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PUBLIC VENTURE IN PRIVATE COMPANIES THROUGH CROWDFUNDING METHOD OF PEER-TO-PEER LENDING IN MALAYSIA*

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ABSTRACT

Digital funding platforms have been contemporaneously developed and utilised as a medium to enable businesses and companies to seek funds and to raise capital for any kind of commercial purposes, at any time or place. Such technology allows the service providers to invite the public to participate in generating funds for the businesses and companies in need. Through this mechanism, it is factual that funds are contributed by the public, while the law clearly provides the restriction of the public to invest or deposit or hold equity in private companies. Allowing the public to directly invest in private companies would be considered as illegal considering the legal restriction imposed on the private companies under the statute. Therefore, this article aims to study the legality of venturing this public money into the business investment of private companies. The focus of this study is the governing law in Malaysia in respect of the legality of funding private companies through online social lending namely peer-to-peer lending

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(P2P lending). This study is conducted by way of contents analysis of various provisions of relevant legislations. The outcomes of this study show that digital social lending such as P2P lending, has grown and been accepted by various natures of enterprises and private companies in order to start-up their business operation in Malaysia, as it compliments the limitation for private companies to invite the public to venture into their business.

Keywords: Crowdfunding, P2P lending, public, private company, Malaysia.

USAHA SAMA AWAM DALAM SYARIKAT PERSENDIRIAN MELALUI KAEDAH PENDANAAN SECARA PEMBIAYAAN ANTARA RAKAN SETARA DI MALAYSIA

ABSTRAK

Platform pendanaan digital telah dibangunkan dan kini digunakan sebagai medium untuk membolehkan perniagaan dan syarikat mencari dana dan mengumpul modal untuk sebarang jenis tujuan komersial, pada bila-bila masa atau tempat. Teknologi sedemikian membolehkan penyedia perkhidmatan menjemput orang ramai untuk mengambil bahagian dalam menjana dana untuk perniagaan dan syarikat yang memerlukan. Melalui mekanisme ini, adalah nyata bahawa dana disumbangkan oleh orang ramai, manakala undang-undang jelas memperuntukkan sekatan bagi orang ramai untuk melabur atau menyimpan atau memegang ekuiti dalam syarikat persendirian. Membenarkan orang ramai melabur secara langsung dalam syarikat persendirian adalah perkara yang menyalahi undang-undang memandangkan sekatan undang-undang yang dikenakan ke atas syarikat persendirian di bawah statut. Oleh itu, artikel ini bertujuan untuk mengkaji kesahihan penglibatan dana awam ini ke dalam pelaburan perniagaan syarikat persendirian. Fokus kajian ini adalah undang-undang yang mengawalselia kesahihan pembiayaan syarikat persendirian melalui pembiayaan sosial dalam talian iaitu pembiayaan antara rakan setara (pembiayaan P2P) di Malaysia. Kajian ini dijalankan dengan cara alisis kandungan pelbagai peruntukan perundangan yang berkaitan. Hasil kajian ini menunjukkan bahawa pinjaman sosial digital seperti pembiayaan P2P, telah berkembang dan diterima oleh pelbagai jenis perusahaan dan syarikat persendirian untuk memulakan operasi perniagaan mereka di Malaysia, kerana ia memenuhi sekatan bagi syarikat persendirian untuk mengajak orang ramai menceburi perniagaan mereka.

Kata Kunci: Pendanaan ramai, pembiayaan P2P, awam, syarikat persendirian, Malaysia.

INTRODUCTION

Private companies raise their capital by way of issuing their shares to their participants or also known as members. In consideration of the fund injected by members into a company's capital, the company then issues shares to them. That is the reason why these participants are also known as shareholders and they hold legal interests in the company upon their names being registered in the companies' register of members. Such fundraising exercise can be undertaken in phases or can also take place only upon its incorporation.

It is obvious that offering shares to a large number of investors could speedily result in a large number of people being declared as shareholders of the company. The Companies Act of 2016 in Malaysia nonetheless limits the maximum number of persons that can be registered as shareholders in all private limited companies and the number should not exceed 50. Therefore, it is crucial for private companies to precisely determine the appropriate method to get funds towards raising their capital for the purpose of commencing the business.

A private company may, subject to the passing of a resolution in the general meeting accept deposits from its members. The law on the incorporation of private companies is stipulated in the Companies Act 2016 (CA 2016). It is clear that in the case of private companies, deposits from the public cannot be accepted in any situation. Similarly, an offer of shares is only limited to the members and can never be extended to the public. This is pursuant to the restriction under section 43(1) of the CA 2016 which states the prohibition for private companies to:

(a) offer to the public any shares or debentures of the company;

(b) allot or agree to allot any shares or debentures of the company with a view to offer such securities to the public; or

(c) invite the public to deposit money with the company for fixed periods or payable at call, whether bearing or not bearing interest.

The term ‘offer’ in section 43(1)(a) of the CA2016 does not apply to any offers made to a person already connected with the company, or an employees' shares scheme.[1] With regard to the expression 'person already connected with the company', section 44(4) of the CA2016 describes such person as:

(a) An existing member or employee of the company;

(b) A member of the family of a person who is or was a member or employee of the company;

(c) An existing debenture holder of the company; or

(d) A trustee, acting in his capacity as such, of a trust of which the principal beneficiary is a person within any of paragraphs (a) to (c).

With regard to the term ‘crowdfunding’, it involves an invitation to raise funds from a large number of individuals, via an online platform and it is regarded as a method used to finance a project or company using the digital platform or online funding, hence the use of technology is the essence in its operational mechanism. In Malaysia, technology-based public funding is rising and expanding as an industry. It nowadays exists along with the traditional financing dominated by banks and credit companies and is regarded as an alternative financing approach. In order to provide the funding needed by the borrowers and push the project off the ground, the publics comprising of large groups of persons, pool together their monies to venture into the business and contribute as lenders for the business of private companies. Any interested persons or individuals can venture into projects or campaigns launched by enterprises, individuals, private businesses, charities, and so on, by becoming a lender and participating in the fundraising. Obviously, these funds come from public investors who are neither members nor shareholders of private companies. They are totally outsiders. In relation to this, a question arises as to the legality of this investment vehicle which invites the

[1] Section 44(3) of the Companies Act 2016.

public to venture into private companies when the provision of the statute restricts the private company from receiving the public's money. Therefore, this article aims to examine the legality of corporate funding through public venture via P2P lending into the business investment of private companies, in Malaysia.

METHODS

This article employs library-based research comprising of primary and secondary sources of law. It involves an analysis of statutory provisions and regulations related to the restriction of public investment in private companies in Malaysia as well as the legality of social lending or known as crowdfunding based on P2P lending to be utilized by private companies in Malaysia. This research is conducted by way of contents analysis of various provisions of relevant legislation enforced in Malaysia. Further, other materials such as various literature from journals, textbooks, newspapers, reports including internet sources are also referred to. The relevant legislation namely the CA 2016, Capital Markets and Services Act 2007 (CMSA 2007), and the Securities Commission's (SC) Guidelines on Recognised Markets (ECF, P2P, DAX, PCF, and E-Services) (the Guidelines) governing the operational framework of such financing are examined in order to determine the actual legal effect of such financing in Malaysia.

LEGAL PROHIBITION FOR PUBLIC TO DEPOSIT MONIES IN PRIVATE COMPANIES

There are a number of legislations currently introduced and enforced to regulate the existing traditional funding vehicles. The purpose of this legislation is to ensure the operational mechanism are in compliance and inline with the different financial reporting standards required by different regulators in Malaysia. The legislations such as the CA 2016, the Partnership Act 1961, the Limited Liability Partnerships Act 2012, the Societies Act 1966, and the Companies Commission of Malaysia (CCM) Act 2001 regulate both the governance and establishment of various business organizations as well as societies or clubs or associations in Malaysia. As for Bursa Listing Requirements and the Malaysian Code of Corporate

Governance, they serve to govern the conduct of listed entities on Bursa Malaysia. On the other hand, the country's central bank, namely Bank Negara Malaysia regulates banking and financial institutions in the country.[2] The private company is described as an incorporated entity as stipulated in section 2(1) of the CA2016 as follows:

> (a) A company which was incorporated as a private company in accordance with the then written law, prior to the enforcement of the CA2016;
>
> (b) A company which has been incorporated pursuant to the CA2016, as a private company; and
>
> (c) A company which has gone through conversion pursuant to section 41of the CA2016 from different types of entity into a private company.

The law imposes restrictions on public participation in the private companies. It means, a private company cannot raise funds from the public either by issuing shares or debentures to the public as stipulated in section 43 of the CA2016 where it provides that:

> (1) A private company limited by shares shall not-
>
> (a) Offer to the public any shares or debentures of the company;
>
> (b) Allot or agree to allot any shares or debentures of the company with a view to offer such securities to the public; or
>
> (c) Invite the public to deposit money with the company for fixed periods or payable at call, whether bearing or not bearing interest.

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[2] Loo Choo Hong, "Crowdfunding: Issues Pertaining to Financial Reporting and Assurance in Malaysia", *Journal of Wealth Management & Financial Planning* 18 (June 2018) 5: 17 – 24, https://mfpc.org.my/wp-content/uploads/images/JWMFP/2018/OriginalResearchCrowdfunding.pdf.

Failure to adhere to the restrictions stated in section 43(5) of the CA2016 constitutes a legal contravention of the law, and the offender i.e. the company, or its officer, if found liable and convicted, may be subject to sentences such as imprisonment for a term up to five years or a monetary penalty or fine up to three million ringgits or both. An instance of an offence that is against the restrictions of section 43 is accepting unlawful deposits from public investors to be injected into the private company's capital.

The CA 2016 expressly prohibits private companies from having access to public equity in the event the company requires working capital or funding.[3] Such privilege is only available to companies that are registered as public companies.[4] Unlike private companies, the public companies, subject to their constitution, may opt to issue shares to the public to participate in their companies as shareholders i.e. they are given shares for the fund or capital they injected into the companies.[5] Apart from inviting the public to become shareholders and consequently hold legal interests in the company, the public company may also invite the public to participate in the company as a debenture holder through the issuance of bond or certificate of debt under which the public can enjoy the interests they received under such debenture until it expires.[6] This is regarded as one form of debt financing which is considered to be public-based for a public company to get funding, apart from getting loans or credits or any form of financing facilities from financial institutions such as banks. Hence, it becomes a big advantage for a public company in terms of exploring and choosing from various sources of funding as

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3 See section 43 of the CA 2016.

4 "What is a Private vs Public Company?", CFI Education Inc, accessed October 5, 2021, https://corporatefinanceinstitute.com/resources/knowledge/finance/private-vs-publiccompany/?__cf_chl_f_tk=SnuZERSpX1zTLL8zt9jUecXqLnOYjfwZTTG1QBXlPyc-1642306726-0-gaNycGzNDJE.

5 Kate Ashford, John Schmidt, "What Is An IPO?", *Forbes Advisor*, August 25, 2021, https://www.forbes.com/advisor/investing/initial-public-offering-what-is-an-ipo/.

6 "Malaysia Bond Market", Bank Negara Malaysia, accessed October 5, 2021, https://www.bnm.gov.my/financialmarkets/bondmarket.

its equity investment can be shared by huge size of participants from the public.[7]

The restriction of public deposit in private companies is motivated by the significance of the concept of a modern private entity which is also described as 'Close Corporation' or 'Close Companies'.[8] For this type of firm, members typically come together and related in view of their bonds of kinship, affinity, friendship, or other similar close. Examples of 'Close Corporation' or 'Close Companies' are private companies, family corporations, and incorporated partnerships.[9] As a private company, inviting outsiders to become a stakeholder or allowing them to deposit and enjoy a certain degree of control over the company is not something the company would be keen to do.[10] The members are fully aware of the objectives of their business and the direction of their companies or firms as well as the methods to achieve their aims without interference from anyone else.[11] Hence, the companies are free to explore things independently, and compliance with the laws further benefits private companies to attain the objects of its incorporation.[12]

There are several reasons for a company to be set up and remain a private company. One of the main advantages is the autonomy to manage the business operation and its internal managerial affairs, free from public inquiry or activist shareholders'

7 "Bonds', Investor.gov, accessed October 10, 2021, https://www.investor.gov/introduction-investing/investing-basics/investment-products/bonds-or-fixed-income-products/bonds.

8 "Open versus Closed – Ownership of the Corporation", LawShelf Educational Media, accessed October 3, 2021, https://lawshelf.com/coursewarecontentview/open-versus-closed-ownership-of-the-corporation.

9 "Close Corporation Laws", LegalMatch, accessed October 3, 2021, https://www.legalmatch.com/law-library/article/close-corporation-laws.html.

10 "What Is a Close Corporation?", LegalNature, accessed October 3, 2021,https://www.legalnature.com/guides/what-is-a-close-corporation.

11 "All about Private Limited Company: A Complete Guide", Legal Raasta, accessed October 3, 2021, https://www.legalraasta.com/private-limited-company/.

12 "Close Corporation", WallStreetMojo, accessed October 3, 2021, https://www.wallstreetmojo.com/closed-corporation/.

observation.[13] Further, a private company does not need to conform with the expensive and tedious regulatory, corporate governance, disclosure requirements and financial reporting requirements like public companies do.[14] Further, all officials and managers of a private company can avoid the technicalities involved in honouring various directions and regulations issued by the authorities.[15] Moreover, a private company does not need to be bothered by the pressure of meeting with a mass audience of public members.[16] The tension created may distract the management from other primary matters that relate to the interest of the company.[17]

Nevertheless, given the statutory limitation that the law imposed on the private companies with regard to public venture,[18] the

13 "Private Company", CFI, accessed October 4, 2021, https://corporatefinanceinstitute.com/resources/knowledge/finance/private-company/.

14 "Audit Exemption For Selected Categories Of Private Companies", SSM, accessed October 4, 2021, https://www.ssm.com.my/Pages/Publication/Press_Release/2017/Audit-Exemption-For-Selected-Categories-Of-Private-Companies.aspx.

15 "Doing Business in Malaysia 2020", PWC, 14, accessed October 4, 2021, https://www.pwc.com/my/en/assets/publications/2020/PwC-Doing-Business-Guide-2020.pdf.

16 See Chapter 8: Continuing Listing Requirements of Bursa Malaysia SecuritiesBerhadMain Market Listing Requirements, where public companies decision-making are subject to the wishes of public shareholders via general meeting for various matters, such as issuance of shares or convertible securities or options that may lead to material dilution, material change to utilisation of proceeds, provision of financial assistance, listing of subsidiaries, dividend distributions. Chapter 8 however does not apply to private companies in Malaysia.

17 Nor Hayati Abdul Samat, HasaniMohd. Ali, "A legal perspective of shareholders' meeting in the globalised and interconnected business environment", *Elsevier Procedia - Social and Behavioral Sciences* 172 (2015) 762 – 769, https://www.sciencedirect.com/science/article/pii/S187704281500467X.

18 Section 43 CA 2016 expresslyprohibits public from acquiring shares or depositing money with the private companies for fixed periods or payable at call. In this respect, public have to explore different method in order to venture or participate in the business of private companies without acquiring any stake in the company as shareholders or

companies afterward have to struggle in order to get funding, especially for their working capital purposes, and to commence the business operation accordingly. Unlike public companies, private companies are legally prohibited from selling a share of their business to public investors.[19] Therefore, apart from the share capital contributed by the members and certain loans from the directors and families, they might have to be subjected to the traditional financing products regularly in the forms of bank loans and credits. Further, the current predicament of the world economy has inveigled both profit-oriented and non-profit-oriented firms or organisations into a stiff and strenuous fiscal state.[20] Such a condition does not only disfavour the chance for the private companies to get loans or funds but also has adverse impacts on the companies' financial standing, especially to those companies which are young and do not have a known and respectable financial reputation among the financiers, especially banks. This is based on the survey conducted and reported by the Business Sustainability Taskforce COVID-19, unveiling the bank's stance in refusing to help companies whose financial cycle had yet to mature, or who were rather new in the market.[21]

THE CROWDFUNDING

Crowdfunding has, over the last few years, emanated as a new fangled avenue for businesses and enterprises to get funding aside

depositors. One method of exploring venture is by way of P2P lending ie public become lenders for the company's business.

19 Section 43 CA 2016 prohibits any form of invitation to the public to subscribe for any shares of the private companies.

20 HasnizamShaari, Yong Phoon Lee, Salniza Md Salleh, Selvan Perumal, Fakhrul Anwar Zainol, "Millennials alumni and donor behaviour: An insight from management-based university in Malaysia*", International Journal of Applied Management Science* 352 (2019) 11(4): 352 – 369, DOI:10.1504/IJAMS.2019.103706.

21 "Banks being difficult with loans, says SME group", The Malaysian Entrepreneurs Festival, accessed October 17, 2020, https://www.tmef.com.my/sme-news-details.php?id=4224.

from bank loans.[22] Crowdfunding is described as an act of contribution of money by the crowd in order to raise funds in which interested persons from the public confided to support the project's capital via the use and access of online platforms which has expanded rapidly in recent years.[23] In many jurisdictions, crowdfunding has been recognised as another mode of business financing.[24]

Crowdfunding features an interminable and overwhelming saga since the 1700s.[25] Some authors described crowdfunding as an open invitation via online for the collection of money towards a particular project.[26] Mollick on the other hand, set a broader depiction of crowdfunding "as any form of business endeavours undertaken jointly by different groups of people with the aim of profit through monetary contribution via the internet, without going through financial intermediaries.[27]

Generally, crowdfunding offers several advantages to the companies such as follows. Firstly, it can be considered as a fast way to raise finance with no requirement for advance fees.[28] Secondly, it is

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22 Ethan Mollick, "The dynamics of crowdfunding: An exploratory study", *Journal of Business Venturing* 12 (2014) 29: 1–16, https://doi.org/10.1016/j.jbusvent.2013.06.005.

23 Tanya Beaulieu, SuprateekSarker, and SaoneeSarker, "A Conceptual Framework for Understanding Crowdfunding", *Communications of the Association for Information Systems*, 3 2 (2015) 37: 1-31, https://doi.org/10.17705/1CAIS.03701.

24 Tan Wai Kit "Crowdfunding As An Alternative Financing For SMEs And Start-Ups In Malaysia: An Introductory Note From The Legal Perspective", *IIUM Law Journal*, 29(2) (2021) 221–269. https://doi.org/10.31436/iiumlj.v29i2.614.

25 "The History of Crowdfunding", Fundable, accessed June 5, 2021, https://www.fundable.com/crowdfunding101/history-of-crowdfunding.

26 Armin Schwienbacher& Benjamin Larralde, "*Crowdfunding of Small Entrepreneurial Ventures*" in "Handbook of Entrepreneurial Finance", (Oxford: Oxford University Press, 2010), 3-19, https://doi.org/10.2139/ssrn.1699183.

27 Ethan Mollick, "The dynamics of crowdfunding: An exploratory study", *Journal of Business Venturing* 12 (2014) 29: 1–16, https://doi.org/10.1016/j.jbusvent.2013.06.005.

28 Rachel Morgan Cautero, "Ways People Are Crowdfunding to Raise Emergency Money", The Balance, June 28, 2021,

capable of pitching a project or business through the online platform which can be a worthy form of marketing and result in media attention of the company's business and its products or services.[29] Thirdly, it comprises sharing of the business idea and the company can get feedback and expert guidance on how best the company can improve it. Fourthly, it is a good way to test the public's reaction to the company's products or services or business ideas, i.e. if the public is keen to invest in it, it is a good sign that the company can identify if it is going to be marketable or not. Fifthly, crowdfunding enables the investors to track the progress of the company's business in terms of the promotion of the company's brand. Sixthly, it is highly probable that the investors themselves may become the potential customers or followers of the company's products or services as they tend to develop interests in the company's brand through their participation in crowdfunding. Finally, crowdfunding is regarded as an alternative finance option if the companies are in a struggle to get their banks loan or traditional funding facilities approved.[30]

Crowdfunding nowadays is fully initiated and operated through digital platforms, for both equity-based crowdfunding and P2P lending.[31]After the 4th industrial revolution, the growth of technologies and innovation has contributed to new business models of financing or funding in Malaysia.[32] This is one of the reasons for

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https://www.thebalance.com/ways-people-are-crowdfunding-to-raise-emergency-money-4172903.

29 Virendra Sharma, "Why P2P money lending apps are getting popular", Business of Apps, September 9, 2021, https://www.businessofapps.com/insights/why-p2p-money-lending-apps-are-getting-popular/.

30 "Crowdfunding", NIBUSINESSINFO.CO.UK. assessed October 4, 2021, https://www.nibusinessinfo.co.uk/.

31 "Equity Crowdfunding (ECF)" Capital Markets Malaysia, accessed June 5, 2021, https://www.capitalmarketsmalaysia.com/digital-equity-crowdfunding-ecf/, and "Peer-to-Peer (P2P) Financing", Capital Markets Malaysia, accessed June 5, 2021, https://www.capitalmarketsmalaysia.com/digital-peer-to-peer-p2p-financing/.

32 Chong Tun Pin, William Choo Keng-Soon, Yip Yen San, Chan Pui Yee, Julian Teh Hong Leong, Ng ShwuShing, "An Adoption of Fintech Service in Malaysia", *South East Asia Journal of Contemporary*

crowdfunding to be operated through an efficient platform via financial technology (Fintech).[33]

The two main categories of funding are equity and debt-based crowdfunding. It is identified that the operation of equity-based crowdfunding and peer-to-peer lending is regulated by the financial authority such as the SC, while other models of crowdfunding namely the reward-based crowdfunding (RBC) and donation-based crowdfunding (DBC) are yet to be regulated, neither in the United Kingdom or the United States.[34] Similarly, in Malaysia, the SC has yet to introduce any specific guidelines for the RBC and DBC.

Private companies can explore debt financing in various forms, such as term loans, lines of credit or credit card, crowdfunding, invoice financing, etc. As for crowdfunding, it is further categorised into two main categories, namely equity crowdfunding, and P2P lending.[35]

Equity crowdfunding was first known as a funding platform when it was launched in 2007 in Australia, called the Australian Small-Scale Offerings Board (ASSOB),[36] and was later became a phenomenon beginning from 2010 in the United Kingdom.[37] In

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Business, Economics and Law 134 (2019) 18(5): 134-147, https://seajbel.com/wp-content/uploads/2019/05/seajbel5-VOL18_241.pdf.

33 Muhammad ShahrulIfwat Ishak, Md Habibur Rahman, "Equity-based Islamic crowdfunding in Malaysia: a potential application for mudharabah", *Qualitative Research in Financial Markets* 183 (2021) 13(2): 183-198, https://doi.org/10.1108/QRFM-03-2020-0024.

34 Ying Zhao, Phil Harris, Wing Lam, "Crowdfunding industry—History, development, policies, and potential issues", *Journal of Public Affairs* 1 (February 2019): 1-9, https://doi.org/10.1002/pa.1921.

35 "Your Guide to Financing", Xero, accessed October 17, 2020, https://www.xero.com/my/resources/small-business-guides/how-to/guide-to-financing-your-business/debt-vs-equity/.

36 "Crowdfunding's Potential for the Developing World", Information for Development Program (infoDev)/The World Bank, 2013, 46.

37 Saul Estrin, Daniel Gozman & Susanna Khavul, "The evolution and adoption of equity crowdfunding: entrepreneur and investor entry into a new market", *Small Bus Econ* 427 (2018) 51:425–439, https://doi.org/10.1007/s11187-018-0009-5.

Malaysia, equity crowdfunding was first recognised and regulated by the SC by the release of the Guidelines on Regulation of Markets under Section 34 of the CMSA 2007 on 10 February 2015. It serves to introduce new requirements for the registration of equity crowdfunding platforms and provide governance arrangements for the operator of such platforms.[38]

Equity crowdfunding is one form of social lending which mechanism allows a company to receive money from the public to be used as its working capital.[39] In return for money injected by the public into the company's capital, the public would be issued with unlisted shares i.e. shares that are not listed or sold in the open market on the stock exchange.[40]Alternatively, in consideration of the capital being injected by the public, the company may also offer them a convertible bond with prospects that such debt will in the future, be converted into shared equity.[41] This mechanism is very beneficial to companies that are searching for capital for their business start-up.[42] In this respect, equity crowdfunding is normally adopted better for raising bigger amounts of fund.[43] Individuals and organisations who

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[38] "SC Releases New Guidelines to Facilitate Equity Crowdfunding", Securities Commission, accessed June 5, 2021, https://www.sc.com.my/resources/media/media-release/sc-releases-new-guidelines-to-facilitate-equity-crowdfunding.

[39] Oliver Christopher Gomez, "Investing: The ECF growth story", The Edge Markets, February 11, 2020,https://www.theedgemarkets.com/article/investing-ecf-growth-story?__cf_chl_f_tk=ThVvdP1VJH7RuJATk0NPMcAJomcrTpKS0lod94R2pRo-1642397188-0-gaNycGzNCX0.

[40] Frequently Asked Questions (FAQ)onEquity Crowdfunding (ECF) Framework, accessed October 4, 2021, https://www.sc.com.my/api/documentms/download.ashx?id=b392ed41-0d9b-47ef-95a8-f64f39a7498b.

[41] "Guidelines on Issuance of Corporate Bonds and Sukuk to Retail Investors", Securities Commission, accessed October 4 , 2021, https://www.sc.com.my/api/documentms/download.ashx?id=78ced436-2082-4120-9e91-dce870f3a9f0.

[42] "Investing in Bonds", InvestSmart, accessed October 4, 2021, https://www.investsmartsc.my/who-we-are/.

[43] Krishan Arora, "Equity Crowdfunding Will Revolutionize Fundraising For Startups", Forbes, June 8, 2020, https://www.forbes.com/sites/forbesagencycouncil/2020/06/08/equity-

finance companies or acquire a stake as members in the companymust expect that the business may either flop or prosper. In case it fails, the investor may in the end lose their investment. Nonetheless, if it turns to flourish, the investor may eventually enjoy the benefit in the form of a handsome return. From the business financing's perspective, this model has a distinct edge; if the business goes bust, its shares are worth nothing, and the borrowing companies are not required to pay back.[44] It may sound horrid for the investors. However, if the business turns splendid, they will enjoy substantial prospects and gain. In terms of risk, the investors will lose all of their investment if the business fails.[45] In addition, while it is fairly easy to dispose of a share by way of sale and transfer in a listed company, shares in smaller, early-stage companies are disreputably illiquid and subject to instability.[46] This means investors have to deal with how to recover their money which has been earlier invested.

As for P2P lending, although it operates almost similar to a bank's term loan,[47] it is not considered to be in the same category of traditional loan products offered by banks.[48] It is a fintech product

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crowdfunding-will-revolutionize-fundraising-for-startups/?sh=35ce94fac433.

44 Katie Cunningham, "What is equity crowdfunding?", The Guardian.com, November 14, 2021, https://www.theguardian.com/australia-news/2021/nov/15/what-is-equity-crowdfunding-why-cleaning-product-and-nail-polish-start-ups-ask-you-to-invest.

45 "Crowdfunding: What you need to know before investing", MonaySense, accessed October 4, 2021, https://www.moneysense.gov.sg/articles/2018/10/crowdfunding-what-you-need-to-know-before-investing.

46 Wan Amir Azlan Wan Haniff, Asma Hakimah Ab Halim, Rahmah Ismail, "Equity Crowdfunding in Malaysia: Legal and Sharia Challenges", *International Journal of Asian Social Science*453 (2019) 9(8): 450-460, DOI: 10.18488/journal.1.2019.98.450.460.

47 "What You Need To Know About P2P Lending In Malaysia", iMoney Learning Centre, accessed October 4, 2021, https://www.imoney.my/articles/p2p-lending-guide.

48 Liew Jia Teng, "Cover Story: ECF & P2P just scratching the surface of SME funding gap", The Edge Malaysia, June 13, 2019, https://www.theedgemarkets.com/article/cover-story-ecf-p2p-just-scratching-surface-sme-funding-gap.

that holds high potential in terms of offering alternative mediums of financial assistance to the small and medium enterprise (SME) business in Malaysia.[49] Alongside equity crowdfunding, they offer more choices in an industry dominated by banks for so long. Private companies can get the fund from various persons instead of banks.[50] Indeed, the sources are unknown or unrelated to the private companies, as the companies are matched with the agreed lenders through a P2P lending platform or a digital marketplace.[51] This form of social lending is also known as market place lending, debt crowdfunding, or crowdlending.[52] The service is performed digitally, thus, this vehicle has developed its market with lesser operational costs compared to banks.[53] Consequently, the interests imposed are

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49 Mohamed Asmy Bin Mohd Thas Thaker, Hassanudin Bin Mohd Thas Thaker, Maya Puspa Binti Rahman, Md Fouad Bin Amin, Anwar Bin Allah Pitchay, and Nafiu Oladokun Olaniyi, "Factors Affecting Investors' Intention To Invest In A Peer-To-Peer Lending Platform In Malaysia: An Extended Technology Acceptance Model", *ADBI Working Paper Series,* No.998, September 2019, 10, Asian Development Bank Institute, https://www.adb.org/sites/default/files/publication/524101/adbi-wp998.pdf).

50 "Peer-to-Peer Lending: A form of direct money lending to individuals or businesses without an official financial intermediary", CFI Education Inc., accessed October 4, 2021, https://corporatefinanceinstitute.com/resources/knowledge/finance/peer-to-peer-lending/.

51 Mark Rao, "P2P — a growing digital marketplace for lenders and borrowers", *The Malaysian Reserve,* September 5, 2019, https://themalaysianreserve.com/2019/09/05/p2p-a-growing-digital-marketplace-for-lenders-and-borrowers/.

52 "What is peer-to-peer lending?", Xero, accessed October 17, 2020, https://www.xero.com/sg/guides/financing-your-business/peer-to-peer-lending/.

53 Melina Gkionaki, "How it works: Digital marketplaces transform industry", European Investment Bank, September 2, 2020, https://www.eib.org/en/stories/what-is-a-digital-marketplace.

also lower, and it turns into an attractive and competitive funding scheme.[54]

In other words, P2P lending is a very different model compared to equity funding as it refers to an exact amount of money to be given on debt, and subsequently repaid over a defined term, and the investors eventually earn a return from it through payment of interest throughout the loan tenure.[55] Generally, the risks and rewards are considered to be more modest with P2P lending, and further, theP2P lending platforms may specialize in lending to certain types of borrowers i.e. businesses or property businesses – or may diversify across borrower types.[56] The main risk of P2P lending is when the borrower does not pay it back.[57] To assist investors in dealing with this risk, some P2P lending platforms include features such as a provision fund, which accepts contributions from borrowers as part of their loan and takes measures if a payment is missed.[58] Just like any other kind of unsecured investment, there is no actual guarantee that the investors will get their money back, and this fact is a reality that needs to be understood by the lenders.

By studying the two models, equity crowdfunding is regarded to be of higher risk, but it could be argued that the rewards on offer

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54 "What You Need To Know About P2P Lending In Malaysia", iMoney Learning Centre, accessed October 4, 2021, https://www.imoney.my/articles/p2p-lending-guide.

55 Arjunwadkar, Parag Y. *FinTech : The Technology Driving Disruption in the Financial Services Industry*. Milton: Auerbach Publications, 2018, accessed September 2, 2020, https://books.google.com.my/books?id=cSJWDwAAQBAJ&printsec=frontcover&hl=ms#v=onepage&q&f=false.

56 Emma Dunkley, "Peer-to-peer lending: the risks and rewards", *Financial Times*, August 2, 2014, https://www.ft.com/content/b923be40-18ad-11e4-933e-00144feabdc0.

57 Pallavi ArunVerma, "How Do P2P Companies Handle Defaults?", *The Economic Times*, October 31, 2018, https://economictimes.indiatimes.com/wealth/p2p/how-do-p2p-companies-handle-defaults/articleshow/66440834.cms?from=mdr.

58 "How Does Crowdfunding Differ to P2P Lending?", Fleximize, accessed October 4, 2021, https://fleximize.com/articles/006773/crowdfunding-and-peer-to-peer-lending.

reflect this. As a consequence, equity crowdfunding platforms are typically aimed at sophisticated investors, i.e. persons with a high level of financial literacy as well as a strong awareness of early-stage businesses and the risks involved. P2P lending provides more predictable returns, and both the risks and returns are comparatively lower.

Regulations governing P2P lending in Malaysia

Comparing the two crowdfunding vehicles, P2P lending fits the limitation faced by a private company as it is restricted from dealing with any deposit or investment of the public.[59] Indeed, private companies are eligible to borrow money or to get funds through the P2P platform.[60]

Being part of the fintech market, P2P lending is governed by the CMSA 2007 and its digital operation is regulated by the SC. On 13 April 2016, the Guidelines on Recognised Markets (the Guidelines) was issued by the SC to regulate the practice of P2P lending in Malaysia.[61] The Guidelines are issued by the SC pursuant to section 377 of the CMSA 2007[62] and must be read together with subdivision 4, division 2 of Part II[63] of CMSA 2007. Three main parties contribute towards realisation of P2P lending operation, namely the P2P operators, issuers, and investors.

For P2P operators, section 34 of the CMSA 2007 states that it is mandatory for all P2P operators in Malaysia to become registered and approved operators by the SC, and they are known as Recognised

59 Section 43 of the Companies Act 2016.

60 "Frequently Asked Questions on The Peer-To-Peer Financing (P2P) Framework", Securities Commission, last modified June 5, 2021, https://www.sc.com.my/regulation/regulatory-faqs/frequently-asked-questions-on-the-peer-to-peer-financing-p2p-framework.

61 "Guidelines on Recognized Markets 2016", Securities Commission, accessed June 5, 2021, https://www.sc.com.my/api/documentms/download.ashx?id=73180796-2958-44d3-90a1-7dab13ec9839).

62 S377 of the CMSA 2007 provides that the SC may issue any guidelines as well any practice notes as for the purpose of regulating the market.

63 This subdivision regulates the recognized market operators.

Market Operator (RMO). This is also in line with paragraph 14.03 of the Guidelines. According to paragraph 14.04 of the Guidelines, every P2P operator shall be locally incorporated as a corporate body with a minimum paid-up capital of RM5 million. The list of the RMO or registered P2P operators are:

- Bay Smart Capital Ventures Sdn Bhd
- B2B Finpal Sdn Bhd
- Capsphere Services Sdn Bhd
- Crowd Sense Sdn Bhd
- Ethis Kapital Sdn Bhd
- FBM Crowdtech Sdn Bhd
- MicroLEAP PLT
- Modalku Ventures Sdn Bhd
- Moneysave (M) Sdn Bhd
- Peoplender Sdn Bhd
- QuicKash Malaysia Sdn Bhd.[64]

The Guidelines, apart from requiring the registration of P2P operators, also list the duties of the P2P operators, which includes, *inter alia*, maintaining a consistent system of risk scores for investment notes, performing a risk evaluation on prospective issuers to ensure its fitness and soundness, and ensuring compliance with its regulations.[65] Further, as provided under paragraphs 14.07 to 14.15 of the Guidelines, the SC also requires a P2P operator to open a trust account in a bank for the fund raised by the issuer, as well as for the money received for repayments to the investors. In brief, the Guidelines set forth the condition precedents before any money can be released or withdrawn to the issuers or investors respectively.

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64 "List of Registered Recognized Market Operators", Securities Commission, accessed June 5, 2021, https://www.sc.com.my/bm/pembangunan/digital/list-of-registered-recognized-market-operators.

65 Guidelines, paras 14.05 and 14.06.

Although it is merely an alternative financing mechanism besides other mainstream traditional loans, it is highly regulated. The movement of funds from one party to another party is all subject to certain conditions as stated in the Guidelines. All directions stated in the Guidelines must be observed as required by section 36 of the CMSA 2007.[66] The strict governance and directions imposed by the SC on the P2P operators are for the sake of ensuring the P2P lending vehicles shall be carried on smoothly and systematically without compromising the reliability and soundness of the country's financial system.

Apart from being part of the fintech industry, another reason for P2P lending to be subject to strict regulation is due to the fact that it is easily exposed to the risk of money laundering.[67] These are several factors that are associated with money laundering:

Firstly, the identity of the customers may be deceptive.[68] Through the online platform, a money launderer may apply for financing online for illegal purposes.[69] They may also use other's corporate or business profiles as their proxies to convince investors to grant them the financing.[70] Secondly, there is a possibility for money launderers to use the online platform to transfer their illegal funds to a third party in need i.e. other legitimate companies which are seeking

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66 Section 36 of the CMSA2007 stipulates that a RMO shall comply with any direction issued by the SC.

67 Kathryn Gaw, "P2P is 'number two target' for money launderers", Peer2Peer Finance News, February 12, 2021, https://www.p2pfinancenews.co.uk/2021/02/12/p2p-is-number-two-target-for-money-launderers/.

68 Ryan Randy Suryono, Betty Purwandaria and Indra Budia, "Peer to Peer (P2P) Lending Problems and Potential Solutions: ASystematic Literature Review", *Procedia Computer Science* 161 (2019) 204–214, www.sciencedirect.com.

69 "Peer-to-peer lending", IFEC, accesed October 4, 2021, https://www.ifec.org.hk/web/en/financial-products/fintech/peer-to-peer-lending.page.

70 Rainer Lenz, "Peer-to-Peer Lending: Opportunities and Risks", *European Journal of Risk Regulation*, December 2016 7(4):688-700, DOI:10.1017/S1867299X00010126.

financing through the online platform.[71] Thirdly, P2P lending often involves the movement of funds across jurisdictions.[72] In this context, there is a possibility that money launderers are capable of manipulating different standards of regulation, such as a requirement for verification of identity or reporting thresholds of any suspicious activity.[73] In view of the difference in governing laws enforced in different jurisdictions, it is very challenging to track illegal funds that move from one country to another.[74] Thus, it is complicated on the part of the authorities to conduct an investigation to trace money laundering activities.[75] Fourthly, the P2P lending mechanism is very structured in its operation.[76] It means, it is expected that the funds move through several stages or transactions across multiple platforms.[77] The process is expedient; thus, may entice criminals to engross in such systematic transactions more effortlessly and develop

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71 "P2P Money Laundering: How to Comply with AML Regulations", Comply Advantage, accessed October 4, 2021, https://complyadvantage.com/insights/aml-p2p-lending-crowdfunding/.

72 Rainer Lenz, "Peer-to-Peer Lending: Opportunities and Risks", *European Journal of Risk Regulation*, December 2016 7(4):688-700, DOI:10.1017/S1867299X00010126.

73 "P2P Money Laundering: How to Comply with AML Regulations", Comply Advantage, accessed October 4, 2021, https://complyadvantage.com/insights/aml-p2p-lending-crowdfunding/.

74 Naoko Nemoto, David Storey and Bihong Huang, "Optimal Regulation Of P2P Lending For Small and Medium-Sized Enterprises" ADBI Working Paper Series, No.912, September 2019, 11, Asian Development Bank Institute, https://www.adb.org/sites/default/files/publication/524101/adbi-wp998.pdf).

75 OECD, "Money Laundering and Terrorist Financing Awareness Handbook for Tax Examiners and Tax Auditors", OECD,Paris, 2019, 23, https://www.oecd.org/tax/crime/money-laundering-and-terrorist-financing-awareness-handbook-for-tax-examiners-and-taxauditors.pdf.

76 Jamie Johnson, "What Is Peer-to-Peer (P2P) Lending?", *Business News Daily*, December 02, 2021, https://www.businessnewsdaily.com/16480-peer-to-peer-lending.html.

77 "How To Launch A Peer-To-Peer Lending Operation – 6 Critical Components", TurnKey Lender, accessed October 4, 2021, https://www.turnkey-lender.com/blog/how-to-launch-a-peer-to-peer-lending-operation-6-critical-components/.

a genuine legal presence over the actual illicit funds which are illegal.[78]

Subsequent to the above factors, the P2P operators are required by the SC to carry through an anti-money laundering compliance regime.[79] This is despite the fact that all monies raised and collected must be held in trust accounts. This ensures that the P2P operators complement Malaysia's devotion to combat money laundering by complying with two separate guidelines, namely: Guidelines on Prevention of Money Laundering and Terrorism Financing for Reporting Institutions in The Capital Market[80] and Guidelines on Implementation of Targeted Financial Sanctions Relating to Proliferation Financing for Capital Market Intermediaries.[81] From these two guidelines, the SC has set forth several measures to combat such crimes, for example, by imposing a risk-based reporting approach of deterrence procedure and requiring the P2P operators to integrate greater due diligence performance where individuals are described to be of higher risk.[82]

From the above discussion, it can be summarised that P2P operators are subject to numerous legal duties in ensuring the legal and systematic operation of P2P lending in Malaysia.

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78 JianyingXiong, "An Early Risk Warning Model for ElectronicFinancial Crime Based on Big Data", *Advances in Social Science, Education and Humanities Research (ASSEHR)*, (2017), 95: 291-294,https://www.atlantis-press.com › article.

79 Guidelines, para 6.01(i).

80 "Guidelines on Prevention of Money Laundering and Terrorism Financing for Reporting Institutions in The Capital Market", issued by SC, accessed October 5, 2021,https://www.sc.com.my/api/documentms/download.ashx?id=b682d829-38bc-4827-b48d-022726d75a17.

81 "Guidelines on Implementation of Targeted Financial Sanctions Relating to Proliferation Financing for Capital Market Intermediaries", issued by SC, accessed October 5, 2021,https://www.sc.com.my/api/documentms/download.ashx?id=00470125-f15c-4b3e-8edb-f17c38560c51.

82 Examples of measures to counter money laundering crimes can be seen in Parts II & III of the Guidelines on Implementation of Targeted Financial Sanctions Relating to Proliferation Financing for Capital Market Intermediaries.

As for the issuers, these are the persons who are applying for financing and they are hosted on a P2P platform. Private companies are among the eligible categories of person who can be hosted on the P2P platform.[83] The Guidelines stipulate the requirements and restrictions imposed on the issuers, for example, the prohibition of an issuer to be hosted on various platforms for the purpose of the same fundraising,[84] as well as requirements for disclosure of information to P2P operators.[85]

Once a campaign is launched to raise funds on a hosting P2P platform, the issuer will only be allowed to keep the amount raised thereon if it has reached at least 80 percent of the targeted total sum.[86] The Guidelines do not permit the issuer to retain any amount on top of the originally targeted fund.[87]

Part of the pre-requisite to loan application is the evaluation of the lenders' credit score. A credit score refers to "a number that is based on information in a credit report (a record of someone's debt and payment of a debt), which financial organizations consider in making decisions about lending money".[88] It reflects the overall credit standing and debt payment observation of a borrower, which are referred by creditors to determine if such borrower is financially credible to be granted with a new loan.[89] Credit score or credit rate helps the banks to recognize the risks and repercussions they might suffer if they agree to approve the borrowing to their customers. The higher is the score, the better it is and the higher the chance of getting the loan applications approved.[90] The credit score can be obtained

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83 Guidelines, para 14.19(a)(i).
84 Guidelines, para 14.21.
85 Guidelines, paras 14.29 to 14.31.
86 Guidelines, para 14.27.
87 Guidelines, para 14.28.
88 Cambridge Dictionary, accessed October 5, 2021, https://dictionary.cambridge.org/dictionary/english/.
89 "How To Improve Your Credit Score" CIMB, accessed 12 January 2022, https://www.cimb.com.my/en/personal/life-goals/planning-for-my-future/how-to-improve-your-credit-score.html.
90 "Ultimate Guide To Credit Scores", CompareHero.my, accessed October 5, 2021, https://www.comparehero.my/banking-finance/articles/guide-credit-

through certain assessments over the persons' credit history, account track records, etc. Essentially, it is an indicator of the creditworthiness of the potential lenders. Nevertheless, businesses or companies which are still new in the market and do not have valuable assets or strong records on credit history or previous loan performance, may not be able to score high in their credit ratings or credit scoring.[91] Thus, they will unlikely get their loan application approved by the banks. Unlike traditional bank loans, P2P lending offers businesses an opportunity to have access to funding assistance for those who have poor credit scores or ratings, and funding may also be possible even without collateral.[92] Hence, these businesses may opt to propose to be hosted on a P2P platform in order to seek funding. The issuers nevertheless are subject to a certain duty of disclosure and submission of certain information required by the P2P operators who are responsible for conducting credit risk assessments of the proposed issuers. Such credit rating or credit scoring based on conducted assessments of the respective issuers must be disclosed and made available for the investors on the P2P platform.[93]

With regard to investors, P2P lending allows different classes of persons who are interested to become investors on the P2P platforms, such as retail investors, angel investors, and sophisticated investors. Retail investors are persons other than angel and sophisticated investors. For these categories of investors, the SC does not encourage them to venture into any investment offered digitally on a P2P platform that exceeds the maximum value of RM50,000 on any one occasion.[94] The purpose of this caution is to safeguard the

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score#Credit_History_Credit_Report_Credit_Score_What_does_it_all_mean.

91 "The Role of Alternative Finance to Fund the Needs of a New Economy", BNM, accessed October 5, 2021, https://www.bnm.gov.my/documents/20124/1073866/Role+of+Alternative+Finance.pdf.

92 Oliver Christopher Gomez, "Investing: P2P Investors Increasingly Spoilt for Choice", *The Edge Malaysia Weekly*, December 12, 2020, https://www.theedgemarkets.com/article/investing-p2p-investors-increasingly-spoilt-choice.

93 Guidelines, paras 14.24 to 14.26.

94 "Frequently Asked Questions on The Peer-To-Peer Financing (P2P) Framework", Securities Commission Malaysia, accessed October 5,

interest of these investors from any uncalculated risks of losing their investment in the end.[95] Further, such caution reminds these investors to be more vigilant and prudent in venturing into any form of investment but not to agitate them from participating as investors in the digital fundraising platforms.[96] Angel investors are those investors who fall within the definition of paragraph 14.01 of the Guidelines. They are accredited by the Malaysian Business Angels Network (MBAN),[97] an official trade association that is empowered to oversee the angel investors in Malaysia.The MBAN is a body commended by the Ministry of Finance Malaysia (MOF) to endorse several programmes for angel investors under the purview of the MOF.[98] The other category of investors is sophisticated investors who are described and listed in Part 1, Schedules 6 and 7 of the CMSA 2007. For both types of investors, namely angle and sophisticated investors, the law does not prescribe any restriction with regard to the investment amount they wish to venture on the P2P platforms.

2021, https://www.sc.com.my/regulation/regulatory-faqs/frequently-asked-questions-on-the-peer-to-peer-financing-p2p-framework.

95 Eleanor Kirby and Shane Worner, "Crowd-funding: An InfantIndustry Growing Fast", Staff Working Paper of the IOSCO Research Department[SWP3/2014] (2014),50-51,OICV-IOSCOInternational Organisation of Securities Commissions, https://www.iosco.org/research/pdf/swp/Crowd-funding-An-Infant-Industry-Growing-Fast.pdf.

96 "Frequently Asked Questions on The Peer-To-Peer Financing (P2P) Framework", Securities Commission Malaysia, accessed October 5, 2021, https://www.sc.com.my/regulation/regulatory-faqs/frequently-asked-questions-on-the-peer-to-peer-financing-p2p-framework.

97 "Peer-to-Peer (P2P) Financing", Capital Markets Malaysia, accessed October 5, 2021, https://www.capitalmarketsmalaysia.comdigital-peer-to-peer-p2p-financing/.

98 "Angel Accreditation", Malaysian Business Angels Network, accessed October 5, 2021, https://www.mban.com.my/membership/angel-investor-membership.

P2P lending operation

The general overview of the operation of the P2P lending platform can be summarised as follows:[99]

i. Signing up on the P2P lending platform: The private companies seeking funding must provide all relevant business information,[100] such as the nature and type of the company's operations and business, corporate details such as contact information, equity or paid-up capital, board of directors, and its shareholders, and so on. Other information that may be required to be included is an enclosure of a copy of the directors' NRIC or passport and other official documents relating to the company and its business if any. This information is relatively important to be referred to by the public who may be interested to participate as lenders in favour of the private company. The aim of disclosure of relevant information helps the potential lenders to make a fair and informed judgment as to whether it is viable enough for them to choose the private company as their investment portfolio as well as to develop emotional attachment between the potential investor and the corporate reputation of the company.[101]

ii. Determining the project that meets the needs of the company's business: A private company that wishes to be hosted as an issuer on a P2P platform can only be permitted to launch one project for funding campaign and is restricted from launching a similar campaign on other separate numbers of P2P platforms at the same time.[102] It is therefore very pertinent for the private company to properly strategise and

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99 "The guide to P2P lending for SMEs in Malaysia", Foundingbird, accessed modified June 5,2021, https://foundingbird.com/my/blog/guide-to-p2p-lending-in-malaysia-for-smes.

100 The Guidelines, paras 14.22, 14.29 –14.31.

101 Usman AhmadQadri, Mazuri Abd Ghani & Sheikh Muhammad Azhar, "Role of corporate identity, image and reputation in investors' behavioral decision making: Does emotional attachment matter?", *Pakistan Journal of Commerce and Social Science* 120 (2020) 14(1): 120-142.

102 Guidelines, para 14.21.

launch the project according to its plan in order to ensure such project will be able to achieve the required or targeted amount of fund, tenure for repayment, etc.[103]

iii. Authentication and permission by P2P operator to host an issuer on its P2P lending platform: Prior to approval to be hosted, the SC requires every P2P operator to perform a proper investigation and various screening of the requesting company in terms of its business and corporate profiles, company's directors' identity, financial creditworthiness, business prospects, credit performance, and history.[104] This process signifies the obligation imposed on the P2P operator to ensure only a genuine and potential issuer will be allowed to be hosted on its P2P platform.[105] This verification process could take somewhere around a few days to a few weeks to be completed.

iv. Accepting the offer to be hosted: There will be clear and specific terms and conditions as well as the applicable interest rate outlined and imposed on the company's requested funding. Once the company has accepted the offer, the funding request will be launched on the P2P lending platform, so that the investors will have the opportunity to scrutinise and make a well and informed judgment as to whether or not to participate in and fund the company's business.

v. Receiving the money from the raised fund: The amount of money that has been successfully raised will be credited to the private company's bank account once it has reached at least 80 percent of the target amount. The company can only receive the amount of fund as originally targeted, even if the

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103 Tan Zhai Yun, "Cover Story:New P2P platform offers different approach", *The Edge Malaysia*, June 17, 2020, https://www.theedgemarkets.com/article/cover-storynew-p2p-platform-offers-different-approach.

104 Guidelines, para 14.06.

105 Nikola Skibicka,"Identity verification in peer-to-peer lending industry", Fully-Verified, accessed October 5, 2021, https://fully-verified.com/identity-verification-in-peer-to-peer-lending-industry/.

fund is overachieved. Hence, the excess amount will be returned to the investors. The stamping and origination fees are borne by the borrowing company.

Upon successful funding, the investors' position remains unchanged towards the company. They neither hold interests in any part of the company's shares pending repayment of the extended loan. This arrangement ensures the compliance of restrictions of inviting the public to hold shares, interests, debentures, or deposits with the private companies as expressly prohibited in section 43 of the CA 2016. Further, the investors are regarded as unsecured creditors[106] of the company, thus, avoiding any element of public offering as stipulated in section 44 of the CA 2016.

Private Companies benefit from P2P lending

Through P2P lending, some several advantages or benefits may be enjoyed by private companies.

Firstly, P2P lending is a technology-based financing product that is operated on a digital platform involving online networking of various parties, namely companies or businesses as issuers, P2P operators, and also investors. The process of pairing the investors and the borrower is all done online.[107] If they are combined into an automated process, the processing time for investors to get the money will be far less than a few hours. P2P lending offers an easy application process as the fund raising process can be completed instantly, provided the companies can present strong prospective returns to the investors. A borrower can obtain the fund in a much shorter time compared to traditional bank loans whose approval process often takes weeks or months.

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[106] Andrew Verstein, "The Misregulation of Person-to Person Lending", *University of California, Davis,* vol. 45 (2011): 445 – 530,https://core.ac.uk/download/pdf/72832957.pdf.

[107] "Frequently Asked Questions On The Peer-To-Peer Financing (P2p) Framework", Securities Commission Malaysia, accessed October 4, 2021, https://www.sc.com.my/regulation/regulatory-faqs/frequently-asked-questions-on-the-peer-to-peer-financing-p2p-framework.

Secondly, the mechanism does not impact the credit score of private companies as it merely involves a decision of public investors in P2P lending networks.[108] This will give the private sector a good insight into the viability and the rate of the loan that will be offered.

Thirdly, P2P lending is perceived to be a more open-source of funding. Compared to traditional loans from banking and financial institutions, P2P lending is preferred as it is regarded as more open-source financing for many borrowers,[109] especially private companies. The explanation why it is considered to be more available than others is because even in the case of poor credit scores, P2P provides loans to borrowers.[110] In other words, companies with poor track records or credit ratings may not succeed in a bank loan application, thus, may have to resort to P2P lending platforms as a recourse.[111]

Fourthly, P2P lending offers low and fixed interest rates as opposed to credit cards and banks, and the creditor will not be required to pay any penalty except in the case of late payments.[112] The P2P network, therefore, acts as a lucrative opportunity for borrowers.

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108 "Peer to Peer Loans for Bad Credit", Possible Finance, accessed October 4, 2021, https://www.possiblefinance.com/blog/peer-to-peer-loans-for-bad-credit/.

109 Ed Saiedi, Ali Mohammadi, Anders BroströmandKourosh Shaf, "Distrust in Banks and Fintech Participation: The Case of Peer-to-Peer Lending", *SAGE Journal of Entrepreneurship Theory and Practice*00(0) 1–28, https://doi.org/10.1177/1042258720958020.

110 "5 Best Peer-to-Peer Loans for Bad Credit Borrowers", Credit Summit, accessed October 4, 2021, https://www.mycreditsummit.com/peer-to-peer-lending-bad-credit/.

111 "Financing your business – P2P lenders or bank loans?", DBS SME Banking, accessed June 5,2021, https://www.dbs.com.sg/sme/businessclass/articles/finance-and-operations/p2p-lending-or-bankloan?pk_source=google&pk_medium=organic&pk_campaign=seo

112 "5 Reasons to Invest in Peer-to-Peer Loans", The European Business Review, accessed October 4, 2021, https://www.europeanbusinessreview.com/5-reasons-to-invest-in-peer-to-peer-loans/.

In addition, there is no pre-payment penalty imposed in P2P lending in the event the borrowing companies wish to settle the loan pre-maturely, unlike traditional banks. On the contrary, the borrowers under P2P lending are impelled to fully settle the repayment the soonest as possible.[113]

Further, in terms of financing amount, banks adopt resolute business models which they are reluctant to change unless upon government intervention or direction of the central bank.[114] Thus, it is problematic when a small business plans to obtain a loan below the minimum limit of the loan amount. Unlike banks, P2P lending is very much flexible which means, as there is no minimum amount targeted to be raised, thus, lesser funding needs can be realised and the target amount can be approved much faster.[115]

Besides all the above advantages, the P2P lending model does not require the creation of collateral by the borrower in order to secure the loan itself.[116] Hence, this is considered as a pulling factor that attracts private companies to explore P2P lending as a source of funding.[117]

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113 Peter Daisyme, "Using Peer-to-Peer Lending As A Method For Startup Growth", *Forbes*, Jul 26, 2017, https://www.forbes.com/sites/theyec/2017/07/26/using-peer-to-peer-lending-as-a-method-for-startup-growth/?sh=16eee01250f3.

114 "Why SMEs should choose P2P instead of traditoonal banking", Lendo, accessed October 4, 2021, https://lendoapp.com/2021/02/28/why-smes-should-choose-p2p-instead-of-traditional-banking/?lang=en.

115 Fariz Abdul Aziz, "Malaysia's Match Making Industry is Open for Business", *Insight Newsletter*, Skrine, June 30, 2016, https://www.skrine.com/insights/newsletter/june-2016/malaysia-s-match-making-industry-is-open-for-busin.

116 "Peer-to-Peer Lending", Debt.org, accessed October 4, 2021, https://www.debt.org/credit/solutions/peer-lending/.

117 Jia Jin, Qian Shang, Qing-Guo Ma, "The role of appearance attractiveness and loan amount in peer-to-peer lending: Evidence from event-related potentials", *Neuroscience Letters* 692, (23 January 2019): 10-15, https://doi.org/10.1016/j.neulet.2018.10.052.

Public benefits from P2P lending venture in private companies

The process of making an investment via a P2P platform may vary among the P2P operators subject to their internal policies. Overall, an investor will only make a call to fund the issuers together with the amount they agree to fund after they have duly identified and evaluated information disclosed by borrowers or issuers about their companies' businesses, the objective of fundraising, corporate and financial data; financial appraisal; repayment plan, and risk assessment published on the P2P platform.[118]

As of December 2019, there have been RM632.38 million funds raised with 1866 successful issuers and 8102 successful campaigns, with 95 percent of the investment coming from the retail sector as well as investors demographic is largely aged below 35.[119] This fact shows that P2P lending has managed to attract the public to participate as lenders because of the benefits that they can enjoy from such ventures. The high returns that potentially can be collected in return through venture in P2P lending can stretch from 10 percent to 18 percent which is considered to be high by comparison with other schemes such as unit trusts, Employment Provident Fund, fixed deposits, and other Malaysian stock markets.[120]

Indeed, the recent and still ongoing COVID-19 pandemic is an unexpected and unforeseen calamity that has thrown the economy into uncertainty and mayhem. Further, it has eventually put businesses and enterprises at a standstill. It has struck up to a significant 98.5 percent of businesses in this country embracing the small-medium enterprises (SMEs) and micro SMEs of this country.[121]

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118 "Frequently Asked Questions on The Peer-To-Peer Financing (P2P) Framework", Securities Commission, accessed May 5, 2021, https://www.sc.com.my/regulation/regulatory-faqs/frequently-asked-questions-on-the-peer-to-peer-financing-p2p-framework.

119 "Peer-to-Peer (P2P) Financing", Capital Market Malaysia, accessed June 5,2021, https://www.capitalmarketsmalaysia.com/digital-peer-to-peer-p2p-financing/.

120 "What You Need to Know About P2P Lending In Malaysia", iMoney Learning Centre, accessed June 5, 2021, https://www.imoney.my/articles/p2p-lending-guide.

121 SME Corporation Malaysia, SME Annual Report 2018/2019, accessed October 5, 2021,

Many businesses especially SMEs including private companies suffered the repercussion of facing delay and rejection by banks in procuring loans and credits.[122] It has been reported that banks prefer to deal with their existing customers,[123] hence several SMEs which are relatively new in terms of their establishment and are in the midst of adhering to various regulatory requirements[124] may encounter issues in procuring the Special Relief Facility for SMEs.[125] Bank procedures are known as 'know your customer guidelines employ a traditional scoring method in which the banks would be able to approve their existing customers' applications more quickly as they are already familiar with their profiles, compared to applications made by new customers.[126] The new customers then had to go through a long wait in order to get their applications approved or rejected.[127] Despite the pandemic which reflects the adverse impact

https://www.smecorp.gov.my/images/SMEAR/SMEAR2018_2019/final/english/SME%20AR%20%20English%20-%20All%20Chapter%20Final%2024Jan2020.pdf.

122 Tobias Berg, "Got rejected? Real effects of not getting a loan", ECB Working Paper Series No 1960 / September 2016, European Central Bank EUROSYSTEM, https://www.ecb.europa.eu/pub/pdf/scpwps/ecbwp1960.en.pdf.

123 Jim Woodruff, "Things for a Bank to Consider Before Lending Money to a Business", CHRON Newsletter, January 28, 2019, https://smallbusiness.chron.com/things-bank-consider-before-lending-money-business-57341.html.

124 Examples of regulatory requirements are business registration with Companies Commission of Malaysia and opening of business tax file withthe Inland Revenue Board.

125 Voon Zhen Yi, "Struggle of Malaysian SMEs During the COVID-19 Pandemic", Policy Brief, May 2020, KSI Strategic Institute for Asia Pacific, accessed October 5, 2021, https://kasi.asia/wp-content/uploads/2020/05/KSI-Policy-Brief-Struggle-of-Malaysian-SMEs-During-the-COVID-19-Pandemic.pdf.

126 Dan Ryan, "FinCEN: Know Your Customer Requirements" Harvard Law School Forum on Corpoprate Governance, February 7, 2016, https://corpgov.law.harvard.edu/2016/02/07/fincen-know-your-customer-requirements/.

127 Voon Zhen Yi, "Struggle of Malaysian SMEs During the COVID-19 Pandemic", Policy Brief, May 2020, KSI Strategic Institute for Asia Pacific, accessed October 5, 2021, https://kasi.asia/wp-

on financing available to business and corporate sectors by banks, it has also been reported that the "digital momentum" of fintech such as P2P lending has snowballed tremendously over the past year despite such pandemic.[128] Although the pandemic had proven challenging, the fintech market continues to be in demand as a platform for businesses to obtain fund resources and has since been regarded as an alternative source of getting funds.[129] The situation has turned to favour the growth of P2P lending since attempts to procure financing from banks may result differently compared to this platform.

Challenges in P2P lending for participants and private companies

In the last several years, P2P lending has grown rapidly as many private companies and enterprises switch towards these platforms to look for investments to fundraise their working capital for their business to kick start. Despite this fact, during the COVID-19 pandemic, financial means become constrained, and companies have to endure the deterioration of their incomes and returns. As a result, these companies and businesses have to struggle to meet their loan obligations to lenders on these platforms.[130] Such a situation leads to default and delays in repayment of the loan which is something that would upset the lenders.[131] This is the main downside of P2P lending.

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content/uploads/2020/05/KSI-Policy-Brief-Struggle-of-Malaysian-SMEs-During-the-COVID-19-Pandemic.pdf.

128 Funding Societies Malaysia, "Pembiayaan P2P sebagaiterasutamapembiayaan digital dan FinTech teruskan momentum pada 2021", CISION PR Newswire, January 12, 2021, https://en.prnasia.com/releases/apac/54382-0.shtml.

129 Tan Jee Yee, "Fintech momentum has only grown during Covid-19, and is set to accelerate", Digital News Asia, May 5, 2021, https://www.digitalnewsasia.com/business/fintech-momentum-has-only-grown-during-covid-19-and-set-accelerate.

130 Joy Lee, "Delays and defaults likely for P2P", *TheStar*, April 4 2020, https://www.thestar.com.my/business/business-news/2020/04/04/delays-and-defaults-likely-for-p2p.

131 Esther Lee, "P2P lending platforms see more restructuring, defaults ahead", *The Edge Weekly*, April 15, 2020, https://www.theedgemarkets.com/article/p2p-lending-platforms-see-more-restructuring-defaults-ahead.

Apart from the lack of performance given the current world recession and pandemic, it is common for companies (as borrowers) to release publicly certain information and make them available on the P2P lending platforms.[132] This information includes its business plan, financial history, and other relevant information that serves to accommodate the public lenders in deriving their decision as to whether or not they wish to participate as funders of the companies.[133] Looking at a different angle, such detailed disclosures also mean the private companies are losing some anonymity of their business, in the course of attracting many lenders.[134]

Besides, private companies that stand in the borrowers' shoes may still be subject to payment of an administrative fee for applying for such loans through P2P loan platforms.[135] This is similar to the situation when a person applies for a loan with a bank, building society, or some other lender. P2P platforms make money by arranging the borrower’s loan by suiting the lenders and borrowers, and, an arrangement fee is charged on each loan they manage to suit and match.[136]

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132 Lan Thi Phuong Nguyen, Wisdom Kalabeki, Saravanan Muthaiyah, Cheng Ming Yu, Kwan Jing Hui and Hazik Mohamed,“P2P lending platforms in Malaysia: What do we know?”,*F1000Research*(2021) 10:1088, accessed October 5, 2021, https://doi.org/10.12688/f1000research.73410.1.

133 Michael Klafft, “Online Peer-to-Peer Lending: A Lenders’ Perspective”,*SSRN Electronic Journal*, (January 2008), accessed October 5, 2021, DOI:10.2139/ssrn.1352352.

134 Andrew Verstein, “The Misregulation of Person-to Person Lending”, *University of California, Davis*, vol. 45 (2011): 445 – 530, https://core.ac.uk/download/pdf/72832957.pdf.

135 “Peer-to-peer finance”, ACCA, accessed 5 October 2021, https://www.accaglobal.com/uk/en/business-finance/types-finance/peer-to-peer-finance.html.

136 Kevin Davis and Jacob Murphy "Peer to Peer Lending: Structures, Risks and Regulation" *JASSA: The Finsia Journal of Applied Finance*, (2016) 3, 37-44, Available at SSRN: https://ssrn.com/abstract=2862252.

The amount that the borrower would need to pay will depend on the actual amount they are applying, the term or duration of the loan, and also the creditworthiness of the borrower.[137]

Further, concerning the risk of default as mentioned above, such risk will become greater when the loans are generally unsecured or made on a clean basis in favour of the private company borrower.[138] Therefore, in the event of default, there is no collateral for the investor to go after in order to mitigate their risks. It is conceivable that the public lenders could lose 100 percent of their investment on an early-term default.[139]

In addition to the above, unlike banking investments, P2P investments are not protected by way of insurance coverage by the Malaysia Deposit Insurance Corporation or also known as Perbadanan Insurans Deposit Malaysia (PIDM).[140] That means the lenders will not be reimbursed in the event of the borrower's default. They will also not be reimbursed if the P2P platform fails, although they typically have backdoor arrangements with other institutions to take over the loan portfolios should that happen.

As for private companies, it is important to note that approval of an application by P2P operators to be hosted on a P2P lending platform merely means that the companies now become issuers, which does not warrant the success of the funding.[141] The law requires that within the funding period, at least 80 percent of the

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137 Pallavi ArunVerma, "How are interest rates set on P2P platforms?",*The Economic Times*, January 30, 2019, https://economictimes.indiatimes.com/wealth/p2p/how-are-interest-rates-set-on-p2p-platforms/articleshow/67754829.cms?from=mdrt.

138 Guangyou Zhou, YijiaZhangandSumei Luo,"P2P Network Lending, Loss Given Default andCredit Risks", *Sustainability*(2018) 10, 1010, 1-15, DOI:10.3390/su10041010.

139 Dori Zinnand Mike Cetera, "Your One Stop Guide To Peer-To-Peer Lending",*Forbes Advisor*, October 20, 2020, https://www.forbes.com/advisor/personal-loans/peer-to-peer-lending/.

140 See section 41 of the Malaysia Deposit Insurance Corporation Act 2005.

141 Galit Klein, ZeevShtudinerand Moti Zwilling,"Why do peer-to-peer (P2P) lending platforms fail? The gap between P2P lenders' preferences and the platforms' intentions". *Electron Commerce Research* (2021), accessed June 5, 2021, https://doi.org/10.1007/s10660-021-09489-6

target amount needs to be met.[142] Otherwise, it is considered a failure, and a fresh P2P lending arrangement needs to be done all over again.[143]

CONCLUSION

P2P lending is a digital lending market place that emerges and rises along the prevailing financial services model of banking and financial institution in Malaysia. In line with the government's aspiration towards expanding the digital economy and social entrepreneurship, it forms part of the digital agenda of the SC that will boost access to finance, increase investor engagement, increase the institutional market and build a synergistic financial technological ecosystem. Legally, it is recognised as alternative social lending for private companies being entities that are prohibited from accepting deposits and investments from public investors.

Virtually, the P2P lending platform becomes the medium for the P2P operators, social lenders, and the private companies as well as other business enterprises in need of money, to play their parts to realise fundraising exercise. The social lenders who are public, are strangers to the private company borrowers, yet they are the market players who appraise the project or campaign launched by the private companies or other businesses. They are also being the ones who contribute to the funding of the private companies, especially for those who wish to start up the business. Accordingly, the whole mechanism and operation of P2P lending are subject to austere legal supervision. It is strictly governed and controlled by the government's policy through the enforcement of legislation and issuance of relevant regulations which are placed under the purview of the regulatory authority such as the SC. This is also in view of the fact that P2P lending has its own market in Malaysia and is regarded to be an attractive alternative to existing traditional or conventional financial services in this region. In other words, the development of

[142] Guidelines, para 14.27.

[143] "The guide to P2P lending for SMEs in Malaysia", Foundingbird, accessed June 5,2021, https://foundingbird.com/my/blog/guide-to-p2p-lending-in-malaysia-for-smes.

P2P lending as part of the social lending industry has pushed the regulators to come out with various legal provisions to regulate the operation and manage risks arising from this online financing platform which attracts multiple public lenders to participate in it.

Indeed, P2P lending offers the prospect for investors to earn viable annual returns by venturing into the business in the form of unsecured personal loans to other companies and business enterprises through networks that are recognised by the SC, which can be easily verified from the SC's website from time to time. Depending on the nature of investments made, there is the opportunity for the investors to earn high returns through P2P lending platforms although they might also be exposed to significant risks at the same time. Examples of risks are that the investments are not liquid, and also that the current pandemic or global economic depression could possibly cause extensive unserviced loans leading to reduced returns or in the worst case, loss, while the investors are hardly protected nor insured.

Nevertheless, P2P possesses great potential in providing alternative financing for borrowers lending, thus it remains to be among the popular form of crowdfunding, especially for private companies in small-medium enterprises and businesses. P2P lending has its unique advantages and disadvantages. It is a fast and easy way to obtain capital, but it is not always sufficient for medium and large-sized businesses. If a private company requires a substantial amount of capital to start the business, the company may want to consider a different form of financing.

At the same time, it is indeed very crucial for regulators and other relevant agencies to partake in educating small businesses including private companies as well as investors on P2P lending. Relevant information, for example, the legality of P2P lending, the regulatory control, and enforcement, rights, and obligations of the parties, as well as the nature and risks of P2P lending may help to address the common misconception that P2P lending is akin to borrowing from loan sharks or some kind of Ponzi scheme. Nonetheless, much more efforts need to be mobilized in order to raise awareness and educate SMEs and private companies and investors on the existence and the benefits of this kind of financing, should the government wish to see such industry to further magnify towards expanding the country's digital economy.

Being the latest alternative form of funding in Malaysia, the level of education and awareness of equity crowdfunding and P2P financing has grown notably over the past several years. But there is still room for improvement. Most start-ups, micro-enterprises, and SMEs are still not aware that they can raise funds through equity crowdfunding and P2P lending without hassle.