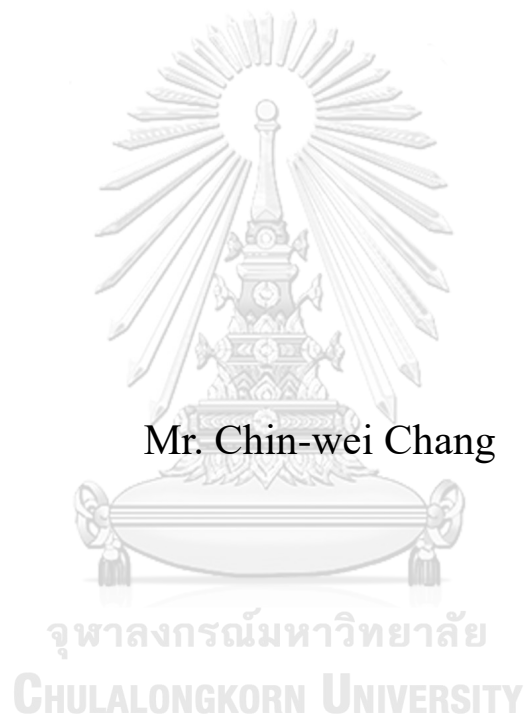


The Supervisory and Regulatory Dilemma on Equity-based  
Crowdfunding in Taiwan



A Thesis Submitted in Partial Fulfillment of the Requirements  
for the Degree of Master of Laws in Business Law

Common Course

FACULTY OF LAW

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“ปัญหาเชิงการควบคุมและกำกับดูแลเกี่ยวกับการระดมทุนคราวด์ฟนดิ้ง  
แบบหุ้นในไต้หวัน”



วิทยานิพนธ์นี้เป็นส่วนหนึ่งของการศึกษาตามหลักสูตรปริญญานิติศาส

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จุฬาลงกรณ์มหาวิทยาลัย  
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Thesis Title	The Supervisory and Regulatory Dilemma on Equity-based Crowdfunding in Taiwan
By	Mr. Chin-wei Chang
Field of Study	Business Law
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จีนเหวย ฉาง :

“ปัญหาเชิงการควบคุมและกำกับดูแลเกี่ยวกับการระดมทุนคราวด์ฟันดิ้งแบบหุ้นในไต้หวัน”. ( The Supervisory and Regulatory Dilemma on Equity-based Crowdfunding in Taiwan) อ.ที่ปรึกษาหลัก : อ. ดร.ภูมิศิริ ดำรงวุฒิ

คราวด์ฟันดิ้งแบบหุ้น (Equity-based Crowdfunding) เป็นช่องทางที่สำหรับ การระดมทุนในไต้หวัน เนื่องจากแหล่งเงินทุนแบบดั้งเดิมไม่สามารถตอบสนองความต้องการด้านเงินทุนของผู้ที่จะสามารถระดมทุนผ่านคราวด์ฟันดิ้งแบบหุ้นได้ แต่อย่างไรก็ตาม ความไม่สมดุลของข้อมูล (Information Asymmetry) เกิดขึ้นระหว่างนักลงทุนและผู้ระดมทุนในการคราวด์ฟันดิ้งแบบหุ้น เนื่องจากผู้ระดมทุนเป็นเจ้าของและดำเนินธุรกิจ พวกเขาจึงมีข้อมูลทั้งหมด แต่นักลงทุนไม่มีข้อมูลดังกล่าว GISA Regulation ของประเทศไต้หวัน สามารถขจัดความไม่สมดุลของข้อมูลได้ โดยกำหนดให้ผู้ระดมทุนมีหน้าที่เปิดเผยข้อมูลที่สำคัญกับการตัดสินใจลงทุน

วิทยานิพนธ์นี้พยายามแสดงให้เห็นถึงความจำเป็นสำหรับ GISA Regulation ในการลดความไม่สมดุลของข้อมูล โดยเมื่อเปรียบเทียบกับ GISA Regulation กับกฎหมายและระเบียบข้อบังคับต่างๆ ของสหรัฐอเมริกาและสิงคโปร์ วิทยานิพนธ์นี้พบว่าระเบียบ GISA Regulation ควรกำหนดให้แพลตฟอร์มคราวด์ฟันดิ้งในไต้หวันต้องมีหน้าที่จัดการเรื่องความเหมาะสมในการลงทุน (Suitability Obligation) นอกจากนี้ GISA Regulation ควรจะถูกรวมอยู่ในพระราชบัญญัติหลักทรัพย์และตลาดหลักทรัพย์หรือประกาศใช้โดยรัฐสภา เพื่อเพิ่มการคุ้มครองผู้ลงทุนสำหรับการคราวด์ฟันดิ้งแบบหุ้น

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on Equity-based Crowdfunding in Taiwan. Advisor: Lect. Dr. POOMSIRI  
DUMRONGVUTE, Ph.D.

Equity-based crowdfunding is an important portal for raising fund in Taiwan because the traditional financing sources are unable to meet the capital needs of those who would be able to raise fund through Equity-based crowdfunding.

However, Information asymmetry has existed between investors and fundraisers in equity-based crowdfunding. Because fundraisers own and operate the business, they have all information, but investors do not. The GISA regulation can eliminate information asymmetry by imposing disclosure duties on fundraisers.

This thesis tries to highlight the necessity for The GISA regulation to reduce information asymmetry. By comparing the GISA with laws and regulations of the USA and Singapore, this thesis found that the GISA regulation should impose the Suitability Obligation on crowdfunding platforms in Taiwan. Furthermore, the GISA regulation shall be incorporated into the Securities and Exchange Act or enacted by the parliament to enhance the investors' protection for equity-based crowdfunding.

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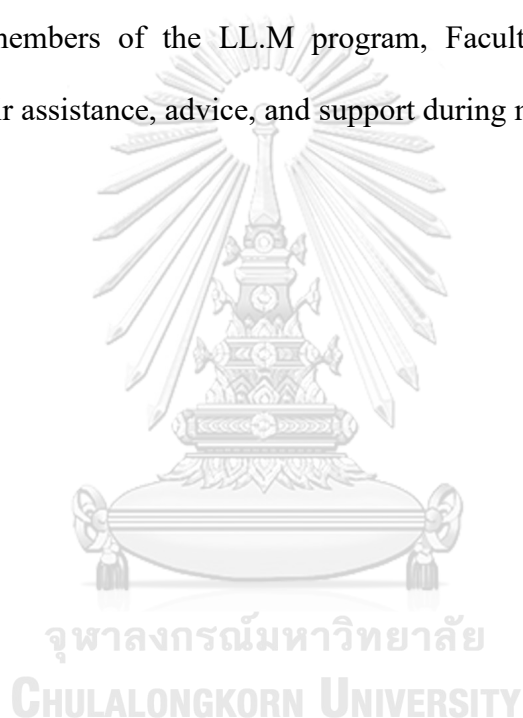
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Chin-wei Chang





## TABLE OF CONTENTS

	<b>Page</b>
ABSTRACT (THAI) .....	iii
ABSTRACT (ENGLISH).....	iv
ACKNOWLEDGEMENTS.....	v
TABLE OF CONTENTS.....	vi
LIST OF TABLES .....	xii
LIST OF FIGURES .....	xiii
Chapter 1: Introduction .....	1
1.1 Thesis Background.....	1
1.2 Research Question and Hypothesis.....	5
1.2.1 Research Question.....	5
1.2.2 Hypothesis.....	8
1.3 Thesis Purpose .....	8
1.4 Scope.....	10
1.5 Research Design and Methodology .....	13
1.5.1 The Research Structure .....	13
1.5.2 The Methodology .....	14
1.6 Benefit of The Thesis .....	14
Chapter 2: The Development of Crowdfunding .....	15
2.1 The History of Crowdfunding.....	17

2.2 Types of Crowdfunding .....	21
2.3 Benefits of Crowdfunding.....	23
2.3.1 New Funding Portal .....	23
2.3.2 User-driven Innovation .....	24
2.3.3 The Improvement of Corporate Governance .....	25
2.4 Risks of Crowdfunding .....	27
2.4.1 Fundraisers .....	27
2.4.2 Investors .....	28
2.5 The Role of Intermediaries .....	31
2.5.1 Intermediaries' Case Review .....	31
2.5.2 A Case Study Shows Intermediary Mitigates the Risks of Investment .....	32
2.6 The Characteristics of Current Regulations on Crowdfunding From Various Jurisdictions .....	34
2.6.1 The Equity-based Crowdfunding Regulations in Taiwan .....	34
2.6.1.1 The Argument of Criminal Liability in Equity-based Crowdfunding .....	36
2.6.1.2 The Protection of Investors and Promoting Fundraising Are Not Enough .....	38
2.6.2 The Equity-based Crowdfunding Regulations in The USA.....	39
2.6.2.1 The Development of Securities Regulations.....	39
2.6.2.2 The Enactment of CROWDFUND Act.....	40
2.6.3 The Equity-based Crowdfunding Regulations in Singapore.....	43
2.6.3.1 The Securities-based Crowdfunding.....	43

2.6.3.2 The Importance of Online Platforms in The Securities-based Crowdfunding .....	44
2.7 Summary .....	45
Chapter 3: Equity-based Crowdfunding in Taiwan.....	47
3.1 Business Model of Financing for SMEs and Startups .....	47
3.1.1 The Governmental Funding .....	49
3.1.2 Loan .....	50
3.1.2.1 Loans from Families or Friends.....	51
3.1.2.2 Funding from Supporters .....	52
3.1.2.3 Loans from Banks or Other Financing Companies.....	52
3.1.3 Equity.....	53
3.1.3.1 Venture Capital and Angel Investors.....	53
3.1.3.2 Private Placement.....	55
3.1.3.3 Initial Public Offering (IPO).....	56
3.1.3.4 Equity-based Crowdfunding .....	56
3.1.4 The Controversial Issue of Investment Contract .....	57
3.2 The GISA Regulation.....	60
3.2.1 How The GISA Regulation Protects Investors?.....	60
3.2.1.1 First-stage Examination .....	60
3.2.1.2 Public Integrative Counseling Mechanism (PICM).....	63
3.2.1.3 Second-stage Examination.....	63
3.2.1.4 Counseling and Disclosure Duty .....	65
3.2.2 GISA Regulation Is Insufficient to Protect Investors .....	70
3.2.2.1 There Is No Merit Review .....	71

3.2.2.2 The PICM Cannot Secure All Business from Fundraisers.....	71
3.2.2.3 Overwhelming But Not Helpful Information .....	72
3.2.2.4 When IPO Is More Promising.....	72
3.3 Summary .....	79
Chapter 4: Regulatory Paths to Protect Investors in Equity-based Crowdfunding.....	80
4.1 The Information Asymmetry in Equity-Based Crowdfunding .....	82
4.1.1 What Is Information Asymmetry .....	82
4.1.2 Solutions for Information Asymmetry .....	84
4.1.2.1 Signaling .....	84
4.1.2.2 Screening.....	84
4.1.2.3. Warranty.....	85
4.1.2.4 Mandatory Information Disclosure.....	85
4.1.3 The Disclosure Duty of Fundraisers in Equity-based Crowdfunding.....	86
4.1.3.1 The USA .....	86
4.1.3.2 Singapore .....	87
4.1.3.3 Taiwan.....	87
4.2 The Framework of Regulation to Protect Investors.....	88
4.2.1 The Authority .....	88
4.2.1.1 The USA .....	88
4.2.1.2 Singapore .....	88
4.2.1.3 Taiwan.....	89
4.2.2 The Governing Law .....	90
4.2.2.1 The USA .....	90
4.2.2.2 Singapore .....	90

4.2.2.3 Taiwan .....	90
4.2.3 The Capital Cap and Investment Amount .....	92
4.2.3.1 The USA .....	92
4.2.3.2 Singapore .....	93
4.2.3.3 Taiwan .....	94
4.3 Screening Investors and Fundraisers .....	95
4.3.1 The Assessment of Fundraisers .....	95
4.3.1.1 The USA .....	95
4.3.1.2 Singapore .....	95
4.3.1.3 Taiwan .....	95
4.3.2 The Assessment of Investors .....	96
4.3.2.1 The USA .....	96
4.3.2.2 Singapore .....	97
4.3.2.3 Taiwan .....	101
4.4 The Legal Liability of Online Platforms .....	103
4.4.1 The USA .....	103
4.4.2 Singapore .....	105
4.4.3 Taiwan .....	105
4.5 Comparing Equity-based Crowdfunding in The USA, Singapore, and Taiwan .....	107
4.5.1 Comparing Issue of 4.1.3 .....	107
4.5.1.1 The Disclosure Duty of Fundraisers .....	107
4.5.2 Comparing Issue of 4.2 .....	108
4.5.2.1 The Authority .....	108

4.5.2.2 The Governing Law .....	109
4.5.2.3 The Capital Cap and Investment Amount .....	110
4.5.3 Comparing Issue of 4.3 .....	112
4.5.3.1 The Assessment of Fundraisers .....	112
4.5.3.2 The Assessment of Investors .....	113
4.5.4 Comparing Issue of 4.4 .....	114
4.5.4.1 The Legal Liabilities of Online Platforms .....	114
4.6 Summary .....	117
Chapter 5: Conclusion.....	118
5.1 The Possible Outcome .....	119
5.1.1 Tools for Investors' Protection .....	119
5.1.2 Investors' Protection from Legal Comparison.....	120
5.2 Recommendation .....	121
5.2.1 Legal Reform .....	121
5.2.2 Policy Reform- The Supervisory Sandbox .....	123
References.....	126
Books .....	126
Articles.....	126
Internet Websites.....	127
Legislations .....	129
REFERENCES .....	130
VITA .....	132

## LIST OF TABLES

	<b>Page</b>
Table 1 Legal Reservation .....	35
Table 2 The Comparison of The IPO Market in Taiwan .....	75
Table 3 Structure of Investors' Protection .....	119
Table 4 Legal Reform.....	122



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## LIST OF FIGURES

	<b>Page</b>
Figure 1 Thesis Structure .....	13
Figure 2 Balance Sheet of A Company.....	48





# Chapter 1: Introduction

## 1.1 Thesis Background

In 2019, the statistics<sup>1</sup> showed that 97.65% of enterprises are small and medium enterprises (SMEs)<sup>2</sup> and 78.73% of the employment population was in the SMEs market in Taiwan. It indicates that SMEs are critical in Taiwan's society and contribute to economic growth. How to assist SMEs and startups to raise funds becomes a vital issue to the government. Suppose Taiwan can offer a friendly environment for SMEs and startups. In that case, it will catch the eyes of SMEs and startups around the world and improve the competitive power in the world. If the domain market is not friendly to the SMEs and startups or unable to protect the investors, the capital and industry will flow out of Taiwan and hamper the economic development. Therefore, Taiwan's regulations on capital formation shall not fall behind the global trend of promoting the capital market for SMEs and startups.

Because startups are deemed as high-risk businesses<sup>3</sup>, it is difficult for startups to seek funding from the traditional funding portals which include banks, angel investors, and venture capitalists. But the development of the internet has changed the capital formation environment profoundly because SMEs and startups can raise funds from the internet easily, they are no longer have to rely on traditional portals.

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<sup>1</sup> See the official website of the SME administration, Ministry of Economic Affairs, <https://www.moeasmea.gov.tw/article-tw-2344-5369>. Visiting date: 17/08/2021.

<sup>2</sup> The definition of SMEs means the yearly revenue below NTD \$100 million, but some industries are out of the amount restriction. See <https://www.moeasmea.gov.tw/article-tw-2344-5369>.

<sup>3</sup> In Singapore, around 50% of startups can survive to their 5<sup>th</sup> years, similar to the 41.4% in UK and 50% in USA, see Christian Hofmann (2018). "An easy start for start-ups: crowdfunding regulation in Singapore", *Berkeley Business Law Journal*, Vol 15:1, P.228.

Therefore, online crowdfunding has become an essential portal for people who want to raise funds for small businesses. More and more countries have started regulating the online crowdfunding market to promote capital formation and solve the financial gap for SMEs and startups.

In Taiwan, there are no specific regulations or prohibitions on loan-based, donation-based, and reward-based crowdfunding via online platforms. The civil laws govern the legal relationships between fundraisers and funders in non-equity-based crowdfunding. But the supervisory on equity-based crowdfunding is quite different from non-equity-based crowdfunding in Taiwan. The Securities and Exchange Act prohibited equity-based crowdfunding. In 2013 the government decided to relieve the prohibition on equity-based crowdfunding from the Securities and Exchange Act. The Financial Supervisory Commission (the FSC) authorized Taipei Exchange<sup>4</sup> to enact:

1. the Regulations Governing the Go Incubation Board for Startup and Acceleration Firms (the GISA regulation) in 2013, and
2. Taipei Exchange Regulations Governing the Conduct of Equity Crowdfunding by Securities Firms (the private portal regulation) in 2015.

The purpose of GISA regulation and the private portal regulation is to assist SMEs and startups in raising funds via online platforms in Taiwan<sup>5</sup>.

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<sup>4</sup> The Taipei Exchange, a private legal entity, was founded in 1994 by government to manage and promote the Over-the-counter securities trading (OTC market), but now its business is expanded to bonds, ETFs, derivatives and SMEs fostering to meet the needs of markets. See the introduction of Taipei Exchange [https://www.tpex.org.tw/web/about/introduction/history.php?l=en-us\\_](https://www.tpex.org.tw/web/about/introduction/history.php?l=en-us_) Visiting date:25/3/2021.

<sup>5</sup> The FSC did not propose to revise the Securities and Exchange Act directly because the amendment of laws takes time. See Yao-Ching Shih (2017), “Brief on crowdfunding”, Securities Services Review, Vol.660, P.100.

Therefore, there are two layers of online platforms for the fundraiser to raise funds in equity-based crowdfunding. The first one is the private portal which is regulated by the private portal regulation, the private portal should get a permission license from the authority before running the business<sup>6</sup>. Until today, there are only 4 online platforms permitted by Taipei Exchange to be equity-based crowdfunding platforms<sup>7</sup> and only 2 companies chose the private portal to raise their capital, the total amount raised in the private portal was only NTD (New Taiwan dollars) \$12 million since the Taipei Exchange permitted the private portal from April 2015 to the end of 2020<sup>8</sup>; Another portal is called the “GISA board” (Go Incubation Board for Startup and Acceleration Firms)<sup>9</sup> which was established by Taipei Exchange according to the GISA regulation in 2014, there are cumulative 180 companies

---

<sup>6</sup> See the private portal regulation §4

A securities firm applying to conduct equity crowdfunding business shall submit the application documents specified in Article 9 or 39 of the Standards Governing the Establishment of Securities Firms to the Taipei Exchange, which will review the documents and then forward them to the competent authority for the granting of permission.

After obtaining permission from the competent authority under the preceding paragraph, the securities firm shall submit the application documents specified in Article 10 or 40 of the Standards Governing the Establishment of Securities Firms to the Taipei Exchange, which will review the documents and then forward them to the competent authority for issuance or reissuance of a permission license.

<sup>7</sup> The 4 private platforms are Masterlink Securities, First Securities, DAH CHANG Securities and FlyingVest Equity Crowdfunding Securities, see <https://www.tpex.org.tw/web/option/broker.php?l=en-us#>. Visiting date:25/3/2021.

<sup>8</sup> See <https://www.fsc.gov.tw/ch/home.jsp?id=840&parentpath=0,7>. Visiting date:25/3/2021.

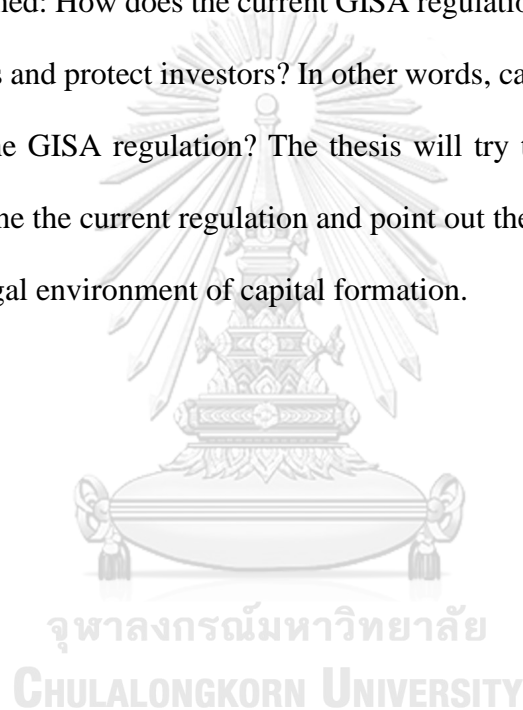
<sup>9</sup> See GISA regulation §2 :

The Go Incubation Board for Startup and Acceleration Firms (the GISA board) refers to the board established by Taipei Exchange to assist innovative and creative enterprises with information disclosure and capital raising, and to provide the investors with participation in company incorporation by public offerings held by promoters, or subscription to company shares for a cash capital increase,

registered on the GISA board and approximately NTD \$659 million raised in the GISA board<sup>10</sup>.

Although there are 2 layers of online platforms in Taiwan. From the scale comparison, the GISA board is apparently the leading intermediary for fundraisers to raise funds in the equity-based crowdfunding market in Taiwan.

After the government opened the equity-based crowdfunding market, a question remained: How does the current GISA regulation assist SMEs and startups in raising funds and protect investors? In other words, can fundraisers and investors benefit from the GISA regulation? The thesis will try to analyze this question. It helps us examine the current regulation and point out the defects for government to improve the legal environment of capital formation.



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<sup>10</sup> See <https://www.tpex.org.tw/web/gisa/announce/GisaSum.php?l=en-us>. Visiting date:25/3/2021.

## 1.2 Research Question and Hypothesis

### 1.2.1 Research Question

The GISA regulation adopted traditional supervisory methods, emphasizing auditing, information disclosure, and expert involvement to regulate fundraising and protect investors. Those traditional supervisory methods are widely applied in securities laws to fill the gap of information asymmetry and protect investors.

Information asymmetry has existed between investors and fundraisers. Fundraisers are the business runner, they have all information about their business situation, including the profitability and loss, but investors do not, most investors are ordinary persons without professional or experienced background, they just seek capital gains from investment. Therefore, it is essential to disclose the material information of security issuance and eliminate information asymmetry in equity-based crowdfunding, so investors can make the right decision for their investment. It is also fair to require the fundraisers who are the information keepers to disclose the company information to the public.

Under the traditional supervisory methods, Taipei Exchange enacted the GISA Regulation to supervise equity-based crowdfunding. The GISA regulation eliminates information asymmetry by imposing many duties on fundraisers. As a result, fundraising in the GISA board leads to a high threshold for fundraisers to utilize. A fundraiser may have to give up equity-based crowdfunding to raise funds for developing the vaccine of covid-19 because it may take years to complete the procedure before fundraising on the GISA board. It is also difficult for fundraisers to raise small capital in equity-based crowdfunding because all applicants have to

comply with the same duties from GISA regulation, there is no exemption for small amount fundraising.

In Taiwan, the main goals of equity-based crowdfunding are promoting fundraising and protecting investors. Promoting fundraising and protecting investors are the same thing, if investors can be protected, more and more people will be willing to invest in equity-based crowdfunding, the fundraiser will be more easily to raise funds. Therefore, Investors' protection is the core value in equity-based crowdfunding. The research questions here are: How does the GISA regulation protect investors? Does it enough to protect investors? If the answer is not, are there any other methods to protect investors in equity-based crowdfunding?

In the USA, the regulation on crowdfunding also relies on traditional supervisory methods (disclosure duties) and requires online platforms to eliminate information asymmetry and protect investors.

Singapore goes further. It does not rely on the traditional supervisory methods to protect investors, but it adopts a new supervisory method to regulate equity-based crowdfunding and protect investors. Singapore does not focus on the disclosure duties of fundraisers. It relies on the Suitability Obligation to regulate the equity-based crowdfunding market. The characteristics of Suitability Obligation is that intermediaries or fundraisers have to “know your customer (KYC)” and “know the financial products” before marketing financial products. In other words, the intermediaries in Singapore have to make sure the financial products and investors are suitable for each other. The Suitability obligation could be a new supervisory method to relieve the disclosure burden on fundraisers to raise funds in equity-based crowdfunding and eliminate information asymmetry.

Furthermore, in 2018, the Taiwan government enacted the Financial Technology Development and Innovative Experimentation Act (the supervisory sandbox act) which is originated from the UK regulatory sandbox, fundraisers or intermediaries can utilize the supervisory sandbox mechanism for fundraising and figure out the best-tailored fundraising procedure on equity-based crowdfunding, especially the FinTech is still developing day by day, there are many possibilities in the crowdfunding market.

Anyone can utilize this experimental sandbox to exploit more possibilities that can benefit equity-based crowdfunding development. For instance, in 2012 Germany adopted specific revenue and profit-sharing arrangements in equity-based crowdfunding because the sale of voting shares through crowdfunding platforms is prohibited at that time, therefore, some online platforms sold a silent partnership which is an equity-like share that gives investors a predefined share of profits but no voting rights<sup>11</sup>. Besides, some companies may be interested in issuing no voting-rights shares because the owner may worry about losing the controlling power or spending time communicating with thousands of investors when investors have voting rights. No voting-right shares could simplify the relationship between the company and investors.

The current equity-based crowdfunding market has highly relied on disclosure duties and complex fundraising procedures to eliminate information asymmetry and protect investors in Taiwan. But the supervisory sandbox act offers a new path for the fundraisers and intermediaries to develop more flexible profit-sharing

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<sup>11</sup>Ahlers, Gerrit and Cumming, Douglas J. and Guenther, Christina and Schweizer, Denis, Signaling in Equity Crowdfunding (October 14, 2012). Available at SSRN: <https://ssrn.com/abstract=2161587> or <http://dx.doi.org/10.2139/ssrn.2161587>, P.9.

arrangements for capital formation and investors' protection. The experimentation result could assist the authority to improve its governance on equity-based crowdfunding and benefit all players in the market.

To conclude, the primary purpose of the thesis is to point out how the GISA regulation eliminates information asymmetry to protect investors, the flaws and obstacles of the traditional supervisory methods in the current GISA regulation. The thesis will also try to find out how to improve investors' protection in the current equity-based crowdfunding.

### 1.2.2 Hypothesis

Information asymmetry is an important problem that existed in equity-based crowdfunding. Information asymmetry makes it difficult for investors to evaluate the true value of equity. Therefore, the GISA regulation may enhance its ability to protect investors by reducing information asymmetry between crowdfunding issuers and investors. In order to do so, The GISA regulation shall be incorporated into the Securities and Exchange Act or enacted by the parliament, and impose an obligation on crowdfunding platforms to screen and inform investors about risks associated with equity-based crowdfunding.

## 1.3 Thesis Purpose

The non-equity-based crowdfunding market has been flourished and popular in Taiwan. Many fundraisers utilize reward-based crowdfunding online platforms to raise funds. The FlyingV<sup>12</sup>, ZECZEC<sup>13</sup>, Backer-founder<sup>14</sup> are famous reward-based

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<sup>12</sup> <https://www.flyingv.cc/>. Visiting date:17/08/2021.

<sup>13</sup> <https://www.zeczec.com/>. Visiting date:17/08/2021.

<sup>14</sup> <https://www.backer-founder.com/>. Visiting date:17/08/2021.



crowdfunding online platforms in Taiwan. According to the statistics in 2021 H1(from January to June), there are 615 reward-based crowdfunding cases in progress in Taiwan. 70% of them have successfully raised their capital. The total amount is over NTD\$800 million. The median amount of those successful cases is NTD\$470,000. Funders are especially interested in cultural, creative products and technological products<sup>15</sup>.

In equity-based crowdfunding, the Taipei Exchange establishes the GISA board to assist fundraisers to raise funds in the capital market. However, the procedure to raise funds is complicated. The disclosure duties are burdensome for fundraisers because the Taipei Exchange adopts the traditional supervisory methods to protect investors. The GISA regulation and GISA board are tailor-made to fit the protection of investors. The purpose of this thesis is to point out that traditional supervisory methods are not sufficient to protect investors and those traditional supervisory methods become obstacles for fundraisers to utilize equity-based crowdfunding. There is a dilemma to balance the investors' protection and fundraisers' fundraising.

The first step to reach the purpose of the thesis is to discuss the history and development of equity-based crowdfunding and analyze the benefits and risks of equity-based crowdfunding, then discuss why the current GISA regulation is not enough to protect investors by material study.

Finally, the thesis will introduce why the Suitability Obligation and supervisory sandbox could solve the supervisory and regulatory dilemma and make

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<sup>15</sup> <https://findit.org.tw/researchPageV2.aspx?pageId=1809>. Visiting date:17/08/2021.

the GISA regulation better to fit its purpose to protect investors and assist the SMEs and startups in raising funds<sup>16</sup>.

#### 1.4 Scope

There are 4 types of crowdfunding in Taiwan, but this thesis will focus on equity-based crowdfunding, the others are excluded. The scope of this thesis is to introduce the development of equity-based crowdfunding.

The private portals will also be excluded because the GISA board is the primary online platform in the equity-based crowdfunding market in Taiwan.

Furthermore, the thesis will introduce the USA and Singapore regulations and discuss how those jurisdictions protect investors in equity-based crowdfunding. The reasons to choose the USA and Singapore are:

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1. The USA regulations affected the equity-based crowdfunding regulations in Taiwan, it would be helpful to know how the USA government regulates equity-based crowdfunding and protects investors. the defects and

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<sup>16</sup> See GISA regulation §1

These Regulations are enacted for the purpose of counseling the innovative and creative non-public enterprises of the Republic of China (ROC) for development and assisting them in raising capital, in order to enhance the vitality and entrepreneurialism of the ROC's economy.

solutions in the USA regulations may also provide answers for Taiwan's government to improve the supervisory and regulatory method in equity-based crowdfunding in Taiwan.

2. Singapore, as an Asian and Chinese community, is famous for its friendly legal environment in business running and corporate governance, it was ranked in the top 2 for the "ease of doing business ranking" according to World Bank's report<sup>17</sup>, Singapore model is quite different from the USA model and Taiwan, it develops a unique approach to regulate equity-based crowdfunding and focuses on the duties of online platforms to protect investors and promote fundraising, it may provide a new path of regulatory to balance the investors' protection and fundraisers' capital need.

To make the comparison clearer, this thesis will focus on analyzing those foreign jurisdictions from three aspects:

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<sup>17</sup> See World Bank,  
<https://www.worldbank.org/en/programs/business-enabling-environment/doing-business-legacy>.  
Visiting date: 17/03/2022.

1. The legal framework to protect investors
2. The information asymmetry.
3. The legal liability of online platforms.

The standard of the comparison is focusing on “investors’ protection”. The spectrum of investors’ protection could be weak or strong.



## 1.5 Research Design and Methodology

### 1.5.1 The Research Structure

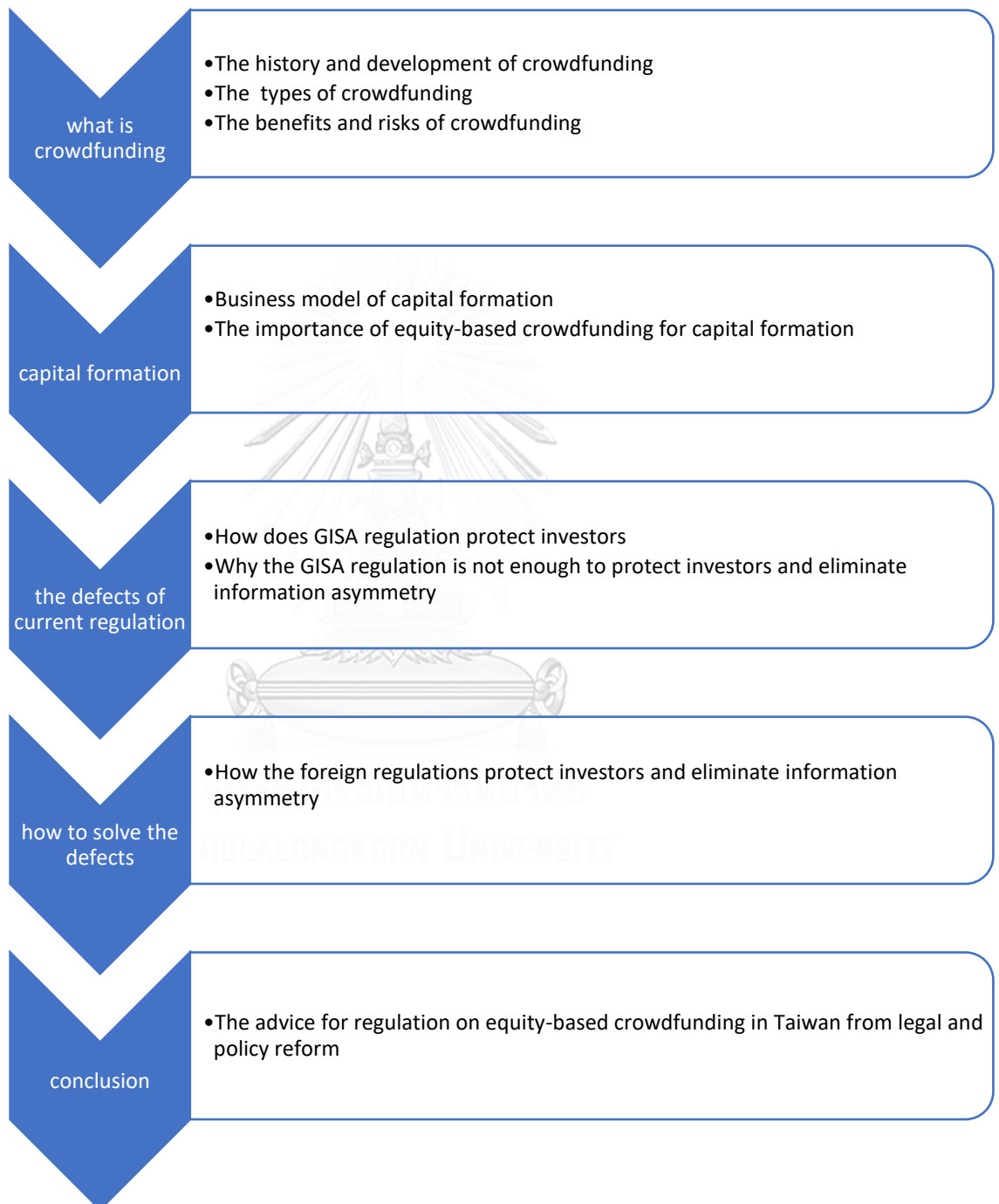


Figure 1 Thesis Structure

### 1.5.2 The Methodology

Due to the pandemic around the world since 2019, traveling and accessing the library becomes difficult for the researcher. However, thanks to technology development, there are some online academic data still available. The library in the Faculty of Law also provides some online legal data that helps me get much digital literature about equity-based crowdfunding. Therefore, this thesis will rely on literature surveys and analysis from internet resources.

Furthermore, the thesis will also collect related information from government websites and other online websites that provide first-hand information about crowdfunding development in Taiwan.

### 1.6 Benefit of The Thesis

Taiwan's government opened the door to equity-based crowdfunding in 2013 for the purpose of promoting the capital formation of SMEs and startups. This thesis will have the benefits to:

1. Understand the development of equity-based crowdfunding in Taiwan.
2. Help fundraisers to understand the procedure of fundraising under the current GISA regulation.
3. Point out the legal problems of the current GISA regulation and propose the advice to fix it up.

## Chapter 2: The Development of Crowdfunding

Crowdfunding can be understood easily by its literary meaning: funding from the crowd. Scholar Freedman gives a more precise explanation to understand the characteristics of crowdfunding: “a method of collecting many small contributions, employing an online funding platform, to finance or capitalize a popular enterprise<sup>18</sup>.”

Crowdfunding has been developed for a long history. Some milestones make crowdfunding catch the eyes of investors and become more prosperous day by day. Crowdfunding catches crowds' eyes because players including fundraisers, investors, and intermediaries can benefit from it.

However, Crowdfunding may be accompanied by risks of fraud, how to protect investors becomes a severe issue in the crowdfunding market. Taiwanese regulator takes the traditional measures which focus on disclosure duty to mitigate the risks of investment and protect investors, but on the other hand, those measures are burdensome for fundraisers. How to balance the protection of investors and promoting fundraising is a dilemma for the regulator, however, thanks to the development of the internet, investors can access more helpful information from the internet to evaluate their investment decisions and protect themselves. Although the internet changes crowdfunding, it does not mean that the internet changes the relationship of crowdfunding, that is “fundraisers get small contributions from investors”. Internet is just a new platform to facilitate crowdfunding and fill the gap

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<sup>18</sup> David M. Freedman, Matthew R. Nutting, Equity Crowdfunding for Investors: A Guide to Risks, Returns, Regulations, Funding Portals, Due Diligence, and Deal Terms, John Wiley & Sons, Inc, P.1

of traditional capital formation, it does not mean fundraising from the internet becomes a new type of crowdfunding.

Capital formation has been a vital issue for business owners to start their business. In the USA, raising small capital between USD \$150,000 and \$5 million has been an enduring problem for fundraisers. This capital formation gap has lasted at least 100 years since 1929, policymakers are struggling to find the solutions<sup>19</sup> because most investors and larger institutions or angel investors are more interested in the very beginning companies with great investment value. They are not interested in providing small amounts of capital for those SMEs or startups and getting a small return from their investment. Therefore, most SMEs have difficulties raising funds. Furthermore, in the early time without the internet, raising funds has a geographical restriction, people lives on the west coast of the USA is very difficult to get funding from the far east coast, how to overcome the geographical limitation of capital formation and find out the potential investors who reside far from the fundraisers' residence becomes an obstacle for fundraisers to overcome, the invention of internet wipes out the barrier and becomes an essential portal for fundraising in the world, it changes the traditional capital market intensely just over the past decade.

Meanwhile, online platforms also have high incentives to take measures to protect investors. A legal case study from Taiwan shows that online platforms can play a crucial role in the crowdfunding market to protect investors. How to protect investors and reduce the cost for fundraisers to raise funds in equity-based

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<sup>19</sup> Thomas E. Vass, Accredited Investor Crowdfunding: A Practical Guide for Technology Executives and Entrepreneurs, The Great American Business & Economic Press, P.35.



crowdfunding is a dilemma for regulators. The intermediaries may play a key role in solving this dilemma.

## 2.1 The History of Crowdfunding

Here will begin with a famous and classical case in the traditional crowdfunding in 1885, France had donated the Statue of Liberty to the USA to celebrate the friendship between the two countries. The Statue of Liberty designed by sculptor Frederic Auguste Bartholdi was shipped to New York in June 1885 and was stored in a warehouse for 1 year because the construction of the pedestal had been delayed. The American Committee of the Statue of Liberty ran out of budget and also suffered from an economic recession at that time. The Congress and state of New York refused to fund it, although the cities of Baltimore, Boston, San Francisco, and Philadelphia made the offer but the statue had to relocate. The Hungarian-born American publisher of the New York World newspaper-Joseph Pulitzer, also known as the founder of the Pulitzer Prize, hoped the statue can stay in New York City, the cost was estimated at USD \$300,000 to build the pedestal and place the statue upon it. Pulitzer called for donations and collected USD \$102,000 (roughly USD \$2.3 million in today's currency value) from 125,000 people within 5 months, most donated amounts were USD \$1 or less than USD \$1. The World newspaper published their names as a reward to donors<sup>20</sup>. Finally, the pedestal and statue were dedicated to America on October 28, 1886. This crowdfunding makes people today can see the beauty of the Statue of Liberty in New York harbor.

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<sup>20</sup> See supra note 18, P2.

After the internet era arrived decades ago, the internet shortened the distance from fundraisers to investors. Fundraisers could access supporters around the world easily by internet. Brian Camelio, who is one of the pioneers of modern crowdfunding, developed an online website called “ArtistShare” in 2003, fans of musicians can figuratively fund the artists they are interested in ArtistShare. Maria Schneider’s jazz album “Concert in the Garden” was the first case raised about USD \$13,000 from the ArtistShare website<sup>21</sup>. Her album also won a 2005 Grammy Award. More and more artists, composers, photographers, and filmmakers are supported by their fans through ArtistShare. Those artists may offer supporters with privileged to download songs, copies of CDs or VIP tickets of concerts, etc..., the online platform like ArtistShare becomes an essential portal for artistry fundraising, fundraisers and supporters also connect and communicate with each other via the online platform, the reward-based crowdfunding becomes more and more popular, the Indiegogo launched in 2008 and Kickstarter in 2009 are now the main reward-based crowdfunding platforms in the World. Statistics of Kickstarter show how popular reward-based crowdfunding is in the world<sup>22</sup>.

Fundraisers make their dreams come true with the support from their fans in reward-based crowdfunding. But sometimes it may not be fair for their supporters, in the summer of 2012, Oculus Rift, a virtual reality headset developer, launched a campaign on Kickstarter which is one of the world’s largest online platforms at that time, it raised around USD \$2,437,429 from 9,522 supporters in about a month,

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<sup>21</sup> See supra note 18, P.3.

<sup>22</sup> Since 2009 to today, there are around 208,215 cases in Kickstarter, more than 20 million people support the fundraising, the total amount raised in Kickstarter exceed USD \$ 6 billion, see [https://www.kickstarter.com/about?ref=about\\_subnav](https://www.kickstarter.com/about?ref=about_subnav). Visiting date:25/3/2021.

those contributors may get a T-shirt or an unassembled Oculus Rift prototype kit as a reward according to the amount they contributed<sup>23</sup>. Oculus also sought investment from venture capital firm Spark Partners and hedge fund Matrix Partners, each of them invested USD\$19 million in Oculus. 2 years later, Oculus Rift was acquired by Facebook for USD \$2 *billion*, the value of equity investment of Spark and Matrix grew up from USD \$19 million to USD \$380 million, the contributors from Kickstarter did not get any single penny back because they did not “buy” the shares of Oculus Rift, they should have no expectation of any capital gain. The success of Oculus Rift made contributors disappointed and angry, but it also marked the importance of equity-based crowdfunding, the public shift their attention from traditional crowdfunding to equity-based crowdfunding to maximize their investment after this case<sup>24</sup>.

In Taiwan, Reward-based crowdfunding started in 2012 because the famous online platforms ZECZEC and FlyingV were born in that year. There were 2,760 cases successfully raised funds via online platforms from 2012 to 2019, the total amount was NTD \$ 2.7 billion<sup>25</sup>. People support cases they are interested in from online platforms without any restrictions. Technological and design products are the most popular cases. It reflects the prosperity of non-equity-based crowdfunding in Taiwan.

Debt-based crowdfunding (also known as Peer to Peer lending or P to P) emerged for investment profitability in 2006. The borrower can apply for an

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<sup>23</sup> See supra note 18, P.10.

<sup>24</sup> See Jo Won (2019),” Jumpstart Regulation Crowdfunding: What Is Wrong and How to Fix It”, Lewis & Clark Law Review, Vol. 22:4, P.1395.

<sup>25</sup> See <https://findit.org.tw/researchPageV2.aspx?pageId=1326>. Visiting date:17/08/2021.

unsecured loan or without collateral from the online platforms. If the platforms approve the application, the borrower can get the loan from crowds, and the borrower has to pay back the loan with interest and service fee. After the recession between 2008 and 2009, the banks tightened the threshold to borrowers, debt-based crowdfunding filled the gap for fundraisers at that time.

The Kiva, founded in 2005<sup>26</sup>, is developing a very unique online platform figure. It is a debt-based crowdfunding platform, but not for the purpose of investment because people register as a lender in Kiva and get repayment back without any interest. The lender can support any cases they are interested in by lending as little as USD \$25 on the platform and make a real personal impact in our society. It is a hybrid of donation and debt-based crowdfunding. There are 1.9 million lenders from 77 countries joining this platform. The successful story of Kiva shows the power of crowdfunding can balance charity and investment. Crowdfunding can help people in need and make our society better.

2012 was also a milestone in crowdfunding because The USA Congress passed the JOBS Act. Equity-based crowdfunding has become possible in the USA, more and more portals are available for fundraisers and investors to utilize in the crowdfunding market of the USA. Taiwan also followed the trend to regulate equity-based crowdfunding in the following year.

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<sup>26</sup> See <https://www.kiva.org/>. Visiting date:17/08/2021.

## 2.2 Types of Crowdfunding

There are four models of crowdfunding from the legal form of fundraising<sup>27</sup>, they are all available for fundraisers to utilize and investors to invest in Taiwan:

1. Donation-based crowdfunding: people donate money to support a project for a charity or other purposes. Fundraisers have no duty to return the money.
2. Reward-based crowdfunding: people contribute money to fundraisers in exchange for a specific reward which could be a product or service.
3. Debt-based crowdfunding: people lend money to fundraisers and receive repayment and interest.
4. Equity-based crowdfunding: people invest in shares of a business to receive capital gains from that business.

The donation-based and reward-based crowdfunding do not provide financial returns, there are no specific regulations on non-equity-based crowdfunding in Taiwan. The legal relationship between the contributors and fundraisers is a contract. The non-equity-based crowdfunding online platforms have successfully developed in Taiwan. The FlyingV, ZECZEC, and Backer-founder are well-known platforms.

Debt-based crowdfunding usually offers investors a financial return. It could be a security-based or non-securities-based model. The online platforms are allowed to run the non-securities P2P crowdfunding without any permission from the government because the non-securities P2P crowdfunding is a contractual

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<sup>27</sup> See Hu Ying (2015), "Regulation of Equity Crowdfunding in Singapore". Singapore Journal of Legal Studies, Vol.2015, P.1.

relationship regulated by civil law, but securities-based P2P is not allowed in Taiwan according to the Securities and Exchange Act and GISA regulation.

In Taiwan, the GISA regulation only permits equity-based crowdfunding. the securities-based P2P shall qualify the securities issuance procedure according to the Securities and Exchange Act, but Singapore has different regulations, all securities-based crowdfunding, no matter it is debenture or equity, is allowed to raise via the online platform under the Securities and Futures Act of Singapore. This is why people in Singapore use the term “securities-based crowdfunding” to replace “equity-based crowdfunding.”

Equity-based crowdfunding was prohibited by the Securities and Exchange Act in Taiwan until 2013. The Taiwan government authorized Taipei Exchange to regulate equity-based crowdfunding. Taipei Exchange enacted the GISA regulation in 2013. Since then, equity-based crowdfunding was allowed to raising funds via online platforms. The leading fundraising portal in Taiwan is the GISA board.

There is no standard for fundraisers to determine which type of crowdfunding is the most suitable for their business. If fundraisers want to reach the target amount successfully, they have to catch the eyes of investors or supporters. Besides, They have to consider the market strategy and the cost of each type of crowdfunding. For SMEs and startups, their financial condition is vulnerable, it is crucial for them to calculate fundraising costs, a smaller target amount is easier to accomplish, but the cost will consume most of the amount. On the other hand, it is not easy to reach the enormous target amount, but the cost won't consume most of the funds.

Fundraisers also have to consider the investment amount from investors. The investment amount in reward-based or donation-based crowdfunding is tiny because there is no repayment in reward-based or donation-based crowdfunding. In debt-based and equity-based crowdfunding, investors are more willing to invest in the program because they can expect capital returns. Fundraisers have to plan their capital formation program carefully, if they utilize non-equity-based crowdfunding, they are unable to attract those investors who are seeking investment returns.

### **2.3 Benefits of Crowdfunding**

Since 2012, The development of reward-based crowdfunding has been developing year by year. In 2019, there are more than 600 cases raised in reward-based crowdfunding platforms in Taiwan. The total amount raised in reward-based crowdfunding already exceeds NTD \$1,200 million<sup>28</sup>. In equity-based crowdfunding, there are cumulative 180 companies registered on the GISA board with around NTD \$659 million raised in equity-based crowdfunding. Crowdfunding fills the gap of capital formation for SMEs and startups in traditional financing portals in Taiwan and benefits fundraisers and investors.

#### **2.3.1 New Funding Portal**

Online crowdfunding is a new funding portal for fundraisers. SMEs and startups do not have to depend on the traditional funding portals because it is a challenge for SMEs and Startups to get capital from them. The traditional funding

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<sup>28</sup> See supra note 25.

portals are also not interested in funding those high-risk businesses. But the situation has been changed, fundraisers are no longer struggling to persuade those institutional investors or banks, fundraisers can utilize crowdfunding via the internet to start their businesses easily.

Crowdfunding also assists fundraisers to tap into the international market and other potential markets around the world. A good example would be the Israel equity-based crowdfunding platform “OurCrowd.” OurCrowd attracts investors from all nations around the world and only 10 percent of investors are locals<sup>29</sup>. Crowdfunding allows fundraisers to get funding not only in their home countries but also from the world. On the other side, crowdfunding also offers investors to join the innovation market without borders. Investors can fund any business around the world and benefit from their investment by crowdfunding.

Finally, the traditional portals and governmental funds can shift more budget to support other projects that cannot be funded by crowdfunding. As a result, all businesses can benefit from the expanded capital market.

### 2.3.2 User-driven Innovation

Some SMEs and startups have no problem with capital formation, but they are not sure whether their business plans are feasible or not? their products can cater to customers’ needs or not?

Fundraisers usually have a unique business idea and expect to run a business to fulfill their idea, but the market may not accept that kind of idea or product. Crowdfunding could be a portal for fundraisers to test the market. Fundraisers can also communicate or receive much feedback from supporters through online

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<sup>29</sup> See supra note 27, P.57.



crowdfunding. Fundraisers can adjust their business plans from feedback and improve the profitability of their business.

Therefore, crowdfunding could be a helpful tool for fundraisers to reduce business risks. More and more businesses have started to utilize reward-based crowdfunding to pre-sale their product or service and test the market temperature. For instance, a magazine press wants to publish a special magazine. However, the manager doesn't know if readers are interested in this special magazine or how many copies it should print in advance. If it prints too many copies, it will suffer a significant loss when magazines cannot be sold out, so it can utilize reward-based crowdfunding to estimate the demand and guarantee profitability. The magazine press can consider utilizing any type of crowdfunding to test the market, it may receive a lot of feedback from funders to improve its marketing. If it fails in crowdfunding, that means this project cannot catch the eyes of the market, it would be better to stop the publishing plan early.

Therefore, crowdfunding has benefits for SMEs and startups to reduce the business risks and cater to the consumer's preferences.

### 2.3.3 The Improvement of Corporate Governance

The collapse of Enron Corporation in 2002 marks the importance of corporate governance<sup>30</sup>. Directors of a company play a crucial role in shaping corporate governance and culture, but they also rely on their partners and experts<sup>31</sup>. Without those partners and experts, it will be difficult for directors to make any business decisions or make the wrong decisions that harm the business. Therefore, if more

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<sup>30</sup> See the introduction of Enron case: <https://www.investopedia.com/updates/enron-scandal-summary/>.  
Visiting date:17/08/2021.

<sup>31</sup> See supra note 27, P.59.

and more partners or experts are involved in the business decision, the directors will likely make better decisions for the company. Crowdfunding allows more investors from different backgrounds to join or monitor the decision-making in the company and share their professional opinions with the company. The crowd's wisdom in the corporate could improve the corporate governance and protect investors' investment.

People may concern that if there is a dispute occurred between investors and directors about the business running, or if the board of directors rejects the advice from investors, can that wisdom from investors bind the corporate? Basically, that wisdom or recommendation from investors cannot bind the corporate in crowdfunding, but the answer could be yes in equity-based crowdfunding because investors are shareholders. In the 1970s, **shareholder activism** appeared in the USA capital market. Shareholder activism means shareholders want to take more actions in corporate decision-making, an activist shareholder uses his equity stake to influence corporate management. The effect of Shareholder activism changes many countries' attitudes toward the protection of minority shareholders. Many countries enact laws to promote the right of shareholders in corporate decision-making. In Taiwan, shareholders holding 1 percent (1%) or more of the total number of outstanding shares of a company may propose a proposal for discussion at a regular shareholders' meeting<sup>32</sup>. The purpose of the proposal could be promoting public interests or fulfilling corporate's social responsibilities. If the proposal was passed in regular shareholders' meeting, the board of directors have to implement the proposal, otherwise, the proposal cannot bind the company.

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<sup>32</sup> See Company Act of Taiwan §172-1.

## 2.4 Risks of Crowdfunding

### 2.4.1 Fundraisers

Running a business in early-stage, startups is riskier than other established businesses. There are a lot of challenges for those startups. They have to form a team (partners, manager, and employees), raise capital, produce products, pioneer the market, compete with other companies, etc....., Starting a business is filled with uncertainty and challenge in the early stage of a business. People may be shocked when they know that 7 to 8 out of 10 new businesses failed within the same year in Singapore<sup>33</sup>, even though Singapore is one of the easy-running business countries in the world according to the World Bank rankings in 2019<sup>34</sup>. Therefore, running a business is not easy at all for fundraisers. If their businesses failed, they have to endure the total loss they contribute.

Utilizing equity-based crowdfunding in Taiwan has other risks for fundraisers. Fundraisers have to disclose their innovations to the public due to the disclosure duty from GISA regulation. The disclosure duty may lead to an imitation because their competitors may know some information from the disclosed documents.

Another risk may be concerned by fundraisers in equity-based crowdfunding. If fundraisers sell many equities to raise capital, they may lose the controlling power of their business because they are not the principal shareholders, and most of the profit will return to other shareholders. For instance, a startup earned NTD \$1 million net income last year, if the fundraiser owns 100 % of shares, he takes all

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<sup>33</sup> See supra note 27, P.60.

<sup>34</sup> See <https://www.doingbusiness.org/en/rankings>. Visiting date:9/8/2021.

profit from the company, but if the fundraiser only owns 10% of shares, he gets only NTD\$100,000 from the profit.

Because running a business is filled with challenges for SMEs and startups, GISA regulation was enacted to assist SMEs and startups in starting a business with capital formation.

#### 2.4.2 Investors

The common risks for investors would be:

1. The information asymmetry: the investors usually do not have enough knowledge or information to assess fundraisers' business, there is an information gap between investors and fundraisers. The information gap is a severe issue in equity-based crowdfunding because investors need that information to determine the value of shares, if they don't have that vital information from fundraisers, investors may overestimate the value of shares and suffer significant losses. The information asymmetry could also lead to<sup>35</sup>:
  - a. possible failure to deliver products or capital gain.
  - b. Fraud.
  - c. failure of the business.
2. Difficulty in monitoring fundraisers' business: fundraisers may provide misleading information or omit some material information to investors.

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<sup>35</sup> See Chang-Hsien Tsai (2016). "Legal Transplantation or Legal Innovation? Equity-Crowdfunding Regulation in Taiwan After Title III Of the U.S. Jobs Act". Boston University International Law Journal, Vol. 34, P.243.

For example, fundraisers may exaggerate their business running and say they expect high growing profitability in the next year or neglect the risks from the worldwide pandemic.

Most investors are also unwilling to spend time and money to monitor fundraisers' business judgment because their investment is minimal, or Even though they are willing to monitor the business, investors still lack experience, knowledge, or material information to monitor fundraisers' business.

The moral hazard makes this situation worse. Directors or managers of the company may sacrifice investors' interests and pursue their interests at the expense of investors. To mitigate the difficulty in monitoring fundraisers' business, the government always requires companies to disclose a lot of information about the companies' business running situation.

Scholars are also very worried about the risk that investors suffer. They call for attention to investors' protection. Professor Dorff even claims that disclosure duty is not sufficient to protect those unaccredited investors because investors are not able to read the overwhelming information proffered by issuers and intermediaries. "There is no way to rescue retail crowdfunding" he said, he worried that the equity-based crowdfunding offerings are terrible investments since those fundraisers only turn to retail crowdfunding after being rejected by the traditional funding portals like banks, angel investors, and venture capitalists<sup>36</sup>.

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<sup>36</sup> See supra note 24, P.1416.

But when we look back at the development of crowdfunding, investors may not be as blind as the scholar worried. In non-equity-based crowdfunding, investors highly select the project they want to support. Only 1% of the projects accounted for 36% of the total amount raised on the Kickstarter platform. The knowledge gap has dramatically diminished by the internet because investors can search for a lot of information from the internet or interact with fundraisers and other investors directly via the internet platform. The internet provides tons of information for investors to make an investment decision<sup>37</sup>. The investors may be quite more discerning than the scholar expected.

Although there are some crowdfunding cases involved in fraud, there is no evidence showing that crowdfunding has more fraud cases than the Initial Public Offering (IPO) market. The World Bank's 7-year (2007-2014) crowdfunding report showed that there are no cases of equity-based crowdfunding fraud in the UK and Australia, and only 4 out of 43,193 cases in reward-based crowdfunding ended in fraud in Kickstarter's online platform in the USA, the open dialogue forum in the online platforms let investors can find out more helpful information to make an investment decision and avoid most frauds<sup>38</sup>. It is risky for investors to invest in SMEs and startups via crowdfunding, but the internet and online platforms mitigate investment risks in crowdfunding.

How to protect investors and reduce the risks in equity-based crowdfunding are crucial issues for regulators to govern equity-based crowdfunding because of the high risks in crowdfunding. For the Taiwan government, it adopted the traditional

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<sup>37</sup> Ibid, P.1417.

<sup>38</sup> Ibid, P.1418.

regulation method to regulate equity-based crowdfunding. The traditional regulation method relied on disclosure duty and experts' supervision.

It is risky for investors to rely on the government's policy and securities laws to protect their investment in today's internet society. They also need to catch up with the internet era and improve their knowledge and ability to protect their investment on their own.

## **2.5 The Role of Intermediaries**

### **2.5.1 Intermediaries' Case Review**

Intermediaries are the online platforms where investors buy shares from fundraisers. The disclosure duty may mitigate the risks of investment for investors, but intermediaries can also play a key role to deter investment frauds or abuse because the intermediaries have a case review to determine the case is appropriate to raise fund via their platforms. For example, "Wefunder," the most famous equity-based crowdfunding online platform in the USA, has done its best to screen the application to avoid any frauds. The platform will research the applicants and verify the documents they submitted<sup>39</sup>.

One of the reasons for intermediaries to do the due diligence check is that intermediaries get service fees from successful crowdfunding. Therefore, choosing good quality companies which can successfully raise funds could contribute to the profits of intermediaries. Take Wefunder for example, Wefunder charges 7.5% of the total fund raised only if the fund is successfully raised. Another reason is that if fraud happened in that online platform, more and more investors might stop

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<sup>39</sup> See <https://help.wefunder.com/#/investor/getting-started-for-investors>. Visiting date:6/7/2021.

investing via that online platform. The intermediaries have a strong incentive to keep a good reputation for their business<sup>40</sup> because a good reputation could attract more fundraisers and investors to utilize that online platform.

### 2.5.2 A Case Study Shows Intermediary Mitigates the Risks of Investment

A criminal judgment shows how online platform mitigates the risks of investment in the crowdfunding market<sup>41</sup> in Taiwan. “FlyingV” is one of the leading reward-based crowdfunding online platforms in Taiwan, a fundraiser wanted to raise a fund with an amount of NTD \$350,000 for his “Tide of Moon” online game development project from the FlyingV platform. Around one month (from 08.05.2015 to 08.06.2015), he raised NTD \$490,565 successfully, and 368 persons were sponsoring this project, sponsors got a reward depending on the funding amount, but the fundraiser didn’t execute his project and suspended his online game development since the fundraiser got the total funding amount from the platform. Sponsors informed FlyingV about such a situation. The platform tried to contact the fundraiser but failed. As a result, the online platform accused the fundraiser of fraud. This criminal case was finally ruled by the district court. During the hearing, the defendant reconciled with the FlyingV and promised to pay back NTD\$610,565 to FlyingV. The fundraiser was finally found guilty of fraud and sentenced to only 6 months with probation because the defendant reconciled with Flying V.

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<sup>40</sup> See supra note 24, P.1420.

<sup>41</sup> Taiwan Taipei District Court criminal judgement, 109 Chien no.1312, judgement date: 29/05/2020, the defendant did not appeal.



According to article 14.1 of FlyingV crowdfunding service clauses, FlyingV is not the contractor of the sponsoring project. If there are any disputes happen, the sponsor shall seek solutions with the fundraiser<sup>42</sup>. FlyingV will not involve in the contractual relationship and not guarantee the reward from the fundraiser. Therefore, FlyingV can claim that it is not responsible for this case according to the service contract mentioned above. But in this case, FlyingV did not quote the terms and kept silent, it took legal action to assist sponsors in getting the contributions back. This case shows that the platforms are still very willing to protect investors and secure the transaction without any contractual liability because they have incentives to protect their investors and keep a good reputation in the crowdfunding market. Therefore, intermediaries do play an excellent role in mitigating the risks in the crowdfunding market.

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<sup>42</sup> See <https://www.flyingv.cc/policy>. Visiting date:8/8/2021.

## 2.6 The Characteristics of Current Regulations on Crowdfunding From Various Jurisdictions

### 2.6.1 The Equity-based Crowdfunding Regulations in Taiwan

In Taiwan, which kind of human rights protection shall be reserved by laws is explained by Constitution Court in Interpretation No. 443 (interpretation date: 26/12/1997), the reasoning of the Interpretation No. 443 said: “The range of freedom and rights of the people stipulated in the Constitution is very broad. Any freedom and right, which is not in contravention of the order of the society and the public interest, is protected by the Constitution. Nevertheless, not every freedom and right is protected in the same way in the Constitution. The physical freedom of the people is stipulated in detail in Article 8 of the Constitution, in which those rights reserved in the Constitution shall not be limited even by the legislative authority (See J. Y. Interpretation No. 392), whereas freedom and rights under Articles 7, 9-18, 21 and 22 may be limited by the law upon meeting the conditions stipulated in Article 23 of the Constitution. The determination of which freedom or right shall be regulated by law or by rules authorized by the law shall depend on regulated intensity. Reasonable deviation is allowed considering the party to be regulated, the content of the regulation, or the limitations to be made on the interests or freedom. *For instance, depriving people’s lives or limiting their physical freedom shall be in compliance with the principle of definitiveness of crime and punishment and stipulated by law; limitations concerning people’s other freedoms shall also be stipulated by law, in the case where there is authorization by the law to the administrative institutions to make supplemental rules, the authorization shall be specific and precise. The competent authority, on the ground that such limitations*

*shall not be inconvenient for the people, may make only those limitations concerning details and technical matters of law enforcement. For policies concerning benefit to the people, the law governing such policies may be constructed more loosely compared to laws governing limitations on people's rights. Nevertheless, in the case where such policies are related to major public interests, they shall be made by law or rules authorized by law ( also see Table 1).''<sup>43</sup>*

Categories of human rights	Human rights reservation level
The physical freedom of the people is stipulated in detail in Article 8 of the Constitution	Reserved by Constitution
Depriving people's lives or limiting their physical freedom shall comply with the principle of definitiveness of crime and punishment and stipulated by law or act	Must be reserved by law or act
Limitations concerning people's other freedoms	Could be reserved by law or regulation which was authorized by law
Limitations concerning details and technical matters of law enforcement	Not reserved by constitution or laws, could be regulated by rule or regulation

Table 1 Legal Reservation

<sup>43</sup> See the Constitutional Court, <https://cons.judicial.gov.tw/en/docdata.aspx?fid=100&id=310624>, Visiting date:17/3/2022.

According to the Interpretation No. 443 of the Constitutional Court, crime and punishment which deprives people's physical freedom shall be regulated by laws, Therefore, it is not allowed that the FSC which is an administrative institution, or the Taipei Exchange which is a private legal entity to enact any regulation to punish people and deprive their physical freedom, even if they are authorized by laws.

In Taiwan, the Securities and Exchange Act is the primary law that governs securities issuance, IPO procedures, and criminal punishment. securities issuers have to comply with the duties of the Securities and Exchange Act. It prohibits insider trading, requires the duty of good faith, sets up legal liability for false information or omission in the prospectus. The Securities and Exchange Act has established a net to protect investors in the securities market.

#### 2.6.1.1 The Argument of Criminal Liability in Equity-based Crowdfunding

Unlike the amendment of the Securities and Exchange Act to regulate equity-based crowdfunding and punish violators, Taiwan passed the GISA regulation to regulate equity-based crowdfunding, but the relationship between the Securities and Exchange Act and GISA regulation is unclear, that is, when there is a criminal behavior happened in equity-based crowdfunding, how to punish the violator? Can the criminal court apply the Securities and Exchange Act to punish the violator?

The FSC excludes securities issued in equity-based crowdfunding from the Securities and Exchange Act and authorizes Taipei Exchange to regulate equity-based crowdfunding, but the GISA regulation remains silent when it comes to securities frauds or misrepresentation in equity-based crowdfunding. For instance, a director of an issuer directly or indirectly causes the company to conduct a

disadvantaged transaction which is not a reasonable transaction, the director is liable for criminal penalty under the Securities and Exchange Act, but GISA regulation does not regulate those criminal behaviors. The possible “punishment” for those behaviors in GISA regulation is to terminate the qualification as a GISA company<sup>44</sup>. Therefore, it is doubted whether investors of equity-based crowdfunding could apply the Securities and Exchange Act to accuse those criminal behaviors or not<sup>45</sup>?

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<sup>44</sup> See GISA regulation §22

<sup>45</sup> Securities and Exchange Act §20

**During the public offering, issuing, private placement, or trading of securities, there shall be no misrepresentations, frauds, or any other acts which are sufficient to mislead other persons.**

The financial reports or any other relevant financial or business documents filed or publicly disclosed by an issuer in accordance with this Act shall contain no misrepresentations or nondisclosures.

**Anyone who violates the provisions of paragraph 1 shall be held liable for damages sustained by bona fide purchasers or sellers of the said securities.**

The principal who commissions a securities broker to purchase or sell securities as a commission agent shall be deemed as a "purchaser" or "seller" for the purpose of the preceding paragraph.

Securities and Exchange Act article §171 paragraph 1

A person who has committed any of the following offenses shall be punished with imprisonment for not less than three years and not more than ten years, and in addition thereto, a fine of not less than NT\$10 million and not more than NT\$200 million may be imposed:

1. **A person who has violated the provisions of paragraph 1 or paragraph 2 of Article 20,** paragraph 1 or paragraph 2 of Article 155, or paragraph 1 or 2 of Article 157-1.
2. A director, supervisor, managerial officer or employee of an issuer under this Act who, directly or indirectly, causes the company to conduct transactions to its disadvantage and not in the normal course of operation, thus causing substantial damage to the company.
3. A director, supervisor, or managerial officer of an issuer under this Act who, with intent to procure a benefit for himself/herself or for a third person, acts contrary to his/her duties or misappropriates company assets, thus causing damage of NTD\$5 million or more to the company.

Where the value of property or property interests gained by the commission of an offense under the preceding paragraph is NTD\$100 million or more, a sentence of imprisonment for not less than seven years shall be imposed, and in addition thereto a fine of not less than NTD\$25 million and not more than NTD\$500 million may be imposed.

Scholars have different arguments about this<sup>46</sup>. Some support that the criminal provisions of the Securities and Exchange Act are still applicable in this situation, but some argue that the criminal provision of the Securities and Exchange Act should not apply because it will violate the principle of *Nulla poena sine lege* (no penalty without a law).

#### 2.6.1.2 The Protection of Investors and Promoting Fundraising Are Not Enough

The Taipei Exchange created the GISA Board and enacted the GISA regulation by legal transplantation from the USA CROWDFUND Act. The GISA regulation focuses on the investor's protection. The aggregate investment amount during the 12 months preceding the date of offer or sale cannot exceed NTD \$150,000. The GISA regulation also set up the Public Integrative Counseling Mechanism (PICM), the PICM provides counseling service on accounting, internal control, and marketing for fundraisers, the purpose of PICM is to ensure the safety of investor's investment<sup>47</sup>, but it is also doubted that those traditional supervisory measures could protect the investors or not? Will those traditional supervisory measures become a high threshold for fundraisers to raise funds? The scholar pointed out that the GISA regulation may still cause unbearable compliance costs for SMEs and startups to join equity-based crowdfunding and hamper equity-based crowdfunding. He worries that this legal transplant from the USA may become a form rather than

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<sup>46</sup> Cheng -Yun Tsang et al (2018), "Trends in Crowdfunding Regulation-From the Perspective of Blockchain Financing", *Taiwan Law Journal*, Vol.273, P82-83.

<sup>47</sup> Chang-Hsien Tsai (2016). "Legal Transplantation or Legal Innovation? Equity-Crowdfunding Regulation in Taiwan After Title III Of the U.S. Jobs Act". *Boston University International Law Journal*, Vol. 34, P. 252.

substance transplantation to assist the SMEs and startups<sup>48</sup> because the purpose of equity-based crowdfunding is not just focusing on investors' protection, but “between optimizing investors protection and not hinder the creative impetus of the burgeoning capital formation” Professor Tsai said<sup>49</sup>, this is a dilemma existed in the current GISA regulation.

## 2.6.2 The Equity-based Crowdfunding Regulations in The USA

### 2.6.2.1 The Development of Securities Regulations

The Great Crash in Wall Street of 1929 was a significant crash in the stock market, the share price collapsed since September, it reflected the vulnerable capital market system in the USA at that time, the Great Crash was not only the beginning of the Great Depression, but a lot of investors also suffered losses in the stock market. It revealed the securities governance and regulations were insufficient to protect the investors. Under this background, the USA congress enacted the Securities Act of 1933 and the Securities Exchange Act of 1934 to reconstruct the market. The Securities Act of 1933 was also known as “truth in securities” laws, the purposes of the Securities Act of 1933 are<sup>50</sup> 1. prohibition of frauds and misrepresentation in the sale of securities; 2. requiring the registration of securities issuance, so investors can acquire the financial and significant information of securities offered for public sale. The registration shall include the description of the

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<sup>48</sup> Ibid, P. 277.

<sup>49</sup> Ibid, P. 274.

<sup>50</sup> See

<https://www.investor.gov/introduction-investing/investing-basics/role-sec/laws-govern-securities-industry>. Visiting date:17/03/2022.

business and the securities offered, information about the management and financial statements, the disclosed information enables investors to make the correct investment decision, and the Securities and Exchange Commission (the SEC) requires the information shall be accurate, but the SEC does not guarantee the information is accurate, investors are still responsible for their investment decision.

The Securities Exchange Act of 1934 created the Securities and Exchange Commission (the SEC), which was empowered with broad authority to regulate the capital market. It also prohibited fraudulence activities in security issuance to protect the investors, e.g., the prohibition of insider trading, those who possess the material and undisclosed information of a company shall refrain from trading the shares until the information is disclosed. The law also required some qualified companies to file annual and periodic reports.

#### 2.6.2.2 The Enactment of CROWDFUND Act

By the enactment and amendment of the Securities Act of 1933 and Securities Exchange Act of 1934, investors have more protection from the securities laws, but a debate arose in protecting investors of equity-based crowdfunding: shall equity-based crowdfunding be exempted from the SEC registration? Because the registration is accompanied by the registration statement, prospectus, and financial information. Equity-based crowdfunding is a high-risk investment for investors, fundraisers may use information asymmetry and the internet to deceive investors<sup>51</sup>. The USA congress ended up this controversial issue by passing the Jumpstart Our Business Startups Act (also known as the “JOBS Act”) which amended the

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<sup>51</sup> See Joan Macleod Heminway & Shelden Ryan Hoffman (2011), “Proceed at Your Peril: Crowdfunding and the Securities Act of 1933”, *Tennessee Law Review*, Vol. 78:879, P.933



Securities Act of 1933 and the Securities Exchange Act of 1934 and exempted the securities registration of equity-based crowdfunding to promote SMEs and startups. President Obama signed the bill on 5 April 2012, the purpose of the JOBS Act is to increase American job creation and economic growth by improving access to the public capital markets for SMEs and startups.

There are 7 TITLES in the JOBS Act, the TITLE III of the JOBS Act is the chapter that regulates equity-based crowdfunding. TITLE III may also be cited as “Capital Raising Online While Deterring Fraud and Unethical Non-Disclosure Act of 2012” or “CROWDFUND Act.” It allowed SMEs and startups to issue securities via the online platform without registering with the SEC.

The governing law in the USA is very different from Taiwan. Taiwanese regulators excluded equity-based crowdfunding from the Securities and Exchange Act and authorized the private sector- Taipei Exchange to regulate the equity-based crowdfunding, but the CROWDFUND Act was part of the Securities Act of 1933 and the Securities Exchange Act of 1934.

The CROWDFUND Act authorized the SEC to carry out the rules as the SEC determines the necessary or appropriate for the protection of investors and the implementation of CROWDFUND Act. Therefore, the SEC issued the Regulation Crowdfunding to implement the CROWDFUND Act. The Regulation Crowdfunding permits SMEs and startups to raise funds via online platforms. The aggregate amounts of securities offered shall not exceed USD \$5,000,000 according to the latest Regulation Crowdfunding<sup>52</sup>.

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<sup>52</sup> Regulation Crowdfunding, 17 C.F.R. §227.100(a)(1). The SEC raised the amount from USD\$1.07 million to USD \$5 million on 15 March 2021.

After the Great Crash in 1929, the securities laws in the USA focused on the protection of investors, the capital formation became burdensome for securities issuers, especially for SMEs and startups. The CROWDFUND Act tried to change this situation to promote small fundraising and relieve the burden of registration requirements from the securities laws. But the scholar pointed out the CROWDFUND Act and Regulation Crowdfunding still remained some obstacles for SMEs and startups due to the disclosure duty in the regulations, he doubted that the CROWDFUND Act and Regulation Crowdfunding do not release much freedom for small amount fundraisers because of the very nature of equity-based crowdfunding is to obtain **small amount capital**<sup>53</sup>, under the current regulations, most of the fundraising will be excluded because it is still too expensive for small amount fundraisers to raise funds in the equity-based crowdfunding market in the USA.

The USA Congress passed the CROWDFUND Act to assist SMEs and startups to access the capital market, but it does not mean the USA Congress did shift the mind from the protection of investors to promoting fundraising. The concern of investors' protection still remains a key role in the CROWDFUND Act. The clue can be found easily in the CROWDFUND Act because it said: "Not later than 270 days after the date of enactment of this Act, the Securities and Exchange Commission shall issue such rules as the Commission determines may be necessary or appropriate for the protection of investors to carry out sections 4(6) and section 4A of the Securities Act of 1933, as added by this title<sup>54</sup>", the USA Congress did not

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<sup>53</sup> Jo Won (2019), "Jumpstart Regulation Crowdfunding: What Is Wrong and How to Fix It", Lewis & Clark Law Review, Vol. 22:4, P.1410-1412.

<sup>54</sup> See the SEC.302 (c) of the CROWDFUND Act

forget to remind the SEC of taking measures to protect investors when carrying out the CROWDFUND Act.

### 2.6.3 The Equity-based Crowdfunding Regulations in Singapore

Singapore takes a lot of effort to improve its doing business environment for a long time. Singapore is well-known for its friendly business environment globally. It is ranked in the Top 2 of 190 “the ease of doing business” economic regions according to the World Bank 2020 rankings<sup>55</sup>.

The SMEs and startups consistently accounted for over 99% of registered enterprises in Singapore and relied on government funding estimated close to 70 % of the initial funding amount in Singapore<sup>56</sup>. To solve the vulnerable capital funding for SMEs and startups, the Singapore government seeks the equity-based crowdfunding market to fill the gap left by traditional corporate financing and government funding.



#### 2.6.3.1 The Securities-based Crowdfunding

The model of Singapore's regulation on equity-based crowdfunding is unique if compared to other countries. Singapore did not pass any tailor-made legislation on equity-based crowdfunding. It relies on the Securities and Futures Act of Singapore to govern equity-based crowdfunding.

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<sup>55</sup> See <https://www.doingbusiness.org/en/rankings>. Visiting date:9/8/2021.

<sup>56</sup> Hu Ying (2015),” Regulation of Equity Crowdfunding in Singapore”. Singapore Journal of legal studies, Vol.2015 P.48-49.

In Singapore, Securities issuance is regulated by the Securities and Futures Act. Securities mean shares, debentures, and other products prescribed by the Securities and Futures Act. Therefore, the issuance of shares and debenture in the crowdfunding market are all involved in securities issuance. The Securities and Futures Act regulates the securities issuance in the crowdfunding market<sup>57</sup>, “securities-based crowdfunding” would be the best term than “equity-based crowdfunding” to describe the market in Singapore. According to the Securities and Futures Act, the Monetary Authority of Singapore (MAS) is the authority governing securities-based crowdfunding and constraining online platforms.

#### 2.6.3.2 The Importance of Online Platforms in The Securities-based Crowdfunding

To balance the investor’s protection and fundraiser’s need, the MAS does not require fundraisers to file or disclose the business information, but it pays much attention to regulating online platforms to protect investors in the crowdfunding market. A “Capital Markets Services” (CMS) license granted by MAS is required for online platforms before running their business of securities-based crowdfunding. The platform should also provide the “Risk Disclosure Statement”, “Knowledge or Experience Test” or “Suitability Assessment Test” to investors for assessing investors and reducing the investment risks when dealing with securities-based crowdfunding.

Unlike the other regimes that rely on disclosure duties to protect investors and regulate the equity-based crowdfunding market, Singapore applies a more flexible

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<sup>57</sup> Adrian Ang and Samuel Kwek (2020),” Regulation of Crowdfunding in Singapore”, Business law International, Vol 21:1, P.61.

method that widely relies on the “know your customer (KYC)” and the customized risk warning mechanism. Investors can evaluate their investments are suitable or not. Furthermore, they are also educated with investment knowledge while they do the assessment for investment each time. Singapore protects investors and promotes the securities-based crowdfunding market by enhancing the role of intermediaries.

## 2.7 Summary

Funding from the crowd becomes more and more popular from the old time till today, the Pulitzer and ArtistShare marks the era of crowdfunding, the case of “Oculus Rift” fundraising marks the importance of equity-based crowdfunding because only equity investment can enjoy the benefit and revenue of a company. Furthermore, online crowdfunding supports fundraisers to raise funds more easily and tap into the international market, fundraisers can also utilize crowdfunding to reduce the risks of business running and test the market temperature, some companies can also improve their corporate governance by crowd’s wisdom in the corporate.

For investors, the risks in equity-based crowdfunding are the existence of information asymmetry and the difficulty in monitoring fundraisers’ business. To reduce the risks, the internet, intermediaries, and legal regulations may take a role to reduce the risks in equity-based crowdfunding. The case in Taipei District Court shows that intermediaries could play a role to mitigate the risks for investors.

Although the GISA regulation is not enough to protect investors, by comparison, the GISA regulation shall consider applying a more flexible regulatory

method that relies on investors' assessment and take action to cope with criminal behavior in equity-based crowdfunding.

For fundraisers, if their business failed, they have to endure the total loss they contribute. When fundraisers raise funds in equity-based crowdfunding, they may lose the controlling power of their company because of security issuance. Taiwan's government opens the equity-based crowdfunding market for fundraisers and authorizes the Taipei Exchange to regulate the market. The regulatory method relies on disclosure duty which hampers those who look for a small capital cap. It is crucial to find a way to support those small capital cap fundraisers.



### Chapter 3: Equity-based Crowdfunding in Taiwan

Capital formation is a significant financial issue for people who want to start a new business. There are many portals to raise funds for fundraisers nowadays. Those portals are mainly from governmental funding, debt, or equity, but those traditional business portals for financing cannot satisfy the needs of fundraisers in today's business activities. Therefore, equity-based crowdfunding becomes an important funding portal for fundraisers and a chance for crowds to seek bonanza.

Taiwan's government opened its capital market to equity-based crowdfunding in 2013 and authorized Taipei Exchange to regulate equity-based crowdfunding. Taipei Exchange enacted the GISA regulation and set up the GISA board to assist SMEs and startups to raise funds in equity-based crowdfunding. Because of the risks of the investment in equity-based crowdfunding, it is doubted whether GISA regulation can protect investors or not? This chapter will discuss how the GISA regulation protects investors and leave one question: is the GISA regulation enough to protect investors?

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CHULALONGKORN UNIVERSITY

#### 3.1 Business Model of Financing for SMEs and Startups

Business owners are always concerned about 2 things when running a business. One is the operating issue listed on the left side of the balance sheet (see Figure 2). Operating means how to make cash flows to the company, in other words, how to make a profit by the business operating. The other is the financing issue which is listed on the right side of the balance sheet. Financing is consisting of debt and equity in a company (See figure 2), financing is very important for business owners who don't have enough capital to start a new business. To balance debt and equity in

the balance sheet is very important for any business running because too much debt or equity may seriously harm the company. This part will focus on the introduction of the financing issue and discuss how fundraisers plan their financing structure.

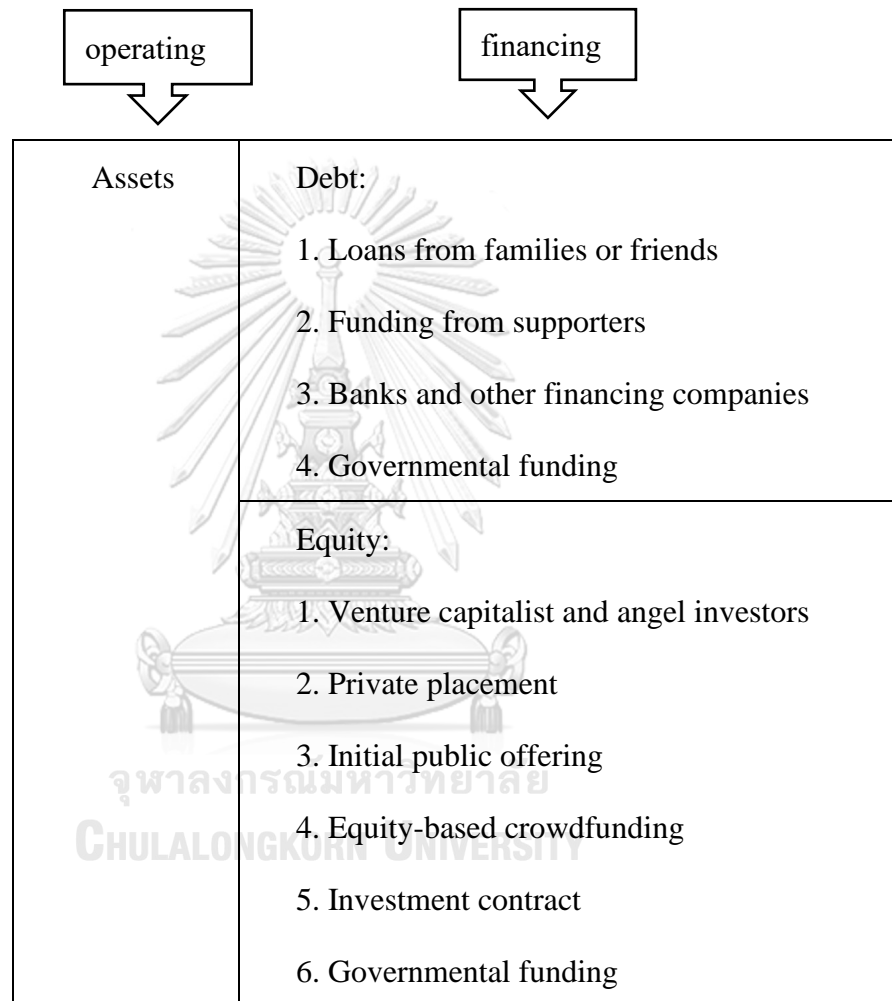


Figure 2 Balance Sheet of A Company



### 3.1.1 The Governmental Funding

Governmental funding is vital for some business owners. Governments offer many kinds of financing programs to support SMEs and startups. For example, in Singapore, SMEs consistently account for 99% of all registered companies and contribute more than 50% of economic output and 70% employment rate. Startups in Singapore are intensely relying on governmental funding. It is estimated that around 70% of the earlier stage financing is primarily supported by the Singaporean government<sup>58</sup>.

In Taiwan, there are also many governmental funding programs from the central and local governments, it could be a subsidy scheme, loan, or investment of equity<sup>59</sup>, one of those famous programs is the angel investment in 2018. The National Development Fund of Executive Yuan passed a program of angel investment to support startups<sup>60</sup>, the program is established for assisting startups with NTD \$5 billion budget for 5 years, any business is qualified to apply for this program if it was established within 5 years and the capital is less than NTD \$100 million, but the investment amount from the program will not exceed NTD \$20 million per application.

Funding from the government has some obstacles. Each governmental funding program has its own specific public objectives, conditions, and funding caps<sup>61</sup>. Government always has a specific policy purpose and target. Not all types of businesses can be funded easily. Besides, the bureaucratic procedure to deal with the

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<sup>58</sup> See supra note 27, P.49.

<sup>59</sup> See <https://sme.moeasmea.gov.tw/startup/modules/funding/index.php>. visiting date:6/7/2021.

<sup>60</sup> See <https://www.angelinvestment.org.tw/introduction>. Visiting date:6/7/2021.

<sup>61</sup> See supra note 56, P.53.

government and the cruel funding conditions may frustrate fundraisers to apply for the governmental funding programs. Some fundraisers may disqualify from applying for governmental funding due to the high standard.

Furthermore, there is a more serious problem when governmental fund invests in equity. Fundraisers have to share the management power with the government, sometimes the government may become the main shareholder of that company, but the government is different from an enterprise, the government cares about public interest instead of profitability, government as a shareholder may shift the company's business guideline from profitability to the public interest, some fundraisers may worry that business development will be restrained from profitability due to the governmental funding.

### 3.1.2 Loan

A loan is a common financial portal to get a fund for startups, but fundraisers may have some considerations to apply for a loan as a financing tool. In other words, getting a loan usually needs collateral, it will be challenging to get a loan from a lender without collateral or it will be expensive to get a loan because the interest rate is higher than a loan with collateral.

Furthermore, Fundraisers must pay back the loan with interest on time, no matter the business can make a profit or not. If the SMEs and startups suffer a significant loss or they fail in the end, Fundraisers endure all losses, sometimes they go bankrupt because of the overdue repayment.

Too much debt could also harm the business of SMEs or startups, when SMEs or startups have too much debt, business traders may worry that SMEs or startups are unable to honor an agreement, they will doubt whether SMEs or startups are able

to perform their duties or not, SMEs or startups have too much debt in the balance sheet means the high risks of bankruptcy, the business traders may suffer risks once the SMEs or startups fail to fulfill the contractual obligations, so a company has too much debt in the balance sheet may give people a “bad impression” about that company. That company may be difficult to buy more production equipment or get a new loan because business traders may worry that the company is unable to pay the bill in the future.

Too much debt could also make the SMEs or startups difficult to issue new shares from the capital market. Investors will doubt that the fundraisers could not make capital gains for shareholders. They have no incentives to invest in fundraisers’ businesses because all profits will go to the creditor’s pocket instead of the shareholders’.

To sum up, getting a loan is a good method to solve the financial needs of SMEs and startups. However, it is not easy to get a good loan. Sometimes huge debt may not be a good thing for SMEs and startups in doing business. There are still many challenges in financing from loans.

#### 3.1.2.1 Loans from Families or Friends

People always finance their new business with their savings, if the business makes a profit, the founder will enjoy all revenues from his business, but if his savings is not enough for the business, founders may also try to borrow money from families or friends with a negotiable interest rate or without interest rate. Generally speaking, the amount borrowed from families or friends may not be enough to meet the capital need of business because those loans are usually a small amount, but the founder can avoid the extra paperwork for financing from commercial banks or

other financing companies, especially when the founder has a credit problem, it is difficult for him to finance from outsiders. But borrowing money from people we know may leave a shortcoming. If the business is failed or is unable to repay the loan in time, it may harm the relationship with families and friends<sup>62</sup>.

It is also particularly important to write down the agreement when borrowing money from families or friends to avoid any disputes in the future. Without the agreement, the taxation bureau may claim that money is a gift from families and subject to taxation and fine the taxpayer according to Taiwan's Estate and Gift Tax Act<sup>63</sup>.

#### 3.1.2.2 Funding from Supporters

Founders can seek funding from people who are interested in the project. For instance, founders can utilize online P2P or reward-based crowdfunding. Many online platforms are offering non-equity-based crowdfunding services for founders, but statistics show that only around 50% of cases can successfully be funded from reward-based crowdfunding<sup>64</sup>, which means non-equity-based crowdfunding still cannot meet the needs of all capital formation.

#### 3.1.2.3 Loans from Banks or Other Financing Companies

Banks or other financing companies are the widespread institutions for people to seek financial funding, but customer gets the loan only when the banks or other financing companies determine the customer are able to repay the loan and interest in the future. It will be easier to get a loan with collateral. Without a guarantee or

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<sup>62</sup> Fred S. Steingold (2003), Legal guide for starting & running a small business [electronic resource], P.9/11.

<sup>63</sup> The tax rate is between 10% to 20% according to the gift amount, but the taxable gift amount less than NT\$2,200,000 per year is exempted from taxation, see Estate and Gift Tax Act § 19 and § 22.

<sup>64</sup> See supra note 46, P.83.

collateral, it won't be easy to get a loan from banks and other financing companies, or the customer get a loan with high-rate interest.

What is even worse is that banks are not interested in providing loans to support risky startups because startups are unable to prove their profitability or revenues in the future<sup>65</sup>. SMEs are also in the same situation to get a loan from banks or other financing companies. The business risks and uncertain revenue in the future make SMEs and startups difficult to get a loan from those commercial institutions.

### 3.1.3 Equity

Equity is another model to raise funds from the public. Finding investors to invest in a company by shares is a good way to reduce the risks of running a business for fundraisers because fundraisers share the risks with all investors (or so-called shareholders) by equity issuance. If the business fails, all investors share the loss with fundraisers, fundraisers don't have to pay back the investment amount that investors invested in. Although investors may suffer total loss in the investment, on the other hand, they also enjoy the profits from the business, sometimes shareholders can have a significant return if the business is successful in the market.

For fundraisers, equity is an important tool for fundraising and sharing the business risks. For investors, equity investment may bring a potentially higher return, although the risks in equity investment may be higher than money lending.

#### 3.1.3.1 Venture Capital and Angel Investors

There are some professional investors, e.g., venture capital and angel investors, who have capital and look for investment opportunities. There is no doubt that

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<sup>65</sup> See supra note 19, P.14-15.

fundraisers could seek those professional investors for funding. David Cheriton is a well-known investor in this field, he is a computer science professor at Stanford University, he invested in Google with USD \$100,000 in the very early-stage investment and also gave some professional advice on computer development for the development of Google, the success of Google brought professor Cheriton an enormous fortune and the capital from him made the Google a giant company today.

But not everyone can be so lucky as Google. Venture capitalists and angel investors are unable to meet all needs of SMEs and startups adequately. According to the Small Business Administration in the USA, only 300 of the 600,000 new businesses started each year obtain venture financing. Most startups fail to get capital from venture capitalists because venture capitalists focus on “high growth and high-return” investments. There are less than 1% of all proposals accepted by venture capitalists<sup>66</sup>. Furthermore, venture capitalists perform wide due diligence on their target company before making a decision and usually take a large portion of equity stakes from the target company when they make an investment decision, seeking to cash out one day when the business succeeds. The participation of venture capitalists also makes fundraisers worry that the controlling power of the company will shift to the venture capitalist because fundraisers have to sign a cruel investment contract that caters to the protection of venture capitalists.

Angel investors are also unable to adequately meet the needs of the capital formation of SMEs and startups. Angel investors are investors or groups of investors who invest their own money in the startups. They usually take an active role in the business as members of the board. Unlike venture capitalists, angel

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<sup>66</sup> See supra note 24, P.1408-1409.

investors usually possess specialized industry backgrounds and generally make investments in the earlier time of the business. However, angel investors are insufficient to fill the capital gap because they are few and sometimes far from fundraisers' venues. Furthermore, the investment amount of angel investors was usually less than half of what venture capitalists invested<sup>67</sup>.

### 3.1.3.2 Private Placement

SMEs and startups may carry out private placement without securities registration to the government, but they have to meet the requirement of the Securities and Exchange Act<sup>68</sup> in Taiwan. The qualified investors of a private placement are limited to:

1. Banks, bills finance enterprises, trust enterprises, insurance enterprises, securities enterprises, or other juristic persons or institutions approved by the government.
2. Natural persons, juristic persons, or funds meeting the conditions prescribed by the government, the natural persons shall have net assets of more than NTD \$10 million dollars or accumulative NTD \$15 million dollars with his or her spouse, or in recent 2 years, the average income exceeds NTD \$1.5 million or NTD \$2 million with his or her spouse<sup>69</sup>.
3. Directors, supervisors, and managerial officers of the company or its affiliated enterprises.

The total number of the above investors cannot exceed 35 persons, and fundraisers must provide information about the company's finances, business, and

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<sup>67</sup> Ibid P.1409.

<sup>68</sup> See Securities and Exchange Act §22 and §43-6.

<sup>69</sup> See Ministry of Treasury, No.0910003455 announcement.

other information relevant to the private placement and inform the government when the private placement procedure is completed.

The private placement is similar to venture capitalists and angel investors because those investors have professional background and capital to suffer the risks, those investments are not highly supervised by the authority, therefore, those investors will set up a high standard to protect their investment, only some fundraisers can pass the threshold and get the capital.

### 3.1.3.3 Initial Public Offering (IPO)

IPO is a typical capital formation method for a company to raise funds from the capital market, a company raises capital from the public by issuing securities, but one of the obstacles for fundraisers to raise funds from IPO is the “profitability”. For those who want to utilize the IPO and become a listed company in the stock exchange market, they have to show the profitability in their business to attract investors for funding, but most SMEs and startups cannot make profits in the very beginning period, therefore, IPO is almost impossible for them to utilize.

### 3.1.3.4 Equity-based Crowdfunding

Getting a loan or utilizing the common equity issuance to raise funds is difficult for SMEs and startups as discussed above. Most SMEs and startups are not able to prove their future revenues or profitability, those traditional capital formation portals are not friendly for SMEs and startups to utilize, equity-based crowdfunding becomes an essential portal for SMEs and startups to fill the gap in traditional capital formation, this is the background why more and more countries open their market to equity-based crowdfunding and keep improving the capital formation environment for SMEs and startups.



Under the global trend of crowdfunding, the Taiwan government authorized Taipei Exchange to regulate the equity-based crowdfunding market and assist SMEs and startups to raise funds, Taipei Exchange enacted GISA regulation in 2013, since then, SMEs and startups can apply to be a GISA company and raise funds in equity-based crowdfunding market without profitability requirement or prospectus.

#### 3.1.4 The Controversial Issue of Investment Contract

In the USA, there is a definition of “security” in the SECURITIES ACT OF 1933. Security means “any note, stock, treasury stock, security future, security-based swap, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, **investment contract**, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or, in general, any interest or instrument commonly known as a “security”, or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing<sup>70</sup>”.

some companies have incentives to structure “hybrid securities” which is incorporated both debt-and equity-like features to save the tax and get the capital from investors, fundraisers may sign a “loan contract”, but the interest rate is fixed

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<sup>70</sup> See the USA SECURITIES ACT OF 1933 section 2 A (1).

to the corporate's revenue, this "loan contract" can save tax for fundraisers because interest is not taxable, and investors can enjoy a high interest when the debtor's business is successful. But it is questionable whether this contract is a loan or security issuance? this situation could lead to legal risk for fundraisers because securities issuance is governed by securities laws, it is needed to register before securities issuance.

The USA supreme court's Howey case (so-called Howey test)<sup>71</sup> found that an instrument will be qualified as an "investment contract" when there is an investment of money in a common enterprise with a reasonable expectation of profits to be derived from the efforts of a promoter or a third party, regardless of whether it has any of the characteristics of typical securities or terms of the instrument itself, the federal securities laws will apply to that instrument.

There are also some standards for fundraisers to determine their financial instrument is a loan or security<sup>72</sup>, it could be a loan if it qualified the following conditions, otherwise, it could be a security (or equity) issuance:

1. there is a fixed date or an unconditional promise to pay the amount in the reasonably foreseeable future.
2. the instrument holder possesses the right to enforce the payment and interest.
3. compared to other creditors of fundraisers, there is no preference over any indebtedness of the issuer.

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<sup>71</sup> See SEC v. W.J. Howey Co., 328 U.S. 293 (1946) ("Howey case"), also see United Housing Found., Inc. v. Forman, 421 U.S. 837 (1975) ("Forman case").

<sup>72</sup> See overview of the tax treatment of corporate debt and equity, prepared by the staff of the Joint Committee on Taxation, scheduled for a public hearing before the Senate Committee on Finance on May 24, 2016, P.14-15.

4. the intent of the parties, including the name given the instrument by the parties, is not related to securities investment.
5. the fundraisers' debt to equity ratio is reasonable.
6. the instrument holder is not at risk of losing his investment or there is no prescribed opportunity to participate in the business in future profits.
7. the instrument did not provide the holder with the right to participate in the management of the issuer.
8. there are requirements for collateral or other security to ensure the payment of interest and principal.
9. the expectation of repayment of the total amount.

In Taiwan, the Supreme Court ruled that security defined in the Securities and Exchange Act means that an instrument with **“a specific value”** and is also qualified with **“investable”** and **“liquidity”** figures<sup>73</sup>, no matter the title of the instrument is loan or security.

Both loan and equity are the same important for a company's financing planning, but fundraisers must consider that mixed loan and equity may lead to legal liabilities when they raise funds from the public. If the instrument (no matter the title is a contract or not) is qualified with **“a specific value”**, **“investable”** and **“liquidity”** figures, fundraisers shall comply with securities laws for securities issuance or GISA regulation for equity-based crowdfunding. Without registration or exemption, violators may be sentenced to 5 years and fined up to NTD \$15 million<sup>74</sup>.

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<sup>73</sup> See Taiwan Supreme Court, 104 Taisan no.3215 criminal judgement, date: 22/10/2015.

<sup>74</sup> See Securities and Exchange Act §22 and §174 II.

### 3.2 The GISA Regulation

The previous part has shown that equity-based crowdfunding is very important for the business financing of SMEs and startups. This part is going to discuss how the GISA regulation protects investors in equity-based crowdfunding.

The USA congress enacted the Securities Act of 1933 and Securities Exchange Act of 1934 to protect investors, since then, investors' protection is the main purpose of securities regulations. Article 1 of the Securities and Exchange Act of Taiwan also ruled that "This Act is enacted for the purpose of promoting the national economic development and the protection of investors". If investors cannot be protected, the financial market will collapse easily. The GISA regulation was also enacted to regulate equity-based crowdfunding, but it is doubted whether GISA regulation can protect investors or not? Because equity-based crowdfunding is excluded from the current Securities and Exchange Act and relied on the disclosure duty of fundraisers.

#### 3.2.1 How The GISA Regulation Protects Investors?

The protection mechanism of GISA regulation can be divided into four parts (see chapter 3.2.1.1 to 3.2.1.4):

##### 3.2.1.1 First-stage Examination

Fundraisers shall Apply to be a registered GISA company, they must meet the following requirements to apply for GISA registering<sup>75</sup>:

1. The company must be a company limited by shares or a limited company or a preparatory office that will change to a company under the Company Act.

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<sup>75</sup> See GISA regulation §4.

2. The company must have an innovative or creative concept and development potential.
3. The applicant shall also submit the following documents:
  - a. the business running plan.
  - b. the company registration form.
  - c. the most recent financial report (the report should be audited and attested by a CPA if the company is qualified the Article 20 paragraph 2 of Company Act <sup>76</sup>) and the latest financial documents.
  - d. the certificate of no tax violation and tax arrears.
  - e. the certificate of no dishonored checks.
  - f. any document or statement about the company or directors involved in any litigations.

Under these conditions, only those who have “innovative or creative concept and development potential” could be qualified to apply for the GISA registration. The GISA board does not open to all SMEs and startups in Taiwan.

The Innovation and Creativity Examination is the first-stage examination. After receiving the application documents, Taipei Exchange will assign an Innovation and Creativity Examination Committee to issue innovation opinions on the company’s or preparatory office’s application. If more than half of the committee members agree on the application, and Taipei Exchange also examines the application as appropriate, the company will pass the first-stage examination, it

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<sup>76</sup> Where a company's equity capital exceeds NTD \$30 million or a company's equity capital does not exceed the amount, but the company is with a certain scale which prescribed by competent authority, the company shall have its financial statements audited and certified by a CPA.

will be qualified to join the next step: Public Integrative Counseling Mechanism (PICM).

There is a path to exempt the first-stage examination conducted by Taipei Exchange if the applicant meets any of the following requirements:

1. The applicant has obtained an "Innovation and Creativity Opinion Letter" from a recommending agency, e.g., the central competent authority for the target industry, the Ministry of Science and Technology, a government at the level of a county (or county-level city) or above, the National Applied Research Laboratories, the Industrial Technology Research Institute, the Commerce Development Research Institute, the Institute for Information Industry, or other agency that has submitted an application and been recognized by the Taipei Exchange.
2. It has obtained a recommendation letter issued by the central competent authority for the target industry, specifying why the applicant possesses innovation and creativity.
3. It has been awarded a national award recognized by the Taipei Exchange and been recommended by a recommending agency.
4. It has been registered or certified as a social enterprise by a domestic or foreign institution recognized by the Taipei Exchange and been recommended by a recommending agency.
5. Its most recent annual financial report audited and attested by a CPA shows operating revenue of NTD \$50 million or above.

The recommending agency must fully assess and describe concrete reasons for the company's innovative or creative concept and its future development potential

based on the "Innovation and Creativity Opinion Letter" according to the GISA regulation. Although this exemption can save time to raise funds for SMEs and startups, on the other hand, it will be a challenge and uncertain for the applicant to obtain the recommendation from those well-known agencies.

#### 3.2.1.2 Public Integrative Counseling Mechanism (PICM)<sup>77</sup>

After the fundraiser passes the first-stage examination, the Taipei Exchange will provide PICM services with resources from relevant associations to provide the applicant accounting, internal control, marketing, and regulatory integrative counseling services. At this time, the applicant company will have to set up internal control, accounting, and corporate governance systems with assistance from PICM.

Although the PICM period will not exceed 2 years, for reasons deemed as appropriate by Taipei Exchange, the PICM period could be extended, the risk for fundraisers is that no one can know how much time it is going to consume, it may take even more than 2 years, the applicant may not be able to arrange its cash flow in advanced, or even worse, it may lose the business opportunity in the market in the end. If the applicant wishes to shorten the period, the only way is to take much effort and budget to improve its internal control, accounting, and corporate governance systems which could benefit investors' investment.

#### 3.2.1.3 Second-stage Examination<sup>78</sup>

The second-stage examination is an examination before GISA registering. After the company or preparatory office receives PICM for some time and has established a sound internal control and accounting systems, which are being

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<sup>77</sup> See GISA regulation §8-12.

<sup>78</sup> See GISA regulation §13.

effectively implemented, and its accounting treatment complies with the Business Accounting Act, its plan for a cash capital formation is reasonable and feasible, and Taipei Exchange also considers the company is appropriate to be registered in the GISA board, Taipei Exchange will proceed to the second-stage examination before registering in the GISA board. This examination focuses on the company's effective accounting and internal control systems and the reasonableness and feasibility of the capital raising plan. The Taipei Exchange has the discretion to set up a high threshold of examination that focuses on securing investors' protection.

If the company passes this examination, Taipei Exchange will notify the company to raise capital before GISA registering. The company shall also enter into a shareholder services agency contract with the designated shareholder services agency. The applicant is not allowed to sell the shares on its own to save the budget.

After the applicant passes the second-stage exam, the company will be allowed to raise funds via the GISA board before GISA registering. The company can decide to offer the shares to angel investors only or all accredited investors.

The company or preparatory office raising capital before GISA registering should disclose capital raising information on the GISA board's online website, and then investors can purchase through the GISA board online platform.

The accredited investors have to qualify<sup>79</sup>:

1. confirm a "Risk Disclosure Statement" via the Taipei Exchange's GISA company capital raising system before commencing with the subscription.

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<sup>79</sup> See GISA regulation §16



2. the amount of purchasing shall not exceed NTD \$150,000 during the preceding year, but the following persons who have professional investment background or income are exempted from the amount limitation:
  - a. the angel investors.
  - b. a natural person who provides proof of financial capacity showing assets of NTD \$30 million or above, and who also possesses ample professional knowledge of financial products or ample trading experience<sup>80</sup>.
  - c. the original shareholders.

After completing the capital raising process and amending the corporate registration form or corporate registration according to the Company Act, the applicant company will be registered on the GISA board as a GISA company.

#### 3.2.1.4 Counseling and Disclosure Duty

Being registered on the GISA board as a GISA company, Taipei Exchange will keep providing counseling and courses about business transparency and internal control for the GISA companies<sup>81</sup>. Taipei Exchange will require the GISA companies to send employees for relevant training courses or call on the GISA companies if in need. The counseling duty for fundraisers is also a protection of investors after fundraising.

Furthermore, the GISA company shall disclose the following information into the online platform of Taipei Exchange<sup>82</sup>:

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<sup>80</sup> e.g., the passbook of securities depository, securities dealing record or any financial certificate or financial courses certificate to proof his or her professional knowledge or assets.

<sup>81</sup> See GISA regulation §19.

<sup>82</sup> See GISA regulation §22.

1. Basic company information and overview, basic information about the directors, supervisors, and management team, shall be disclosed within 5 days when the company knows any change of the above information.
2. Insider shareholdings of GISA company shall be disclosed by the 15th of every month.
3. The dates of regular and special shareholders meetings, and the period during which the amendment of entries of the shareholders' register is suspended, shall be disclosed at least 5 business days before being suspended.
4. A business report, annual financial statement, and the surplus earning distribution or loss off-setting proposals submitted for recognition by a regular shareholders meeting shall be disclosed at least 10 days before the date of regular shareholders meetings, but if a company's paid-in capital reaches NTD\$ 30 million or more, or the net revenue has reached NTD\$100 million, or the number of employees insured by Labor Insurance Program has reached 100 persons, it shall use the financial statement which has been audited and attested by a CPA.
5. Dividend distribution shall be disclosed on the business day following the resolution by the board of directors or confirmation by the shareholders' meeting.
6. Shareholders' meeting minutes shall be disclosed within 20 days after the shareholders' meeting.
7. the date of record for the company's decision to distribute dividends, bonuses, or other benefits and the period during which changes to entries

in the shareholder register are suspended shall be disclosed online at least 5 business days before the period during which changes to entries in the shareholder register information is suspended.

8. Information on a board of directors' resolution for a cash capital increase through a new share issue shall be disclosed within 5 days after the date of the resolution.
9. Information on capital raising through the GISA board.
10. The capital raising plan and progress shall be disclosed within 10 days after the date of the entire collection of the share prices for the capital raising. Any changes in related information shall be entered into the system within 5 days of the change.
11. Quarterly statements on utilization of capital raised shall be disclosed within 20 days after the end of each quarter.

If any of the following material information happened<sup>83</sup>, fundraisers should input the related information to the website of Taipei Exchange within 5 days from the date of occurrence, with the exception that a GISA company whose GISA registration is terminated according to GISA Regulation, then it shall input the information by the next business day following the Taipei Exchange's announcement of the termination.

1. It has had a negotiable instrument dishonored due to insufficient funds, been blocklisted by a financial institution, or has otherwise experienced a loss of creditworthiness.

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<sup>83</sup> See GISA regulation §23.

2. The company has suffered any major litigation with a **material effect** on the finances or business of the company.
3. The company makes a major cut in production or undergoes a full or partial work stoppage, leases company plant or important equipment to others, or creates a pledge on all or a major portion of its assets, with a **material impact** on the company business.
4. The occurrence of any circumstance under Article 185, paragraph 1 of the Company Act.
5. Any change of the chairman of the board or general manager.
6. The signing of a plan for business cooperation or an important contract, or any alteration, termination, or rescission of such a plan or contract, with a **material effect** on the finances or business of the company.
7. A resolution by the board of directors for a capital increase through a new share issue or the record date of a capital increase, or a **material change** in the preceding.
8. A resolution by the board of directors to file with the competent authority for registration of supplementary procedures for becoming a public company.
9. A resolution by the board of directors or shareholders meeting for termination as a GISA company.
10. Explanation and concrete plan for corrections, and status of subsequent corrections, required to be disclosed for any irregular events, according to paragraph 6 Article 17, or paragraph 2 Article 26 of GISA Regulation.

11. Suspension of the company's qualification for capital raising by Taipei Exchange according to Article 26 or 27, of GISA Regulation and a **material change** in any of the preceding matters.
12. Occurrence of a disaster, group protest, strike, environmental pollution situation, or any other **material event** which has a **material effect** on the finances or business of the company.
13. Any other circumstances have a **material effect** on shareholder equity.

If a GISA company has reported material information and there is a material change afterward, the company shall immediately update or provide supplementary information following the original report. The GISA company fails to disclose material information under the GISA regulation and fails to correct the matter within a prescribed deadline, which may lead to the termination of a GISA company.

The disclosure duty of fundraisers helps investors have sufficient information to make or change their investment decision and supervise the business running of the company. If shareholders are not satisfied with the decision of the board of directors, they can take action against the board of directors and protect their investment, one or plural shareholders of a company who have continuously held 3% or more of the total number of shares more than 1 year, can request the board of directors to call a special meeting of shareholders, if the Shareholders continuously holding 50% or more of the total number of shares for more than 3 months may convene a special shareholders' meeting directly<sup>84</sup>, this is so-called "shareholder

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<sup>84</sup> See company Act §173 and §173-1

activism”. Without the information disclosure from the company, shareholders are very difficult to supervise the business running of the company.

### 3.2.2 GISA Regulation Is Insufficient to Protect Investors

Until today, the cumulative applicant company numbers are 415 companies, and there are only 65 companies without recommendations among the applicant companies. The cumulative registered company numbers are 180 companies, but only 87 companies remain as registered companies, and there are 53 companies now are accepting the PICM service according to the GISA board statistics.

The GISA regulation, as discussed in this chapter, shows it tries to protect investors and eliminate information asymmetry by imposing many duties on fundraisers, investors’ protection relies on the duties of fundraisers according to the GISA regulation, more protection on investors means more duties on fundraisers.

Those duties hamper the capital market because fundraisers need to pay a lot of fees to complete a “perfect” accounting and internal control system before fundraising. The Taipei Exchange has high discretion to pass the fundraising application for the purpose of investors’ protection, but for those who are planning to raise a few amount capital at the very beginning of the business or those who are eager to raise funds for business as quickly as possible, the GISA board may not be the best choice for them to utilize because the procedure and duties under GISA regulation are applied to all applicants, no matter how much capital the company is going to raise or how hurry it is, it is tough to save the budget and time in the current equity-based crowdfunding regulation. How to balance investors’ protection and to promote fundraising becomes a dilemma in equity-based

crowdfunding regulation. Furthermore, those duties from GISA regulation are not so helpful to protecting investors and eliminating information asymmetry, the reasons will be discussed below.

### 3.2.2.1 There Is No Merit Review

For security issuance, there are 2 governing models in securities regulations, one is **the merit review model**, the other is **the registration model**, merit review means the government will examine the content of documents submitted by the issuer, but the shortcoming of merit review is that officers are unable to examine all tons of paper submitted by issuer every day. Furthermore, investors may be misled that those securities are already “guaranteed” or “checked” by the government. On the other hand, the registration model is focused on the disclosure principle, the authority only checks how many forms are submitted by the issuer, the officers do not check the content. It is the duty of investors to check all information disclosed by the issuer.

The GISA regulation adopted registration model, it did not check the information submitted by the issuer is true or false, the Risk Disclosure Statement of GISA regulation<sup>85</sup> clearly said Taipei Exchange did not hire any experts to do merit review, as a result, investors are still responsible to check all information which submitted by fundraisers, the registration procedure of GISA regulation did not guarantee anything from fundraisers.

### 3.2.2.2 The PICM Cannot Secure All Business from Fundraisers

The PICM is a mechanism to assist fundraisers to set up the internal control, accounting, and corporate governance systems, but it does not mean that SMEs and

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<sup>85</sup> See GISA regulation appendix 9.

startups will survive within 5 years with the assistance of PICM because there is no direct connection between the PICM and profitability of a company. After the PICM period, investors may still suffer losses because the business fails thereafter.

### 3.2.2.3 Overwhelming But Not Helpful Information

The GISA regulation relies on disclosure duty to protect investors and eliminate information asymmetry. It requires the GISA company to disclose the material information in time, but it neglects one thing that not all investors are experienced or professional investors who can analyze that information, on the other hand, investors may also have no incentive to spend extra fee for hiring or consulting experts for his investment due to the investment of the small amount and return. Therefore, in the real world, most investors are not apt to read any disclosure information because the tons of information is overwhelming and challenging to understand<sup>86</sup>, so it is not so helpful to protect all investors by imposing disclosure duties on fundraisers.

As a result, the GISA regulation did not reduce the risks from information asymmetry in equity-based crowdfunding by those traditional governing methods. Meanwhile, those duties hamper fundraisers to utilize equity-based crowdfunding. There is a need to seek new paths or supervisory methods to protect investors and eliminate information asymmetry in equity-based crowdfunding, and those methods will not hamper the capital formation for fundraisers seriously.

### 3.2.2.4 When IPO Is More Promising

There are 3 main stock exchange markets in Taiwan's IPO market (see the comparison in Table 1), the first market is listed in Taiwan Stock Exchange

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<sup>86</sup> See supra note24, P.1416.



Corporation (TWSE), which is the main stock exchange center in Taiwan, and the second one is Over-The-Counter (OTC) market which is governed by Taipei Exchange, the third one is Emerging Stock Market (ESM) which also governed by Taipei Exchange.

IPO Venue	TWSE <sup>87</sup>	OTC <sup>88</sup>	ESM <sup>89</sup>
Capital	A paid-in capital is NTD \$600 million or more.	A paid-in capital of NTD \$50 million or more.	none
Established period	It has been incorporated and registered under the Company Act for at least 3 years at the time of the application for listing.	It has been registered for no less than 2 full fiscal years.	none
Financial Requirement	The net income before tax in its financial reports meets either of the following criteria, and it does not have any accumulated deficit in the final accounting for the most recent fiscal year:  1. The net income before	It shall meet one of the criteria:  1. Profitability: The ratio of income before tax to capital (for foreign companies, capital will be replaced to the amount of equity	none

<sup>87</sup> See <https://www.twse.com.tw/en/page/listed/process/standars.html>. Visiting date:8/2/2022.

<sup>88</sup> See [https://www.tpex.org.tw/web/regular\\_emerging/apply\\_way/standard/standard.php?l=en-us](https://www.tpex.org.tw/web/regular_emerging/apply_way/standard/standard.php?l=en-us). Visiting date:30/8/2021.

<sup>89</sup> See <https://www.tpex.org.tw/web/link/index.php?l=en-us&t=2&s=6>. Visiting date:17/8/2021.

	<p>tax for the most recent two fiscal years represents six percent or greater of the share capital stated on the financial report for the annual final accounts.</p> <p>2. The net income before tax for the most recent two fiscal years represent six percent or greater of the amount of paid-in capital in its final accounts and the profitability for the most recent fiscal year is greater than that for the immediately preceding fiscal year; or</p> <p>3. The net income before tax for the most recent five years represents three percent or greater of the share capital stated</p>	<p>attributable to owners of the parent company) shall meet one of the following requirements, and the income before the tax of the most recent year shall not be less than NTD \$4 million:</p> <p>a. Most recent fiscal year: the ratio shall be more than 4%, and there shall be no accumulated deficit.</p> <p>b. The last 2 fiscal years: the ratio shall be more than 3% in each year, or an average of 3% in the 2 years and the ratio of the most recent year is better.</p> <p>2. Net worth, operating revenue, and cash flows from operating activities shall meet each of the following requirements:</p>	
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	<p>on the financial report for the annual final accounts.</p>	<p>a. Net worth for the most recent period shall be not less than NT\$600 million and two-thirds of the share capital.</p> <p>b. Operating revenue from main business for the most recent fiscal year shall be not less than NTD \$ 2 billion and greater than that for the immediately preceding fiscal year.</p> <p>c. Cash flows in the most recent fiscal year show a positive net cash flow from operating activities.</p>	
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Table 2 The Comparison of The IPO Market in Taiwan

The company wants to be a listed company in TWSE or OTC. It must register as an “ESM company” for at least 6 months. Therefore, the ESM is also deemed to be a pre-listing market. The purpose of the ESM is not just a market for capital formation but also a market for the company to learn and prepare to be a listed company in TWSE and OTC in the upcoming future.

To be an ESM company is not complicated. The requirements are as follows:

1. no financial requirement (see Table 2).
2. The applicant shall have received written recommendations by at least 2 Recommending Securities Firms (RSFs), one of which is designated as the lead RSF and the other as co-RSFs.
3. The applicant shall appoint independent directors<sup>90</sup>.
4. The ESM is a security issuance and exchanging market, the applicant shall comply with the Securities and Exchange Act<sup>91</sup> and Regulations

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<sup>90</sup> “Independent directors” was enacted in Securities and Exchange Act in 2015 to enhance corporate governance, independent directors should have professional knowledge and their shareholdings is also restricted, they should be independent when perform their duties in the board of directors, and they should not have any direct or indirect interest in the company, See Securities and Exchange Act §14-2

<sup>91</sup> See The Securities and Exchange Act §22:

With the exception of government bonds or other securities exempted by the Competent Authority, the public offering or issuing of securities without an effective registration with the Competent Authority shall be prohibited.

An issuer under this Act shall be required to comply with the preceding paragraph when it issues new shares pursuant to the provisions of the Company Act, except where the issuance is handled under Article 43-6, paragraphs 1 and 2.

The provisions of paragraph 1 shall apply mutatis mutandis to a holder of securities as defined in Article 6, paragraph 1, or certificates of payment therefor, or documents of title thereto, or stock warrant certificates, or certificates of entitlement to new shares, who publicly offers to resell the securities or certificates.

Governing the Offering and Issuance of Securities by Securities Issuers. Therefore, the applicant shall submit a prospectus and other papers related to the security issuance to the Taipei Exchange for registration. The registration will automatically become effective after 12 business days since submitting.

5. According to the company Act <sup>92</sup>, under any of the following circumstances, a company is not allowed to issue new shares:
  - a. Where it has incurred losses in the most recent two consecutive years; this, however, shall not apply where the nature of business requires a longer period for preparation, or it has a sound business plan under which its profit-making capability will be improved
  - b. Where its assets are not sufficient to meet liabilities.

For fundraisers, there is no capital cap or investment amount limitation in ESM. All businesses are qualified to apply to be an ESM company, the ESM does not examine the innovation, creativity, and internal governance of applicants, there is more flexibility in ESM for fundraisers and investors when we compared to the GISA board. If a company is not an innovation and creativity industry company or the company wants to save time to raise funds or its goal is to be a listed company in TWSE and OTC in the future, the ESM will be a better choice for those fundraisers.

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Regulations governing the conditions, documents to be attached, review and approval procedures, and other matters for compliance with respect to the effective registrations under the preceding three paragraphs shall be prescribed by the Competent Authority.

In formulating or amending provisions of the preceding paragraph's regulations relating to foreign exchange, the Competent Authority shall consult the Central Bank of the R.O.C.

<sup>92</sup> See The Company Act §270.

Although profitability is not required in ESM (see Table 1), profitability is still a crucial factor in the IPO market because most investors are interested in those companies with profitability, the SMEs and startups may not be able to raise funds successfully in ESM due to the lack of profitability or suffering a loss, but this challenge for fundraisers is also the same in GISA board, the SMEs and startups shall proof their investment value to attract the public no matter they want to raise funds in ESM or the GISA board.

As a result, the current GISA board may be only suitable for those SMEs and startups who do not know how to run a business and expect to utilize the PICM system in GISA board to improve their business management, the attraction of the GISA board is depreciated compared to ESM. Some successful SMEs and startups may choose IPO in TWSE or OTC instead of GISA board because the IPO market is more mature and popular than the equity-based market.

For investors, buying shares in the IPO market is governed by the Securities and Exchange Act, which has civil and criminal liability for those who violate the Act. For instance, securities frauds and misinformation have criminal and civil liabilities in Securities and Exchange Act, but in the GISA board, the penalty is the termination of the contract as a GISA company. Investors could have more protection in the IPO market.

Under the current regulations on the capital market, the attraction of IPO may catch the eyes of investors and fundraisers, and the function of the GISA board is narrowed<sup>93</sup>.

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<sup>93</sup> Furthermore, on 20<sup>th</sup> July 2020, TWSE launched a new trading platform to make it easier for

### 3.3 Summary

Financing is very important for business owners to start their businesses, they can finance from debt or equity, the traditional financing portals, e.g. banks, supporters, venture capitalists and angel investors, are unable to satisfy the needs of all fundraisers, it shows that equity-based crowdfunding is very crucial to fill the gap for capital formation.

The GISA regulation was enacted to secure the fundraising in equity-based crowdfunding and set up a complex procedure for fundraisers to meet the needs of investors' protection, but the GISA regulation is still insufficient to protect because it adopted the traditional supervisory method- disclosure duty, there is also no merit review in equity-based crowdfunding to examine the document submitted by fundraisers. Most investors are not experienced or professional investors, it is difficult for them to examine the disclosed information, the disclosure duty may not be helpful to protect investors. How to protect investors and eliminate information asymmetry is a crucial question in equity-based crowdfunding in Taiwan, this thesis will try to find the solution in the next chapter.

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innovative enterprises, which have limited capital or incur losses but have promising outlooks to raise funds for expansion. They can apply to be listed on the “Taiwan Innovation Board (TIB)”. Because TIB is a very new funding portal, it takes time to observe the development of TIB, “can TIB attract fundraisers” is still a controversial issue in Taiwan, therefore, this chapter does not discuss about TIB.

## **Chapter 4: Regulatory Paths to Protect Investors in Equity-based Crowdfunding**

This chapter will discuss the information asymmetry in equity-based crowdfunding and introduce the legal framework on equity-based crowdfunding in the USA, Singapore, and Taiwan, here will also discuss how they regulate equity-based crowdfunding, mainly focusing on 1. the CROWDFUND Act of the USA, and 2. the Regulation Crowdfunding, which was enacted by the SEC of the USA, and 3. the Securities and Futures Act (SFA) of Singapore because Singapore did not pass any tailor-made legislation on equity-based crowdfunding, 4. the GISA regulation in Taiwan.

This chapter will also discuss how they protect investors and eliminate information asymmetry in equity-based crowdfunding. If investors cannot be protected, investors will leave the equity-based crowdfunding market and fundraisers will be very difficult to raise funds from equity-based crowdfunding. The traditional methods (e.g. the GISA regulation) to protect investors are focusing on disclosure duties of fundraisers, which causes a dilemma for the regulator to balance the relationship between investors' protection and promoting fundraising. Those duties are not helpful to protect investors as discussed in the previous chapter 3.2.2, so this chapter tries to find new paths to protect investors without setting up too many burdens on fundraisers and solve the regulatory dilemma in equity-based crowdfunding.



This chapter will be separated into 4 topics:

1. The information asymmetry in equity-based crowdfunding
2. The framework of regulation to protect investors

from the viewpoint of authority and governing law etc., the framework of GISA regulation may have some improvement from comparison.

3. Screening investors and fundraisers

Information asymmetry is a key issue in securities issuance because the issuer has more company information than investors. This privilege can lead to fraud and harm investors. The traditional way to avoid information asymmetry is relying on mandatory disclosure duty which could be a big burden for the issuer. This chapter will try to discuss how the USA and Singapore solve the dilemma by assessing both investors and fundraisers.

4. The legal liability of online platforms

The last part will figure out how the USA and Singapore regulate the online platforms who may play a key role to assist fundraisers for fundraising and to reduce the information asymmetry because the online platforms have incentives to seek funding successfully and charge a service fee, on the other hand, they will also try to protect investors for their long-term business benefits and reputation. The online platforms are not just platforms but could be the key players in the triangle crowdfunding relationship.

## 4.1 The Information Asymmetry in Equity-Based Crowdfunding

### 4.1.1 What Is Information Asymmetry

Information asymmetry assumes one party in an economic transaction possesses greater information about the transaction than the other party. This typically manifests when the seller of a product or service possesses greater knowledge than the buyer<sup>94</sup>. In certain transactions, sellers may take advantage of buyers because information asymmetry exists whereby the seller has more information about the product than the buyer. The existence of information asymmetry may result in market failure.

Although information asymmetry isn't necessarily a bad thing. The fact is that growing asymmetrical information is the desired outcome of a healthy market economy. As employees strive to become increasingly specialized in their chosen careers or people study hard to be lawyers or doctors, those specialized experts benefit society by their professional background. People can also exchange their professional information with each other. But sometimes information asymmetry may have near fraudulent consequences, such as “adverse selection” and “moral hazard”.

George Akerlof, an American economist who won the Nobel Prize in 2001, published a paper “*The Market for Lemons*<sup>95</sup>” in 1970. Professor Akerlof took the lemon (second hand) car for instance, in the lemon car market, the seller knows the value of his car, but the buyer doesn't have too much information about the car,

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<sup>94</sup>See Investopedia, <https://www.investopedia.com/terms/a/asymmetricinformation.asp>. Visiting date: 10/02/2021.

<sup>95</sup> Akerlof, George. "The Market for "Lemons": Quality Uncertainty and the Market Mechanism". The Quarterly Journal of Economics. 84 (3), P. 488–500.

the buyer only knows the probability of whether a vehicle is good or bad. Since the buyer pays the same budget (based on his or her expected quality) for good cars and bad cars. If the budget is higher than the value of the car, the seller will agree to sell the car. If the budget is lower than the value of the car, the seller will reject the transaction. As a result, buyers are unable to buy a car with good value, and some buyers may pay a lot of money to buy a bad car because of information asymmetry, the seller of a good car may leave the market because the buyer cannot tell the difference between a good car and a bad car. The information asymmetry in the lemon car market shows the “adverse selection” phenomenon, which means buyers or those who don’t possess sufficient information in a transaction always choose the bad choice instead of the good one. Any market will not be able to survive if buyers find out that they are unable to get good quality products from the market.

“Moral hazard” is another phenomenon that happened in information asymmetry. It can be found in the insurance market. By being insured, customers may be inclined to be less careful than they otherwise would without insurance because they know their damage will be covered. For instance, the insured may park their car randomly if their cars are insured<sup>96</sup>.

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<sup>96</sup> Tim Harford, *The Undercover Economist*, Good Morning Press (Chinese version) , P.165.

## 4.1.2 Solutions for Information Asymmetry

### 4.1.2.1 Signaling

Michael Spence originally proposed the idea of Signaling. He proposed that in a situation with information asymmetry, it is possible for people who have greater information to signal their product, thus believably transferring information to the other party and resolving the asymmetry. For instance, a decent showroom delivers a positive message that the seller wants to sell good products or services for the long run<sup>97</sup>.

Signaling could be a method for fundraisers to eliminate information asymmetry in equity-based crowdfunding. There are always millions of cases in the online platforms waiting for investment from worldwide investors. the fundraiser could take positive measures, e.g. providing a Q and A meeting for investors to signal investors that its projects are better than others and solve the risks of information asymmetry.

### 4.1.2.2 Screening

Joseph Stiglitz pioneered the theory of Screening<sup>98</sup>. It means that the underinformed party can induce the other party to reveal their information. It can provide a menu of choices, which depends on the private information of the other party. For instance, the insurance company could offer a menu of insurance for customers, customers who think they are at high risk would like to pay the higher insurance fee for protection, and customers who think they are at lower risk would

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<sup>97</sup> Ibid, P.158-160.

<sup>98</sup> Ibid, P.160.

like to pay less for insurance. A menu of choices helps the insurance company to get information on the risks of customers.

#### 4.1.2.3. Warranty

Warranties are utilized as a guarantee of the credibility of a product, warranties are issued by the seller promising to replace or repair the product when the quality is not sufficient. If information asymmetry causes any loss, the loss can be covered by warranties

#### 4.1.2.4 Mandatory Information Disclosure

Voluntary information disclosure like Signaling and Screening is not always feasible. Regulators can also take measures to facilitate the spread of information and lower the trading cost. Mandatory information disclosure is very common in the securities issuance market because investors need material information to evaluate the value of securities.

Fundraisers have all the important information about the business they run, but investors are not the insiders, they don't have any related information to assist them in making investment decisions unless fundraisers disclose necessary information from the company. For the purpose of investors' protection, regulators tend to require fundraisers to disclose tons of information about the business and supervise those companies by experts' involvement (e.g., lawyers or CPA) because directors or managers may also manipulate the information for their personal interests.

Some countries also set up another mechanism to protect investors, that is the assessment of investors. The assessment is to make sure that 1. investors have the

financial background to understand the information disclosed by fundraisers, and 2. investors have enough assets to suffer the risks in equity-based crowdfunding.

#### 4.1.3 The Disclosure Duty of Fundraisers in Equity-based Crowdfunding

##### 4.1.3.1 The USA

In the USA, the fundraisers should fill and submit Form-C to the SEC and provide it to investors and the relevant intermediary before the commencement of the equity-based crowdfunding. There are tons of information that require the fundraiser to disclose in Form-C<sup>99</sup>. There is also an annual reporting duty after the offering<sup>100</sup>. The Form-C shall include at least<sup>101</sup>:

1. Information about officers, directors, and principal security holders.
2. A description of the fundraiser's business and the use of proceeds from the offering.
3. The price of the securities and the method for determining the price.
4. The target offering amount and the deadline to reach the target offering amount.
5. The related-party transactions.
6. The fundraiser's financial statements.

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<sup>99</sup> The Form-C can be downloaded from the SEC website: <https://www.sec.gov/files/formc.pdf>.

<sup>100</sup> See Regulation Crowdfunding § 227.201-227.203.

<sup>101</sup> See supra note 24, P.1401-1402.

#### 4.1.3.2 Singapore

Singapore has a different path about the disclosure duty, the small offeror in Singapore is exempted from preparing prospectus under the SFA<sup>102</sup>, the offeror only gives a statement in writing that states the offering is without a prospectus and a notification with resale limitation, fundraisers have the discretion to disclose or not disclose any information. The MAS does not focus on the disclosure duty because the authority of Singapore notices that the small fundraising is costly and unnecessarily burdensome. The MAS puts burdens on the online platforms that have duties to evaluate their customers before investing.

#### 4.1.3.3 Taiwan

Taiwan also has a similar regulation as the USA on the disclosure duty of fundraisers. There are listed situations requiring fundraisers to disclose the company's information (also see Chapter 3.2.1.4 ).<sup>103</sup> The traditional supervisory method of disclosure duty in the USA and Taiwan (also see Chapters 2.6.1.2 and 2.6.2.2) causes a deadly effect and threshold for small amount fundraisers to utilize equity-based crowdfunding because it is burdensome and expensive for them to comply with the disclosure duty.

To eliminate the threshold of fundraising for the small capital cap, this thesis suggests that there shall be an exemption from disclosure duty for the small amount fundraising raising less than NTD \$1 million, in such a situation, it may raise the risks for investors, but meanwhile, if the Taiwan government also adopts

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<sup>102</sup> See SFA §302 B.

<sup>103</sup> See GISA regulation §22-23.

the “Suitability Obligation” (also see Chapter 4.3.2.2), investors will be able to assess their investment and risks before investing, this may be the better solution to solve the dilemma existed in investors’ protection and fundraisers’ needs.

## **4.2 The Framework of Regulation to Protect Investors**

### **4.2.1 The Authority**

#### **4.2.1.1 The USA**

The Securities and Exchange Commission (SEC), an independent institution of the USA federal government, is the authority of the USA security regulation. For more than 85 years since its founding at the height of the Great Depression, the goal of the SEC is to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation.

#### **4.2.1.2 Singapore**

the Monetary Authority of Singapore (MAS) is Singapore’s central bank and financial market regulator. It is also the regulator of the equity-based crowdfunding market.

As an integrated financial supervisor, MAS fosters a sound financial services sector through all financial institutions in Singapore – banks, insurers, capital market intermediaries, financial advisors, and stock exchanges. It is also responsible for well-functioning financial markets, sound conduct, and investor education. It also works with the financial sectors to promote Singapore’s power as a global financial center. MAS plays a key role to facilitate the development of



infrastructure, adoption of technology, and upgrading of skills in the financial sectors in Singapore<sup>104</sup>.

#### 4.2.1.3 Taiwan

In Taiwan, the Financial Supervisory Commission (the FSC) is the authority of security regulation. Instead of directly regulating the equity-based crowdfunding market, the FSC authorized Taipei Exchange, a private legal entity, to regulate equity-based crowdfunding. The Taipei Exchange is not only a regulator but also an online platform in the market, the Taipei Exchange organized the GISA board which is the main online intermediary of equity-based crowdfunding in Taiwan, this situation leads to an interest conflict, as a regulator and player, the Taipei Exchange will try to reduce the liabilities as an online platform by legal formation. For instance, in the USA and Singapore, the online platforms have to assess customers and obtain the risk acknowledgment from investors for legal compliance<sup>105</sup>, but in Taiwan, the GISA regulation only regulated that **an investor** has to confirm a "Risk Disclosure Statement" through the Taipei Exchange's GISA board before commencing with the subscription<sup>106</sup>, so it's the duty of investors to submit the Risk Disclosure Statement, it's not the duty of online platform to collect the statement from investors. The FSC shall consider regulating equity-based crowdfunding by itself to separate the regulator and player in equity-based crowdfunding. Meanwhile, the FSC can set up more duties of the online platforms to protect investors.

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<sup>104</sup> See <https://www.mas.gov.sg/who-we-are/What-We-Do>. Visiting date: 25/1/2022.

<sup>105</sup> See the USA Regulation Crowdfunding §227.302(a) and Guidelines on Personal Offers Made Pursuant to the Exemption for Small Offers of Singapore §6.12.

<sup>106</sup> See GISA regulation §16.

## 4.2.2 The Governing Law

### 4.2.2.1 The USA

The USA congress passed the CROWDFUND Act, which amended the Securities Act of 1933 and the Securities Exchange Act of 1934 to increase American job creation and economic growth by improving access to the public capital markets for emerging growth companies in 2012, and Regulation Crowdfunding (see 17 C.F.R §227.100-227.503) which was enacted by the SEC to carry out the CROWDFUND Act.

### 4.2.2.2 Singapore

Although Singapore did not pass any specific laws on equity-based crowdfunding, the securities issuance of equity-based crowdfunding is governed by the Securities and Futures Act (SFA) and the Guidelines on Personal Offers Made Pursuant to the Exemption for Small Offers issued by MAS.

### 4.2.2.3 Taiwan

Unlike the USA and Singapore, The GISA regulation of Taiwan was enacted by Taipei Exchange to regulate equity-based crowdfunding. The FSC considered that the amendment of the Securities and Exchange Act by congress to regulate equity-based crowdfunding is inefficient and took a long time. Therefore, The FSC authorized Taipei Exchange to regulate equity-based crowdfunding and excluded equity-based crowdfunding from the Securities and Exchange Act, but equity-based crowdfunding was excluded from the law may lead to problems when it comes to securities frauds or misrepresentation in security issuance. The GISA regulation remains silent about criminal behaviors in equity-based crowdfunding, in such a situation, Shall the court apply the Securities and Exchange Act which has

civil and criminal liabilities on securities frauds and misrepresentation is a question<sup>107</sup>. The scholar said the criminal provisions of the Securities and Exchange Act are still applicable because the GISA regulation “only releases” the restriction of equity-based crowdfunding from the Securities and Exchange Act, not means the fundraiser can escape from the criminal liability of the Act <sup>108</sup>, but it may violate the criminal principle of *Nulla poena sine lege*. The criminal liability of fundraisers in

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<sup>107</sup> Securities and Exchange Act §20:

**During the public offering, issuing, private placement, or trading of securities, there shall be no misrepresentations, frauds, or any other acts which are sufficient to mislead other persons.**

The financial reports or any other relevant financial or business documents filed or publicly disclosed by an issuer in accordance with this Act shall contain no misrepresentations or nondisclosures.

**Anyone who violates the provisions of paragraph 1 shall be held liable for damages sustained by bona fide purchasers or sellers of the said securities.**

The principal who commissions a securities broker to purchase or sell securities as a commission agent shall be deemed as a "purchaser" or "seller" for the purpose of the preceding paragraph.

Securities and Exchange Act §171 paragraph 1

A person who has committed any of the following offenses shall be punished with imprisonment for not less than three years and not more than ten years, and in addition thereto, a fine of not less than NT\$10 million and not more than NT\$200 million may be imposed:

1. **A person who has violated the provisions of paragraph 1 or paragraph 2 of Article 20,** paragraph 1 or paragraph 2 of Article 155, or paragraph 1 or 2 of Article 157-1.
2. A director, supervisor, managerial officer or employee of an issuer under this Act who, directly or indirectly, causes the company to conduct transactions to its disadvantage and not in the normal course of operation, thus causing substantial damage to the company.
3. A director, supervisor, or managerial officer of an issuer under this Act who, with intent to procure a benefit for himself/herself or for a third person, acts contrary to his/her duties or misappropriates company assets, thus causing damage of NT\$5 million or more to the company.

Where the value of property or property interests gained by the commission of an offense under the preceding paragraph is NT\$100 million or more, a sentence of imprisonment for not less than seven years shall be imposed, and in addition thereto a fine of not less than NT\$25 million and not more than NT\$500 million may be imposed.

<sup>108</sup> See supra note 15, at 82-83.

equity-based crowdfunding should be regulated by laws that were enacted by congress, no penalty can live without laws. To solve this question and protect the investors from fraud, equity-based crowdfunding had better be incorporated into the Securities and Exchange Act or enacted by parliament to cope with security fraud problems.

#### 4.2.3 The Capital Cap and Investment Amount

##### 4.2.3.1 The USA

In the USA, the aggregate amount raised in equity-based crowdfunding during the 12 months preceding the date of such offer or sale shall not exceed USD \$5,000,000<sup>109</sup>, and the aggregate amounts of securities sold to any investor who is not an accredited investor (as defined in 17 CFR § 230.501(Rule 501)) across all issuers during the 12 months preceding the date of such transaction (including such transaction) shall not exceed<sup>110</sup>:

1. The greater of USD \$2,200, or 5 percent (5%) of the greater of the investor's annual income or net worth, if either the investor's annual income or net worth is less than USD \$107,000; or
2. 10 percent (10%) of the greater of the investor's annual income or net worth, not to exceed an amount sold of USD\$ 107,000, if both the investor's annual income and net worth are equal to or more than USD \$107,000.

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<sup>109</sup> See Regulation Crowdfunding§227.100(a)(1), **the original amount was USD\$1,070,000, the SEC raised the offering limit by Regulation Crowdfunding from USD\$1.07 million to USD\$5 million to facilitate access to capital on 15 Mar 2021.**

<sup>110</sup> See Regulation Crowdfunding§227.100(a)(2).

There is an issue the scholar argued in the USA, that is no matter how much capital fundraisers are going to raise in equity-based crowdfunding, they have to complete all procedures of fundraising and comply with all duties under regulations, this situation hammers those fundraisers who want a small capital formation. According to the Ewing Marion Kauffman Foundation, the average cost of starting a new small business in 2009 was approximately USD \$30,000, and the transaction cost related to raising USD \$30,000 for startups in equity-based crowdfunding is approximately USD \$5,000 and 75 hours of internal document preparation according to the SEC. If including USD \$2,100 third-party intermediary costs and probable annual reporting costs of USD \$3,000 a year for three years, the total amounts will be USD \$16,100, which is over half of the capital raised<sup>111</sup>. Therefore, the government shall consider exempting some disclosure duty or simplifying some procedures in equity-based crowdfunding to lower the cost for small amount fundraisers, otherwise, investors may be unwilling to invest in those small capital fundraising because more than half of their investment becomes the cost in capital formation.

#### 4.2.3.2 Singapore

Singapore limits the total amount raised by a fundraiser in small offers within any period of 12 months shall not exceed SGD \$5million (equivalent to USD \$3,755,727)<sup>112</sup>.

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<sup>111</sup> See Supra note 53, P.1411.

<sup>112</sup> see SFA §272A.

#### 4.2.3.3 Taiwan

The capital cap in Taiwan is similar to the original amount of USA regulations (USD \$1.07 million) because Taiwan adopted it from the USA model, the total amount raised in GISA board shall not exceed NTD \$30 million (equivalent to USD \$1,074,248), but fundraisers obtained a letter of recommendation or an “Innovation and Creativity Opinion Letter” from recommending agency at the time of application for GISA registration will be exempted from this capital cap<sup>113</sup>, and the aggregate investment amount invested by investors during the 12 months preceding the date of such offer or sale shall not exceed NTD \$150,000 (equivalent to USD \$5,371), but the following persons are exempted from the limitation:

1. Institutional angels.
2. A natural person who provides proof of financial capacity showing assets of NTD \$30 million or more, and who also possesses ample professional knowledge of financial products or ample trading experience.
3. The original shareholders of the company.

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<sup>113</sup> See GISA regulation §15.

### 4.3 Screening Investors and Fundraisers

#### 4.3.1 The Assessment of Fundraisers

##### 4.3.1.1 The USA

The government highly supervises fundraisers in the USA because the insiders of a company could deceive investors by information asymmetry. The USA government requires the intermediaries to take measures for reducing fraud and check that the offeror complies with the laws. The intermediaries shall deny the transaction when they have a reasonable basis for believing that the fundraiser or the offering presents the potential for fraud or otherwise raises concerns about investors' protection<sup>114</sup>. Fundraisers also have to submit and disclose the information of the issuer in Form-C.

##### 4.3.1.2 Singapore

Singapore has no rules on requiring the platform to check or examine the fundraisers' condition. In Singapore, the online platforms do the due diligence checks on fundraisers for their interest as intermediaries because intermediaries may wish to find good customers and avoid any fraud dispute in their platforms.

##### 4.3.1.3 Taiwan

In Taiwan, there are 2-stage examinations and the PICM system to check the fundraisers' applications that are qualified to raise funds in the GISA board or not (also see chapter 3.2.1).

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<sup>114</sup> See Regulation Crowdfunding §227.301.

### 4.3.2 The Assessment of Investors

#### 4.3.2.1 The USA

In the USA, the intermediary during the transaction has to obtain from the investors the following documents<sup>115</sup> and has to deliver the related information about that fundraising and question their customers:

1. A representation that the investor has reviewed the intermediary's educational materials<sup>116</sup> delivered pursuant to Regulation Crowdfunding understands that the entire amount of his or her investment may be lost and is in a financial condition to bear the loss of the investment.

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<sup>115</sup> See Regulation Crowdfunding § 227.302(a)

<sup>116</sup> See Regulation Crowdfunding § 227.302(b):

- (1) In connection with establishing an account for an investor, an intermediary must deliver educational materials to such investor that explain in plain language and are otherwise designed to communicate effectively and accurately: (i) The process for the offer, purchase and issuance of securities through the intermediary and the risks associated with purchasing securities offered and sold in reliance on section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)); (ii) The types of securities offered and sold in reliance on section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)) available for purchase on the intermediary's platform and the risks associated with each type of security, including the risk of having limited voting power as a result of dilution; (iii) The restrictions on the resale of a security offered and sold in reliance on section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)); (iv) The types of information that an issuer is required to provide under § 227.202, the frequency of the delivery of that information and the possibility that those obligations may terminate in the future; (v) The limitations on the amounts an investor may invest pursuant to § 227.100(a)(2); (vi) The limitations on an investor's right to cancel an investment commitment and the circumstances in which an investment commitment may be cancelled by the issuer; (vii) The need for the investor to consider whether investing in a security offered and sold in reliance on section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)) is appropriate for that investor; (viii) That following completion of an offering conducted through the intermediary, there may or may not be any ongoing relationship between the issuer and intermediary; and (ix) That under certain circumstances an issuer may cease to publish annual reports and, therefore, an investor may not continually have current financial information about the issuer.



2. A questionnaire completed by the investor demonstrating the investor's

understanding that:

- a. There are restrictions on the investor's ability to cancel an investment commitment and obtain a return.
- b. It may be difficult for the investor to resell securities.
- c. Investing in securities offered and sold in reliance on CROWDFUND Act involves risk, and the investor should not invest any funds in an offering made in reliance on CROWDFUND Act unless he or she can afford to lose the entire amount of his or her investment.

#### 4.3.2.2 Singapore

Singapore is more reliant on this part to protect the investors. The MAS issued the Guidelines<sup>117</sup> that specify the process and require the intermediaries to execute the “**Knowledge or Experience Test**” or the “**Suitability Assessment Test**,” the Knowledge or Experience Test ensures investors possess sufficient knowledge or experience to understand the risks of the investment, the Suitability Assessment Test ensures the investments are suitable for investors. Besides, the online platforms shall also deliver the “**Risk Disclosure Statement**” to the investor and get his consent.

**Knowledge or Experience Test** means an investor is considered to have sufficient knowledge or experience to invest in the offers of securities or

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<sup>117</sup> See Guidelines on Personal Offers Made Pursuant To The Exemption For Small Offers Appendix 1.

securities-based derivatives contracts made under the small offers exemption as long as he fulfills any one of the criteria listed below:

1. The investor has a minimum of 3 consecutive years of working experience in finance-related fields in the past 10 years.
2. The investor has a diploma or higher qualification in a finance-related field or professional qualification in a finance-related field.
3. The investor has transacted in at least 6 similar investments to the offers of securities or securities-based derivatives contracts made under the small offer exemption in the preceding 3 years.

**Suitability Assessment Test** means that the intermediary uses sample questions to ask the investors, at a minimum, to facilitate the assessment that the investment is suitable for the investor in light of his or her investment objectives and risk tolerance, questions like:

1. Are you prepared and able to lose all of your capital?
2. Are you prepared and able to hold on to your investments for 10 years or more without being able to cash out?
3. Which best describes your preference on investment returns (e.g., capital preservation, stable returns, high variability in returns)?
4. What best describes your investment objective (e.g., retirement planning, children's education, capital appreciation)?
5. What would you say is your risk tolerance (e.g., conservative, balanced, aggressive)?

The platforms shall give the **Risk Disclosure Statement**<sup>118</sup> to investors. The statement shall contain the following information:

1. It could be a 100% loss on such investments.
2. Such investments are difficult to cash in or exit.
3. Risks of equities investments (e.g., no dividend).
4. Online platform fails and becomes insolvent.
5. Risks of investing in foreign issuers: the investment will be subject to the laws and regulations of that jurisdiction. Investors may also be subject to additional tax liabilities, transaction costs and capital controls.
6. No disclosure requirements that investors would reasonably require to make informed assessments of offers.
7. There is no assurance that financial statements from the companies that investors invest in will be accurate or accessible because the companies' financial statements may not be subject to a statutory audit.
8. Remind the investors to seek independent professional advice if they do not fully understand the risks of investing in securities or securities-based derivatives contracts offered on the platform or any statements.

Singapore adopted the **Suitability Obligation**, which required intermediaries to take action to protect the investors, on the other hand, it also released the burdens of fundraisers.

There are two legal theory bases to support the Suitability Obligation of intermediaries<sup>119</sup>. The first is **Shingle Theory** which was developed from USA SEC

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<sup>118</sup> See Guidelines on Personal Offers Made Pursuant To The Exemption For Small Offers Appendix 2.

in the 1930s, **Shingle Theory** argued that there is an implied fair dealing duty for brokers when they sell securities because there is a fiduciary relationship (or principal-agent relationship) between the brokers and their customers, therefore, the brokers are not allowed to misuse the innocence of investors and also have the duty to advise the investors for adequately investment decision.

The second theory is the **Informed Consent Theory** which originated from medical service disputes. The **Informed Consent Theory** argued that brokers are not the business of caveat emptor anymore. Because most of the investors are uninformed consent and without the knowledge of financial products, most of them are financial illiterates, but brokers have the financial knowledge and earn commission from the transaction, brokers and investors are similar to the relationship between doctors and patients, without the informed consent, brokers cannot be exempted from their legal liabilities.

Under the Suitability Obligation, the intermediaries shall have an adequate and reasonable basis on the financial products and recommend those products in the best interest of their customers<sup>120</sup>.

The legal system in Taiwan also adopted the Suitability Obligation. Due to the surge of financial investment disputes, congress enacted **the Financial Consumer Protection Act** to protect the financial customers in 2011. The Act requires the financial services enterprise before it enters into a contract with a consumer for the provision of financial products or services, the financial services enterprise should

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<sup>119</sup> Kuan-chun Chang (2009),” Legal Analyses on the Suitability Obligation in the Sale of Investment Products -- Additive Critiques on the Draft of Article 31 of the Financial Service Act in Taiwan”, Law Journal of National University of Kaohsiung College of Law, Vol.5, P.141-143.

<sup>120</sup> Ibid, P.144-145.

fully understand the background of the consumer and ascertain the suitability of those financial products or services fit the need of the consumer, it shall also explain the important aspects of the financial products or services, and the contact, to the financial consumer, and shall also fully disclose the associated risks, if a financial services enterprise violates its duty and causes loss to the consumer, it shall bear the liability for compensation<sup>121</sup>.

Although **the Financial Consumer Protection Act** adopted the Suitability Obligation of financial services enterprise to protect and assess investors, however, the Act itself excluded the Taipei Exchange as a financial services enterprise<sup>122</sup>. Therefore, no Suitability Obligation could be applied on Taipei Exchange as an intermediary to protect investors in equity-based crowdfunding. If the GISA regulation can adopt the Suitability Obligation, investors will have higher protection in equity-based crowdfunding.

#### 4.3.2.3 Taiwan

In Taiwan, the GISA regulation did not require the online platforms to assess the investors, but the investors have to submit the “Risk Disclosure Statement” via the online platform<sup>123</sup>. The content of “Risk Disclosure Statement” includes:<sup>124</sup>

1. The GISA companies are innovative and micro enterprises, they are non-IPO companies, their financial accountant, internal control system, and corporate governance are unlike the IPO companies, and without the substantial examination by Taipei Exchange, the GISA companies may not be able to

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<sup>121</sup> See Financial Consumer Protection Act §9-11.

<sup>122</sup> See Financial Consumer Protection Act §3.

<sup>123</sup> See GISA regulation §16 paragraph 1.

<sup>124</sup> See GISA regulation appendix 9 -Risk Disclosure Statement” Form.

make a profit and suffer losses, there is a possibility that the GISA company cannot run the business continuously.

2. The Taipei Exchange only accepts the registering of GISA companies and does not make any substantial examination of those companies. The risk of the investment is extremely high. The investors shall assess their financial ability and asset before investment.
3. The GISA companies' fundraising is not an IPO procedure and is not regulated by the Securities and Exchange Act, Securities Investor and Futures Trader Protection Act, and **Financial Consumer Protection Act**. Before investment, the investors shall consider the following situations seriously:
  - a. It's the investors' own investment decision.
  - b. GISA companies may have such characteristics: low liquidity of shares, small capital, the short period since establishment, the uncertainty of profitability, etc.
  - c. There is an investment amounts limitation.
  - d. If there is any dispute in fundraising or the GISA companies, or directors violate the law or breach the contract, the investors may take legal action against them.

The Risk Disclosure Statement of the GISA regulation puts full liability on investors. Taipei Exchange, as an intermediary, has no duty to screen investors.

## 4.4 The Legal Liability of Online Platforms

### 4.4.1 The USA

Intermediaries in the USA have duties to<sup>125</sup>:

1. Register with the SEC as a broker or funding portal and be a member of a national securities association.
2. Take measures to reduce the risk of fraud.
3. Provide investors with education materials:
  - a. The process for the offer, purchase, and issuance of securities through the intermediary and the risks associated with purchasing securities offered and sold.
  - b. The types of securities offered, and the risks associated with each type of security, including the risk of having limited voting power as a result of dilution.
  - c. The restrictions on the resale of security.
  - d. The limitations on the amounts.
  - e. The limitations on an investor's right to cancel an investment commitment and the circumstances in which an investment commitment may be canceled by the issuer.
  - f. The need for the investor to consider whether investing in a security offered is appropriate for that investor.
  - g. Provide on its platform communication channels by which persons can communicate with one another and with representatives of the

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<sup>125</sup> See Regulation Crowdfunding §227.300-227.303.

issuer about offerings made available on the intermediary's platform.

In July 2016, the USA Congress enacted the “**Fix Crowdfunding Act**” and introduced **the crowdfunding vehicle**. A crowdfunding vehicle means an issuer formed by or on behalf of a crowdfunding issuer for the purpose of conducting an offering under the CROWDFUND Act as a co-issuer with the crowdfunding issuer. Although the offering is controlled by the crowdfunding issuer<sup>126</sup>, there is no relationship between investors and issuer but investor and crowdfunding vehicle. Therefore, the crowdfunding vehicle is founded for the special purpose of the issuer, it shall not be deemed as an investor nor intermediary. Fundraisers can simplify their relationships with investors by setting up crowdfunding vehicle, this could encourage fundraisers to utilize equity-based crowdfunding, and there are not thousands of voices from investors who are shareholders in the company, the fundraisers can focus on their business running, and the crowdfunding vehicle deals with the relationship with investors. It may not be so urgent for the Taiwan government to adopt the crowdfunding vehicle because the market scale and investors in Taiwan are smaller than in the USA.

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<sup>126</sup> See Federal Regulations §270.3a-9 - Crowdfunding vehicle, title 17, chapter 2, part 270, C.F.R.



#### 4.4.2 Singapore

the intermediaries in Singapore shall:

1. Have a Capital Markets Services (CMS) license<sup>127</sup>.
2. Assess the investors properly.
3. Do the due diligence checks for the purpose of promoting fundraising.

#### 4.4.3 Taiwan

There are two layers of online intermediary for fundraisers to raise funds in equity-based crowdfunding in Taiwan. One is the private portal which is regulated by Taipei Exchange Regulations Governing the Conduct of Equity Crowdfunding by Securities Firms (the private portal regulations). The private portal should get a license from the Taipei Exchange before running a business. The other is the main fundraising portal - the GISA board<sup>128</sup>. There is no specific duty for the GISA board or Taipei Exchange to protect investors because the GISA regulation did not adopt the concept of Suitability Obligation.

Compared to the USA and Singapore regulations, the Taipei exchange shall consider taking more actions to protect investors, not just only relying on the traditional governing method- disclosure duty that causes a burden on fundraisers and cannot protect investors properly.

From the previous chapters, there are some reasons to support online platforms shall not be a pure platform but have liability to protect investors:

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<sup>127</sup> See SFA §82.

<sup>128</sup> See GISA regulation §2.

1. They make profits from equity-based crowdfunding and want to keep a good reputation in the market (also see Chapter 2.5).
2. The Shingle Theory and Informed Consent Theory provide legal theory bases to require online platforms to take actions protecting their customers (also see Chapter 4.3.2.2).



## 4.5 Comparing Equity-based Crowdfunding in The USA, Singapore, and Taiwan

### 4.5.1 Comparing Issue of 4.1.3

#### 4.5.1.1 The Disclosure Duty of Fundraisers

Taiwan	There are listed situations that require the GISA company to disclose the company's material information according to the GISA regulation §22-23(also see chapter 3.2.1.4).
The USA	<p>The offeror should fill and submit the Form-C to SEC and provide it to investors and the relevant intermediary prior to the commencement of the offering, there are tons of information that require the fundraiser to disclose in Form-C, there is also an annual reporting after offering according to the Regulation Crowdfunding § 227.201-227.203, the Form-C shall include at least<sup>129</sup>:</p> <ol style="list-style-type: none"> <li>1. information about officers, directors, and owners of 20 percent or more of the issuer.</li> <li>2. a description of the issuer's business and the use of proceeds from the offering.</li> <li>3. the price to the public of the securities or method for determining the price.</li> <li>4. the target offering amount and the deadline to reach the target offering amount.</li> <li>5. whether the issuer will accept investments over the target offering amount.</li> <li>6. certain related-party transactions.</li> <li>7. a discussion of the issuer's financial condition and financial statements.</li> </ol>

<sup>129</sup> See supra note 24, P1401-1402.

Singapore	The small offeror is exempted from preparing prospectus under the SFA, but the offeror shall give a statement in writing that states this offering without a prospectus and a notification with resale limitation. The MAS does not focus on the disclosure duty, because the authority notices that the small fundraising is costly and unnecessarily burdensome.
comment	The disclosure duties in Taiwan and the USA are quite burdensome for fundraisers. If Taiwan adopts the Suitability Obligation, the GISA regulation could relieve some burden of disclosure duties.

#### 4.5.2 Comparing Issue of 4.2

##### 4.5.2.1 The Authority

Taiwan	The Taipei Exchange, a private legal entity, was authorized by the Financial Supervisory Commission (FSC) to regulate the equity-based crowdfunding market in Taiwan.
The USA	The Securities and Exchange Commission (SEC), an independent institution of the federal government.
Singapore	The Monetary Authority of Singapore (MAS), Singapore's central bank and integrated financial regulator.
comment	The FSC shall regulate the equity-based crowdfunding itself because the regulator and intermediary shall be separated, and the FSC could also set up duties on the GISA board for investors' protection.

## 4.5.2.2 The Governing Law

Taiwan	The GISA regulation was enacted by Taipei Exchange to regulate equity-based crowdfunding which was excluded from the Securities and Exchange Act because the amendment of laws always takes time.
The USA	<ol style="list-style-type: none"> <li>1. CROWDFUND Act which amended the Securities Act of 1933 and the Securities Exchange Act of 1934.</li> <li>2. Regulation Crowdfunding(see 17 C.F.R § 227.100-227.503) which was enacted by SEC to carry out the CROWDFUND Act.</li> </ol>
Singapore	<ol style="list-style-type: none"> <li>1. Securities and Futures Act (the SFA)</li> <li>2. Guidelines on personal offers made pursuant to the exemption for small offers issued by MAS ( the Guidelines).</li> </ol>
comment	<p>Equity-based crowdfunding in Taiwan is not regulated by laws. Therefore, there are no criminal penalties in the GISA regulation because regulation is not enacted by parliament. For investors' protection, equity-based crowdfunding shall be regulated by laws that have criminal penalties for fraud and other criminal behaviors.</p>

## 4.5.2.3 The Capital Cap and Investment Amount

## I. The Capital Cap

Taiwan	The total amount shall not exceed NTD \$30 million (equivalent to USD \$1,074,248), but those who obtained a letter of recommendation or an “Innovation and Creativity Opinion Letter” from a recommending agency at the time of application for GISA registration will be exempted from the limitation (See GISA regulation§15).
The USA	The aggregate amount during the 12 months preceding the date of such offer or sale shall not exceed USD \$5,000,000 (see Regulation Crowdfunding§227.100(a)(1)).
Singapore	The total amount raised by a fundraiser in small offers within any period of 12 months does not exceed SGD \$5 million (equivalent to USD \$3,755,727) (see SFA§272A).
comment	Compared to other jurisdictions, the capital cap is too small in Taiwan, if the authority can protect investors by adopting Suitability Obligation, the capital cap may be expanded to a higher amount.

## II. The Investment Amounts

Taiwan	<p>The aggregate investment amount during the 12 months preceding the date of such offer or sale shall not exceed NTD \$150,000 (equivalent to USD \$5,371), but the following persons are exempted from the limitation:</p> <ol style="list-style-type: none"> <li>1. Institutional angels.</li> <li>2. A natural person who provides proof of financial capacity showing assets of NTD \$30 million or more, and who also possesses ample professional knowledge of financial products or ample trading experience.</li> <li>3. The original shareholders of the company.</li> </ol>
The USA	<p>The aggregate amounts of securities sold to any investor across all issuers during the 12 months preceding the date of such transaction, including such transaction, shall not exceed:</p> <ol style="list-style-type: none"> <li>1. The greater of USD \$2,200 or 5 % of the greater of the investor's annual income or net worth if either the investor's annual income or net worth is less than USD \$107,000; or</li> <li>2. 10 % of the greater of the investor's annual income or net worth, not to exceed an amount sold of USD \$107,000, if both the investor's annual income and net worth are equal to or more than USD \$107,000.</li> </ol>
Singapore	No limitation under the SFA.
comment	<p>Although the limitation of the investment amount in Taiwan can protect investors from suffering a big loss, but the USA model would be more flexible for the needs of investment from different financial backgrounds.</p>

### 4.5.3 Comparing Issue of 4.3

#### 4.5.3.1 The Assessment of Fundraisers

Taiwan	There are 2-stage examinations and a PICM system to check the offeror's conditions which are qualified as a GISA company (also see chapter 3.2.1).
The USA	The Regulation Crowdfunding regulates that the intermediary shall take measures to reduce the fraud, the intermediary shall check that the offeror complies with the law, the intermediary shall deny the transaction when he has a reasonable basis for believing that the issuer or the offering presents the potential for fraud or otherwise raises concerns about investor protection. (See Regulation Crowdfunding §227.301)
Singapore	There are no rules which require the platform to check the offeror's information, it depends on how the online platforms perform the due diligence checks for their own interest.
comment	For the assessment of fundraisers, Taiwan's model is better for screening fundraisers. Meanwhile, it also assists fundraisers in setting up the internal governance by the PICM system, this model may reduce the risks for both fundraisers and investors.



## 4.5.3.2 The Assessment of Investors

Taiwan	Investors have to sign the “Risk Disclosure Statement” form (See GISA regulation§16).
The USA	<p>The intermediary during the transaction has to obtain from the investor (See Regulation Crowdfunding § 227.302(a)):</p> <ol style="list-style-type: none"> <li>1. A representation that the investor has reviewed the intermediary’s educational materials delivered pursuant to Regulation Crowdfunding § 227.302(b), understands that the entire amount of his or her investment may be lost and is in a financial condition to bear the loss of the investment.</li> <li>2. A questionnaire completed by the investor demonstrating the investor’s understanding that: <ol style="list-style-type: none"> <li>(A) There are restrictions on the investor’s ability to cancel an investment commitment and obtain a return of his or her investment.</li> <li>(B) It may be difficult for the investor to resell securities acquired in reliance on section 4(a)(6) of the Securities Act.</li> <li>(C) Investing in securities offered and sold in reliance on section 4(a)(6) of the Securities Act involves risk, and the investor should not invest any funds in an offering made in reliance on section 4(a)(6) of the Securities Act unless he or she can afford to lose the entire amount of his or her investment.</li> </ol> </li> </ol>
Singapore	MAS issued the Guidelines which clearly specify the process and require the offerors to execute a “Knowledge or Experience Test” which ensures that investors possess sufficient knowledge or experience to understand

	<p>the risks of the investment <b>or</b> rely on the “Suitability Assessment Test” to ensure investments are suitable for investors. Furthermore, the online platforms shall also deliver the “Risk Disclosure Statement” to investors and get the acknowledgment.</p>
comment	<p>The Assessment of investors in Taiwan is too simple because only investors have to submit the “Risk Disclosure Statement” via the GISA board. It is recommended to adopt the Suitability Obligation to ensure that investors possess sufficient knowledge or experience to understand or suffer the risks of their investment.</p>

#### 4.5.4 Comparing Issue of 4.4

##### 4.5.4.1 The Legal Liabilities of Online Platforms

Taiwan	<p>There are two layers of online intermediary for fundraisers to raise funds in equity-based crowdfunding:</p> <ol style="list-style-type: none"> <li>1. one is the private portal which is regulated by Taipei Exchange Regulations Governing the Conduct of Equity Crowdfunding by Securities Firms (the private portal regulation), the private portal should get the license from Taipei Exchange before running the business.</li> <li>2. the main fundraising portal is the “GISA board” which was established by Taipei Exchange, and there is no specific duty for the GISA board as an online platform (see GISA regulation §2).</li> </ol>
The USA	<p>The intermediary shall:</p> <ol style="list-style-type: none"> <li>1. register with the SEC as a broker or funding portal and be a member of</li> </ol>

	<p>a national securities association.</p> <p>2. take measures to reduce the risk of fraud.</p> <p>3. provide investors with education materials:</p> <p>(A) The process for the offer, purchase, and issuance of securities through the intermediary and the risks associated with purchasing securities offered and sold</p> <p>(B) The types of securities offered, and the risks associated with each type of security, including the risk of having limited voting power as a result of dilution</p> <p>(C) The restrictions on the resale of a security</p> <p>(D) The limitations on the amounts</p> <p>(E) The limitations on an investor's right to cancel an investment commitment and the circumstances in which an investment commitment may be canceled by the issuer.</p> <p>(F) The need for the investor to consider whether investing in a security offered is appropriate for that investor.</p> <p>4. provide on its platform communication channels by which persons can communicate with one another and with representatives of the issuer about offerings made available on the intermediary's platform (see Regulation Crowdfunding§227.300-227.303).</p>
Singapore	<p>The intermediary shall:</p> <p>1. have a Capital Markets Services(CMS) license ( See SFA§82)</p> <p>2. assess the investors properly.</p> <p>3. do the due diligence checks for the purpose of promoting fundraising</p>

comment	<p>Under the GISA regulation, The Taipei Exchange (or GISA board) as an online platform has no duty to assess investors but considering the disclosure duty is not enough to protect investors, the Taipei Exchange shall take measures to assess investors properly for investors' protection. Meanwhile, there is no need for Taipei Exchange to register or acquire any license from the government because Taipei Exchange was founded by the government in 1994.</p>
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#### 4.6 Summary

Information asymmetry means one party possesses greater information about the transaction than the other party. There are some solutions to eliminate information asymmetry. Mandatory information disclosure is one of the solutions adopted by the GISA regulation to protect investors.

The USA and Singapore do not rely on disclosure duty, the USA regulation requires the online platforms to take measures to reduce the risk of fraud and provide investors with educational materials. Singapore goes further, it adopts “Suitability Obligation” to protect investors, it requires online platforms to execute the “Knowledge or Experience Test” or “Suitability Assessment Test” on investors, meanwhile, it also has to deliver the “Risk Disclosure Statement” to investors and get their consent.

It is believed that if the GISA regulation could adopt “Suitability Obligation” to protect investors, it would be appropriate to mitigate the requirement of disclosure duty on fundraisers, fundraisers will be more easily to raise funds in equity-based crowdfunding. Meanwhile, investors can be protected by online platforms’ assessment, too.

## Chapter 5: Conclusion

Crowdfunding has been under a long and ever-changing development in the capital market. Crowdfunding becomes not only a new portal for fundraising but also assists fundraisers in testing the market preferences and improving their business running. Although investors are always concerned about the risks in equity-based crowdfunding, under the development of the internet, the risks are mitigated because investors are able to collect more useful information from the internet to protect their investments. Furthermore, the online platforms are willing to take measures to protect investors from a case study in Taiwan.

Equity-based crowdfunding is a type of crowdfunding, it is also a business model in capital financing. Because the traditional capital financing portals, e.g., governmental funds, loans, and IPOs still cannot meet the all needs of fundraisers, equity-based crowdfunding becomes an important financial tool to fill the gap. More and more countries open their market to equity-based crowdfunding. Taiwan also passed the GISA regulation to regulate equity-based crowdfunding and protect investors after the USA passed the CROWDFUND Act.

However, the GISA regulation is insufficient to protect investors by legal comparison, therefore, it is suggested that the GISA regulation shall adopt the Suitability Obligation to enhance investors' protection and eliminate information asymmetry in equity-based crowdfunding in Taiwan.

## 5.1 The Possible Outcome

### 5.1.1 Tools for Investors' Protection

Investors in equity-based crowdfunding are protected not only by the internet and online platforms but also the laws, the GISA regulation focuses on investors' protection by setting up a complex procedure and disclosure duty on fundraisers, but those traditional governing methods are not helpful to protect investors because there is no merit review during the application. Furthermore, investors are unable to fully understand the information disclosed by fundraisers, fundraisers may also consider raising funds from ESM instead of the GISA board because of the burden as a GISA company. This situation makes the GISA regulation unable to pursue its purpose: assist the SMEs and startups and protect investors.

Tools \ Items	Investors' protection	Reasons
Internet	High	No restrictions on internet access in Taiwan.
Online Platforms	High	A case study (see chapter 2.5.2) shows intermediaries mitigate the risks of investment.
Legal Regulations	Medium	Unable to solve the information asymmetry properly.

Table 3 Structure of Investors' Protection

### 5.1.2 Investors' Protection from Legal Comparison

By comparison study of the USA and Singapore regulations, we found that the USA and Singapore regulations are not focusing on disclosure duties but focusing on the assessment of investors and the supervision on online platforms because the traditional methods are not so helpful to protect investors. Therefore, the Taiwan government could consider applying the suitability obligation to set up duty on intermediaries and require the online platforms to screen investors before making an investment decision. This new regulatory path could protect investors and mitigate the disclosure duty of fundraisers, especially in the situation of small capital fundraising.



## 5.2 Recommendation

### 5.2.1 Legal Reform

Issue	Current regulation	Recommended amendment
Disclosure duty	GISA regulation§ 22 and 23	The small capital cap (the amount could be NTD \$1 million) will be exempted from disclosure duty, but investors can inquire about the information individually, the GISA company must respond to the inquiry timely
Framework	The authority: The Taipei Exchange	The authority: The Financial Supervisory Commission (the FSC)
	The governing law: GISA regulation	The governing law: GISA Act or incorporated into Securities and Exchange Act chapter 2
	The capital cap: NTD\$ 30 million	(none)
	The investment amount: NTD\$ 150,000 during the 12 months preceding the date of such offer or sell	1. 5 % of the greater of the investor's annual income or net worth if either the investor's annual income or net worth is less than NTD \$3 million, or 2. 10 % of the greater of the investor's annual income or net worth, not to exceed an amount of NTD \$3 million

		if both the investor’s annual income and net worth are equal to or more than NTD \$3 million.
Assessment	The assessment of fundraisers: 1. the 2-stage examination 2. the PICM	The assessment of fundraisers: 1. the 2-stage examination 2. the PICM which is volunteered for fundraisers to join
	The assessment of investors: “Risk Disclosure Statement”	Fundraisers or online platforms shall execute: 1. a “Knowledge or Experience Test” which ensures that investors possess sufficient knowledge or experience to understand the risks of the investment <b>or</b> the “Suitability Assessment Test” to ensure investments are suitable for investors (See Singapore Model) 2. “Risk Disclosure Statement”
Online platforms	the GISA board has no duty to take measures to protect investors (See GISA regulation §2).	Online platforms have to take measures to reduce the risk of fraud and provide investors with educational materials (See the USA model).

Table 4 Legal Reform

### 5.2.2 Policy Reform- The Supervisory Sandbox

The supervisory sandbox could be another way to solve the dilemma that occurred in equity-based crowdfunding and find out a way to protect investors and promote fundraising from policymaking.

Taiwan enacted the “**Financial Technology Development and Innovative Experimentation Act**”<sup>130</sup> (the Sandbox Act) in January 2018, the Sandbox Act was originated from the UK regulatory sandbox experience, but the Sandbox Act only applied in the financial technology industry in Taiwan, it gives equity-based crowdfunding a way to develop a better regulatory environment which could balance the investors’ protection and fundraisers’ need.

To apply the sandbox experimentation, the applicant shall prepare an innovation experimentation plan first<sup>131</sup>.

Suppose the FSC approves the experimentation plan. There is 1 year for the applicant to run the plan, the period could also be extended. If the experimentation is inventive, effectively increase the efficiency of financial services, reduce operational costs or enhance the interests of financial consumers and enterprises, the FSC will take the following actions in consideration of the implementation status of the innovative experimentation, and the applicant could benefit from the actions<sup>132</sup>:

1. Reviewing and revising relevant financial regulations<sup>133</sup>.

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<sup>130</sup> following after the UK, Singapore, Australia and HK.

<sup>131</sup> See Sandbox Act §4.

<sup>132</sup> See Sandbox Act §17

<sup>133</sup> Also see Securities and Exchange Act §44-1:

To facilitate the development of financial inclusion and financial technologies, applicants, not limited to securities firms and securities finance enterprises, may apply to conduct innovative

2. Providing assistance to the applicant in starting a business or entering into a strategic cooperation.
3. Making referrals to relevant government agencies or organizations or funds that offer business startup assistance.
4. If the relevant financial laws should be amended, the FSC should, no later than 3 months after the end of the innovative experimentation, complete an amendment draft of the financial laws and submit it to parliament.

According to the statistics<sup>134</sup>, there are 8 experimentation plans approved by FSC. The FUNDSWAP is the first success story and takes 18 months to experiment with its plan, which uses blockchain technology to assist its members in exchanging mutual funds they invested. Before this experimentation, exchanging mutual funds was not allowed by regulations, but due to the successful experimentation, the FSC announced that it would revise the related regulations and allow the business of exchanging mutual funds<sup>135</sup>.

Therefore, fundraisers and online platforms could apply the sandbox experiment to seek a better model which could adopt from the experience of the

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experimentation in securities business pursuant to the Financial Technology Development and Innovative Experimentation Act.

An innovative experiment under the preceding paragraph may be exempted from application of the provisions of this Act within the period and scope approved by the Competent Authority.

The Competent Authority shall take into reference the results of implementation of the innovative experimentation under paragraph 1, and review the appropriateness of this Act and relevant financial laws and regulations in light thereof.

<sup>134</sup> See <https://www.fsc.gov.tw/ch/home.jsp?id=667&parentpath=0,7,478>. Visiting date:8/8/2021.

<sup>135</sup> See the official news of the FSC website:

[https://www.fsc.gov.tw/ch/home.jsp?id=2&parentpath=0&mcustomize=news\\_view.jsp&dataserno=202103230002&dtable=News](https://www.fsc.gov.tw/ch/home.jsp?id=2&parentpath=0&mcustomize=news_view.jsp&dataserno=202103230002&dtable=News). Visiting date:8/8/2021.

USA or Singapore and create a friendly investment environment for investors and fundraisers.

To sum up, if investors can be protected properly by internet information, online platforms, and legal regulations, more and more investors will be willing to invest in the crowdfunding market, and fundraisers can raise funds more easily, the supervisory and regulatory dilemma from the traditional method (disclosure duty) will be mitigated. As a result, equity-based crowdfunding may finally fill the gap in traditional capital formation and improve economic development in Taiwan.



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