesn't exist because one source of funding (personal finances, friends, family) ends before another one (VCs) begins. In our research and conversations with ecosystem players in Brazil, this funding void ranges from R$200,000 to R$2,000,000. While most companies do not qualify for Accelerators, those that do can only access up to R$200,000. Venture Capital doesn't begin in earnest until R$5,000,000 (though there are some investors interested in the > R$2,000,000 range, including government agency backed VC funds). Hence depending on the size of company and capital needs, this void can be very sizeable and today, there are no funding solutions/strategies in Brazil to address this void.

This is what securities-based crowdfunding aims to fill. **It is important to understand that crowdfunding is NOT deregulation - it is re-regulation. It is a modern regulatory infrastructure that enables regulators to have better transparency and stronger, more effective investor protections than has ever been possible in the past.** By leveraging tools that we are accustomed to today (e.g. the Internet, regulated crowdfunding websites, online valuation plug-ins, online due diligence tools, online money transfer technologies and online investor relations software) entrepreneurs with viable businesses can upload information about their company, their goals and their investment and investors can review this information, make an investment decision and commit capital. By bringing the process online, it removes the challenges in following up with many individual investors, one-off meetings and asymmetrical information. It also standardizes the process and hence streamlines both the flow of information and capital. Bringing the process online creates a digital footprint of the information for regulators who need to police the markets but it also speeds up the entire process. For companies that either live or die based on cash flow, this could be the difference between access to capital or a death blow.

Crowdfunding / Online finance is the first step in the modernization of the private capital markets. This process increases transparency, investor protection, agility and liquidity in private company transactions that have never been possible before. We can see the benefits of moving public stock markets online 20 years ago. Now technology and our business practices are ready for the private markets to move online. Three important factors in this process that Brazil should consider:

1. Utilize tools to create standardized documentation for crowdfunding offerings. These tools exist today in other countries and can be adapted to use in Brazil. One example of documentation standardization in the US is www.idisclose.com.
2. Utilize common data standards across all platforms in Brazil. These data standards are recommended for the required data to help promote transparency, not to give away trade secrets or business practices of platforms or issuers. The crowdfunding industry can work together with regulators to utilize the currently available global data standards on crowdfunding.
3. Utilize independent and cost effective business valuation services. Today there are modern services that can render a data-driven business valuation at much lower cost and much faster/easier than was available in the past. These tools promote transparency and investor protection. Brazil should seek out these services that are available today that have global experience and track record that can be offered in the Brazil market for under R$500.

With the right framework, there is much potential

It takes a company in the United States about 1 year to close a round of financing. As revealed in our Modern Private Capital Markets Webinar, thanks to Regulation Crowdfunding the time to close a round of financing has been reduced to 135 days. These companies are raising on average US$245,000 (~R$831.640). The average successful crowdfunded deal has about 279 investors and these investors are investing on average $879 (~R$2.984) each. Because this is happening online we can tell that if a company does not hit its minimum funding target within 38 days it is likely that the campaign will fail. Currently 46% of companies using Regulation Crowdfunding are successful. If you consider that this is the relative beginning of an industry, these numbers are very encouraging. Brazil can enjoy the same degree of success if it crafts the right policy that fills not only the funding void but gives the industry enough breathing room to expand.

Positive Aspects of the Proposed Crowdfunding Legislation

In reviewing the proposed framework there are several promising aspects.

1. First and foremost, the basic tenants of crowdfunding are well understood. Issuers are allowed to raise money online from investors provided that Platforms are registered with the CVM. This is the most important step to controlling who can raise funds, how information and capital flows and what is captured in a digital footprint. Together this is important in curtailing any potential fraud. The CVM understands that it is the role of the crowd to perform the diligence on an offering and has removed the pre-approval process that was previously required.
2. Any type of security including debt and equity instruments are allowed. This allows both retail operations that have customers and cash flow, as well as technology companies that could be part of an acquisition, the ability to raise capital under structures that are beneficial to investors. In other words, this allows for exit potentials from these different types of securities, based on the business type.
3. The pool of companies that can benefit from this opportunity was increased to R$10M in Turnover (Revenue) and they can raise up to R$5M per round. Given the data coming out of the US and Europe these are fair starting points.
4. No cap was put on the number of investors that can be part of a crowdfunded offering. This is important particularly when it is likely that developing economies will have many smaller investors over a developed economy that will have fewer, larger investors.
5. Investors are capped at investments based on their qualification. Smaller retail investors are capped at R$10.000 per round unless they have gross income or liquid assets greater than R$100.000 and then they can invest up to 10% and Qualified investors have no cap giving them the ability to step in with more capital (provided they have a liquid net worth greater than R$1M)
6. Prudent disclosures including a business plan, financial statements and valuation are mandated as well as risk factors and investor education documents that train investors on failure rates, lack of liquidity, lack of a secondary market, etc.
    a. We would strongly encourage the CVM to look for new FinTech tools that can assist in the standardization of these offerings, helps issuers create offering memorandums, risk disclosures and valuation reports. Example of such companies were included in pages 4-7.
7. And finally, information is required to be reported to the CVM each year including platform activity, number of offerings, number of successes, start and end date of successful

offerings, amount raised, valuation and number and type (qualified, retail, etc) of investors. All this will be good for transparency purposes and bring credibility to the market.

Elements of the Legislation Where CCA Recommends Improvements

In reviewing the proposal, there are several hurdles that may impede the ability for securities crowdfunding to flourish. Given our global experience, we suggest the proposal be updated to address the following:

1. **Create suitable escrow service and efficient money transfer services to improve transparency and market efficiency. Also, enable a "cooling off period" and overfunding of capital commitments to improve investor protection and liquidity of transactions:**
    a. We would encourage the government to assist in the creation of alternative escrow solutions that can act as an intermediary. Such FinTech solutions exist elsewhere in the world, are cost effective, technology-enabled, and tackle this challenge seamlessly.
    b. We would suggest the CVM require all commitments to be affirmative until 72 hours prior to closing. If more than a certain percent of the capital commitments is withdrawn, then all investors need to be notified before offering may close.
    c. To support this cooling off period, CCA recommends the ability for campaigns to "oversubscribe" by 20% so that in case some investors do rescind their interest during the cooling off period, it does not damage the funding round's ability to close without hitting its funding target.
    d. At a minimum, if alternative escrow cannot be utilized at the onset, then the current best practice of 'signed binding contracts during the offer period and money transfer directly to the (confirmed) company account only if the offer achieves success' should be recognized and permitted.
2. **Self-disclosure of financial suitability should continue to be the standard in crowdfunding as it is today in other investing in Brazil. This should be combined with robust investor education/information provided to investors prior to making an investment, about the risks of investing in SMEs and startups**. Today, investors in Brazil are not required to disclose their financial information to make an investment. This is based on historical and cultural reasons. To require new financial disclosures for crowdfunding that are not required for any other type of investing will destroy the vast majority of the crowdfunding market, which will waste all of the hard work by the government and industry to create balanced regulation that creates a new way to fund companies. Financial self-disclosure for crowdfunding would impose a burden on a new market that does not exist in any other market in Brazil. CCA strongly recommends allowing self-certification of investors as long as the investments are made within the regulatory limits. Platforms should notify all investors that if they make material misstatements about their financial position, the platform, issuer and government will be held harmless for the losses.

3. **Offer greater transparency on the Raise and Spend.** The final rules should allow for minimum and maximum funding targets provided that a company show different scenarios for both. This is beneficial for companies that are over funded because they can have stretch goals that are common in rewards crowdfunding that may allow a company to achieve higher results with more capital. Having a baseline minimum target and corresponding scenario will give investors the opportunity to evaluate whether they believe the company can accomplish its objectives while only hitting a minimum funding target. We believe this is a strong addition.
4. **Utilize global data standards for issuer/investor information so that platforms can efficiently deliver a data set, on a periodic basis, to the financial regulator that will improve transparency and investor protection:** Capital markets operate effectively when there is data and analysts to review the data. Within securities-based crowdfunding there are at least 30 key variables that can provide insight into private offerings. By tracking these variables, the industry, media and regulators can see where capital is flowing, what types of companies are receiving funding, average valuations and much more. All of this provides transparency and credibility in the market. We would encourage the CVM to either create such a database or partner with the Brazilian Crowdfunding Association to have them collect data and monitor the industry.
5. **Create a "safe harbor" to limit Portal liability for misstatements by issuers**. In the proposed rules Platforms are responsible for the veracity of the information in an issuer's disclosures. In theory, this seems logical, however in practice it is nearly impossible. Consider a biotech startup that is seeking capital and has Intellectual Property developed by a PhD. A platform nor its employees could ever understand the intricacies of that intellectual property nor whether something was factually incorrect. However, another PhD who might be a potential investor may. That is the role of crowdfunding, to have the crowd perform that diligence. Not the platform. To have the platform perform a full audit would be too costly and issuers would never be able to bear those costs. In addition, platforms can't handle that risk or the costs of that compliance. We would propose that following the tenets of crowdfunding, the process of diligence be done by the investors and any material misstatements that the platform was aware of at the time of disclosure they may be held accountable for those. Platforms should have a responsibility to conduct standards-based diligence on all issuers, and if they follow those standards-based diligence methods, they should not be held liable for misstatements that fall outside of that process. If this issue is not addressed, it will dramatically limit the ability of portals to survive/succeed.
6. **Support robust communication between investors and issuers via portals and other reasonable/standard communication methods**. Please consider fully leveraging the investor protection power of the Web, social media and face-to-face communication. In the proposed rules entrepreneurs are restricted on how they may communicate with investors. Portals are restricted on how they may communicate with investors as well. Issuers and Portals are not allowed any external contact (i.e. telephone, investor events, webinars, etc) with investors. In theory, while this seems logical, it is impractical with how capital formation takes place and actually damages investor protection. The goal of the crowdfunding framework should be to include these forms of communication rather than

preclude them. CCA suggests that communication channels be opened to allow issuers and portals to drive investors to the portal to learn more about an offering but restrict the discussions to the information available in the materials made available via the platform. Portals should be allowed to host webinars, recorded calls and investor events such that other prospective investors may benefit from that information if it is digitally recorded and stored on the portal. A critical component to the success of crowdfunding is the crowd. You cannot crowdfund without a crowd and the success of an offering comes down to communicating with the crowd that is closest to an issuer, not those an issuer has no prior relationship with. By supporting robust communication that will be part of the "digital footprint" of the issuer, regulators have a more complete and accurate record of what was communicated and when between issuers and investors.

7. **Potential investors should be required to register on the crowdfunding platform before they can view issuer information. This is important for issuer security, investor protection, platform security and money laundering protection.** Under the proposed rules, investors would not have to register with a portal to review issuer information. This presents 3 significant issues.
    a. Without having investors register, Portals cannot tell who is reviewing issuer information. In the case of sensitive information or intellectual property this would present a challenge because in a log in scenario, the platform would know which investors are reviewing sensitive information if in the unfortunate case that a competitor was sniffing for intel.
    b. Without having potential investors register, portals cannot keep potential investors informed as to what is happening with an issuer, on the platform or with the industry in general. This would not allow the platforms to scale commercially. We would recommend that portals be allowed to register any potential investors.
    c. It is important for both portals and regulators to know who is on their platforms and making investments to protect against money laundering.

Summary

If the goal of securities-based crowdfunding is to get capital to entrepreneurs where it doesn't exist so they can create, grow and scale businesses and hire people, then the CVM needs to create policy that creates a transparent and credible market without being overly bureaucratic or costly. Within the current ecosystem, traditional funding players (VCs) are limited in their capacity. Securities-based crowdfunding can solve this problem. Within the current system, investing in startups and SMEs has been restricted which has created a self-fulfilling culture that investing in startups and SMEs is a challenge. Securities-based crowdfunding can solve this problem. It will also allow more investors to experiment with long-term investments and alternatives rather than simply putting their money into a savings account. In general, the headlines from the proposed rules are positive, but learn from Italy's mistakes, securities-based crowdfunding requires the right balance, or else if you build it, they will *not* come.

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