

Sebi wants crowdfunding bodies to warn investors

Sebi directs angel investor networks and start-up funding platforms to issue a disclaimer that crowdfunding platforms are neither bourses nor authorized to solicit investments

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The Sebi directive comes against the backdrop of an increase in crowdfunding activity in the start-up space and the absence of any law to govern it. Photo: Mint

Mumbai: The Securities and Exchange Board of India (Sebi) has directed angel investor networks and start-up funding platforms to warn every company and investor through a disclaimer that crowdfunding platforms are neither stock exchanges nor authorized by the capital markets regulator to solicit investments. The disclaimer must also state that the securities traded on these platforms are not traded on any regulated exchange.

The directive, in a July-end letter, comes against the backdrop of an increase in crowdfunding activity in the start-up space and the absence of any law to govern it.

Mint has reviewed a copy of the letter.

Some of the angel-network operators and crowdfunding platforms have already complied with the directive. These include Venture Catalysts Pvt. Ltd, Lets Venture Online Pte Ltd, and GREX.

Sebi's move will help bring more clarity to investors on the legal aspect of start-up funding, which in turn will help build more confidence among potential investors, said Shanti Mohan, chief executive officer of LetsVenture, which provides an online platform aimed at enabling angel investments in start-ups.

"We, along with all angel investor networks and crowdfunding platforms, have received the Sebi letter. We are a serious enabler in the start-up funding space and there is nothing we do that breaches the law framed by any regulator," Mohan said.

"At present, there is no clear law on start-up funding or crowdfunding in India. All angel investors using our platform have investments of more than Rs5 lakh and we feel Sebi's move will only help entities like us serve better by boosting investors' confidence and removing some of the grey areas in the legality of start-up funding."

India has at least 3,100 start-ups and over the past few years funding activity in the unlisted space has intensified. The Union ministry of finance, in its last budget, has clearly stated the government's intention to support start-up activities, while Sebi has been working since 2014 on ways to bring start-up funding within its regulatory ambit.

Sebi's diktat to crowdfunding entities stems from the concern that transactions on crowdfunding platforms somewhat emulate stock exchanges, but since they are not regulated by Sebi, a crucial clause of the securities law is violated.

As per the Securities Contracts (Regulations) Act (SCRA), any entity facilitating transactions in securities or investments between two or more parties falls under the definition of an exchange, which has to be mandatorily recognized by Sebi. And if such an entity is defined as an exchange, then it can deal only in listed securities.

The existing angel networks and online crowdfunding platforms for start-ups breach these SCRA norms. So, there is no law at present under which entities working like an exchange can be allowed to deal with unlisted companies or securities.

"Sebi has reportedly sent notices to various online equity crowdfunding platforms seeking information to understand the legality of the fund-raising process. If the investor and investee-specific disclosures are coupled with some guidelines by Sebi for standard disclosure/caution about risks regarding private equity investments, particularly, market risks, liquidity issues, etc., it could will really boost the growth of the sector in a mature fashion," said T.P. Janani, a lawyer with Nishith Desai Associates.

On 2 August, the markets regulator formed a 10-member committee on financial and regulatory technologies—headed by Manipal Global Education chairman T.V. Mohandas Pai, who is also a former chief financial officer of software services firm Infosys Ltd—to examine trends related to fintech in the securities market worldwide and advise the regulator on opportunities and challenges.

Before framing the final regulations on crowdfunding, Sebi may adopt a trial-and-error approach, commonly referred to as a sandbox approach, in terms of policy framework for anything related to fintech.

"The regulator should consider introducing any major substantive restrictions only after analysing progress and concerns under the sandbox approach over a defined period of time," said Janani.

Two persons directly familiar with Sebi's latest thinking said the committee on fintech is likely to hold its first meeting within a week to discuss framing the first set of rules for crowdfunding and legalizing this activity in India.

In August last year, through an informal guidance on its website, Sebi had cautioned the public that digital platforms are "neither authorized nor recognized under any law governing the securities market".

That neither stopped angel investors from financing start-ups nor prevented crowdfunding platforms from pooling money from thousands of potential investors.

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