



Report on the international experience in the field of legal and regulatory provisions concerning crowdfunding activities

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List of abbreviations

AIFMD – Alternative Investment Funds Managers Directive

CIIFPSD – Credit Institutions and Investment Firms Prudential Supervision Directive

EU – European Union

JSC – Joint Stock Companies

LLC – Limited Liability Companies

MiFID – Markets in Financial Instruments Directive

SMEs – Small and medium-size enterprises

PD – Prospectus Directive

UK – United Kingdom

US – United States

Executive summary

The present report shall consider the four main types of crowdfunding activities based on the return they offer to the participants. This classification is considered the best one also because of the already existent large consensus in international literature of division of crowdfunding activities.

Thus, the following types of crowdfunding activities shall be assessed:

1. Donation-based crowdfunding
2. Reward-based crowdfunding
3. Lending-based crowdfunding
4. Equity-based crowdfunding

The main difference in terms of crowdfunding activities as per classification offered above is the level of return the participants at crowdfunding activities receive.

When reviewing the best EU Member States practices in regulating donation-based and reward-based crowdfunding activities we shall focus on the various participants and their role in the money flow from the crowd to the beneficiary.

To have a structured approach of the analysis, the following stages of the crowdfunding activities will be assessed for donation-based and reward based crowdfunding:

- a. The operation of the crowdfunding platform operator
- b. The launch of the crowdfunding project
- c. The transfer of the funds from the crowd to the beneficiary

Due to the complex nature of the lending-based and equity-based crowdfunding and to ensure a structured presentation of the data for the two forms the following aspects will be assessed in detail:

For lending-based crowdfunding:

- a) business models for lending-based crowdfunding,
- b) authorisation requirements,
- c) handling of funds,
- d) minimum capital requirements,
- e) types of offered loans and their maximum ceiling,
- f) business continuity,
- g) customer due diligence and anti-money laundering regulations,
- h) verification of suitability and appropriateness,
- i) disclosure of the borrowers' details,
- j) consumer protection,
- k) professional requirements on the platform operators

For equity-based crowdfunding:

- a) availability of specific national legislation on equity-based crowdfunding
- b) authorisation requirements,
- c) provided services,
- d) available financial instruments,
- e) minimum capital requirements,
- f) sizes of offers, including prospectus ceilings,
- g) maximum investible amounts,
- h) customer due diligence and anti-money laundering regulations,
- i) disclosure of the details of investors by the issuers,
- j) professional requirements on the platform operators,
- k) consumer protection

The regulation of four main forms of crowdfunding is different from one jurisdiction to the other. At the same time, there is no single approach of the European Commission with respect to crowdfunding regulation at the EU level.

The donation-based and rewards-based crowdfunding has been left to a large extent regulated to the current level, with application of the national legislation available when the two forms of crowdfunding have emerged on the national markets of the EU Member States, US and Canada.

There are important features of the two forms of crowdfunding which deserve attention:

- a) The crowdfunding platform operators do not require a formal authorisation, provided they do not handle directly funds. If funds are managed by the platform, they qualify as payment service providers under EU legislation. Good examples to avoid licensing is partnering up with an entity which already provides payment services or the use of “escrow accounts”, which exclude any funds handling by the platform operator;
- b) The crowdfunding platform operators must ensure due diligence when accepting projects, to avoid misuse of the platforms for fraudulent activity. Although not part of a strict regulatory framework under national jurisdictions, there are already developed soft-law instruments, such as the recommended code of conduct and standard rules of procedure developed by the European Crowdfunding Network¹;
- c) The projects promoted by the crowdfunding platforms must have a public interest objective;
- d) A degree of scrutiny of donation-based and reward based crowdfunding is necessary, but to the extent it does not overregulate donation-based and involves artificial use of reward-based crowdfunding;
- e) Tax deduction should be available for donors under the donation-based crowdfunding. This may involve additional effort, especially from the tax authorities, but would increase incentives for donation-based crowdfunding;
- f) Crowdfunding projects are subject to personal data protection requirements, as vast amount of personal data is processed in the course of the implementation of projects;

¹ For more details, please consult: <http://eurocrowd.org/about-us/code-of-conduct-2/>

- g) Anti-money laundering and fight against financing of terrorism regulations are applicable for donation-based and reward-based crowdfunding platforms, either directly addressed to the platforms, if they handle funds, or indirectly if a partner entity is managing the payments;
- h) Consumer protection legislation could be applicable for reward-based crowdfunding projects, including extensive rights for consumers who act as beneficiaries of goods and services offered by the recipients of funds.

Due to the risks associated with lending and purchasing equity and the different aims the Member States pursue when regulating these forms of crowdfunding, with an additional limitations of already existent EU legislation for the financial sector, it becomes less likely that the crowdfunding market will see soon a harmonised piece of legislation soon.

However, important good practices can be extracted from some of the evaluated jurisdictions and recommended for absorption, among them being the following:

- a) Platform operators are qualified as financial institutions which provide a limited amount of financial services and operate with a reduced list of equity
- b) Due to associated risks, the platform operators must comply with a set of rules, including on transparency, publication of minimum data on the projects, due diligence on the clients, anti-money laundering review procedures, minimum capital requirements and/or professional indemnity insurance
- c) The maximum ceilings for projects and the maximum amount for non-professional participants on lending and equity markets is indeed necessary to protect the interest of lenders and investors, allow unlimited participation for qualified investors or professional participants
- d) Depending on the primary aim a country looks to attain, crowdfunding may be successfully used to circumvent the cumbersome crediting with already existent entities (banks, credit institutions etc.) and mobilise funds particularly for innovative start-ups and innovative SMEs. As the study has shown, some jurisdictions direct crowdfunding to these forms of equity purchasing, supporting generally SMEs or particularly innovative start-ups and innovative SMEs. The limitation of forms of activity of equity-based crowdfunding to SMEs or to other identifiable transferrable securities must be accompanied by clear bylaws which clarify the criteria to be used to qualify as an innovative start-up or SME.

General considerations on regulation of crowdfunding activities

The present report shall consider the four main types of crowdfunding activities based on the return they offer to the participants. This classification is considered the best one also because of the already existent large consensus in international literature of division of crowdfunding activities.

Thus, the following types of crowdfunding activities shall be assessed:

1. Donation-based crowdfunding
2. Reward-based crowdfunding
3. Lending-based crowdfunding
4. Equity-based crowdfunding

The main difference in terms of crowdfunding activities as per classification offered above is the level of return the participants at crowdfunding activities receive. Thus:

1. For donation-based crowdfunding the main parties of the process are the donor, the crowdfunding platform operator and the beneficiary. Additionally, the financial institutions involved in the management of the transfers, including payment systems are involved in the channelling process.

The donor does not benefit from any return from the beneficiary. Symbolic recognition of the receipt of the funds and feedback on the implementation of the funds collected from all donors may be considered as the only informational return. Based on the different legislative frameworks, the donor may be entitled to some rights, such as return of the funds, if the beneficiary is not using them as prescribed under the crowdfunding project. On the other hand, the beneficiary may be subject to particular obligations to provide proof of adequate and efficient use of funds received from the donor, including reporting on undergone activities.

In the middle, the crowdfunding platform operator may be subject as well to obligations of due diligence when launching crowdfunding projects, including verification of the effective beneficiary. Due to the fact that financial means are mobilized via the crowdfunding platform, the operator may be also subject to criminal liability for fraudulent activity, including premeditated misleading of donors and misuse of obtained donations for the beneficiary. An important element is the level of retention via commissions which the crowdfunding operator may be entitled to charge.

2. For reward-based crowdfunding the main parties are essentially the same, the main difference in the management of these types of crowdfunding activities being the return the contributor receives from the beneficiary which takes other forms than symbolic recognition of receipt of funds or thank you letters.

For regulatory purposes such as the protection of the interests of the parties, a formal differentiation between the two forms does not prove necessary. However, the contractual relations which will arise among the contributor, the beneficiary and the crowdfunding platform operator shall nevertheless make the difference between donation and reward-based crowdfunding contracts.

3. For lending-based crowdfunding the number of variables significantly increase. Thus, the main aspects of the lending-based model are:
 - a. Parties:
 - i. The lender
 - ii. The borrower
 - iii. The platform operator
 - iv. The resources operator
 - v. The financial institutions involved in transfer of funds
 - b. Type of lent object:
 - i. Funds (liquidities)
 - ii. Goods through the use of funds
 - c. Aim of entering into lending-based crowdfunding:
 - i. Financial interest of the lender
 - ii. Lucrative type of activity of the borrower
 - iii. Interest of the platform operator and of the resources operator to earn an interest when acting as an intermediary between the lender and the borrower

Each of the lending-based crowdfunding elements require more elaborate assessment from the perspective of availability of data on the quality of party in such a crowdfunding and the types of activities the parties are entitled to manage, including which prudential, professional liability and facilitating regulations are present.

Thus, when assessing the lending-based crowdfunding practices, the above-mentioned elements shall be assessed in greater detail.

4. For equity-based crowdfunding the number of variables are even higher, as the object of the transactions with crowdfunded sources are channelled into various forms of equity. For the purpose of the present assessment, the stocks of JSC and of LLC, or of their equivalent forms shall be assessed, as well as bonds and other forms of equity generally used by investment funds, credit institutions and alternative investment funds in their daily work. Similarly, to the lending-based crowdfunding, the equity based crowdfunding shall be assessed from the following perspective:
 - a. Parties:
 - i. The purchaser of equity
 - ii. The seller of equity
 - iii. The platform operator
 - iv. The equity operator (investment fund, alternative investment fund managers, credit institutions, banks)
 - v. The financial institutions involved in the transfer of funds (payment services providers, banks)
 - b. Type of equity:
 - i. Stocks in undertakings (transferable securities)
 - ii. Bonds and other derivatives (including non-transferable securities)
 - c. Aim of entering into equity-based crowdfunding:

- i. Financial interest of the purchaser of equity (dividends, private bid with resell, professional broker, other professional acquirers)
- ii. Financial interest of the seller of equity to attract additional financial resources (public bid for stocks, temporary recapitalization of the undertaking, innovative start-ups, SMEs etc.)
- iii. Interest of the platform operator to earn an interest when acting as an intermediary between the purchaser of equity and the seller of equity.

When assessing these elements, not all of the international experience shall be presented, as this may inflate the volume of the report and become an unfriendly tool. Instead, when assessing the above mentioned elements of the crowdfunding regulation in various Member States of the European Union and other relevant international experience, the best models of lesser regulation and higher protection of crowdfunding participants shall be highlighted.

When reviewing the EU best practices in the crowdfunding sector, relevant EU legislation applicable to parts of crowdfunding shall be also assessed, including EU Directives and Regulations which present harmonised legislation for:

- Parties: credit institutions, investment firms, alternative investment funds, banks etc.
- Prospectus requirements when issuing equity
- Consumer protection
- Anti-money laundering and fight against financing of terrorism

At this stage we would like to mention that by the beginning of May 2016, 7 of the 28 EU Member States have already approved specific national legislation which addresses equity based crowdfunding and the other are in the process of approving it. At the same time, the European Commission is taking steps to assess the current stage of development of crowdfunding markets and has successfully approved proposals for legislation to decrease the burden on crowdfunding platforms, especially the ones which operate with equity.

Experience of EU Member States, Switzerland, the US, Canada and Israel in regulating crowdfunding initiatives

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- f) business continuity,
- g) customer due diligence and anti-money laundering regulations,
- h) verification of suitability and appropriateness,
- i) disclosure of the borrowers' details,
- j) consumer protection,
- k) professional requirements on the platform operators

For equity-based crowdfunding:

- a) availability of specific national legislation on equity-based crowdfunding
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- i) disclosure of the details of investors by the issuers,
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- k) consumer protection

Donation-based crowdfunding

Operation of the crowdfunding platforms

Most of the EU Member States, as well as the US and Canada do not have requirements for registration of crowdfunding platform operators if the platform is performing strictly donation-based or reward-based crowdfunding. That is valid if the platform is not performing payment services as provided by the national legislation. If, on the other hand, the operator of the crowdfunding platform is managing funds, it qualifies as a payment services provider and requires an authorisation.

Legal qualification of donations and of crowdfunding platforms

Under **Lithuanian** practice, donations obtained within the crowdfunding platforms are governed by the *Civil Code* and are considered donation contracts. Similar approach is taken by other EU Member States which have codified civil legislation, based on the Franco-German practice, such as Poland, the Netherlands and Hungary. Particularly for Hungary, even if the new Civil Code entered in force in 2014, it did not contain separate specific provisions on crowdfunding, which is another indication that the EU Member States opt for no additional regulation of donation-based crowdfunding and leave it for the current national legislation to cover the various aspects of donation-based crowdfunding initiatives.

Also, under the **Lithuanian** jurisdiction, the *charity and sponsorship legislation* is not applicable to all forms of donation-based crowdfunding, but only to non-profit organisations. Natural persons may not be providers of charity, which means that they can only act as donors, but not as implementers/mobilisers of donations.

Tax deduction for donated amounts

Under certain jurisdictions (ex. **France**), the donor has the option to deduct 2/3 of the donated amount (up to 2% of yearly income) for tax purposes. To be able to benefit from the tax deduction the donation must be made to an implementing entity (usually and public interest NGO), which complies with three conditions:

- a) The donation must be made for a non-profit cause
- b) The manager of funds does not obtain any financial interest and no personal gains
- c) The funds are managed to offer benefits not for just one category of persons

Slovenia allows tax deductions for individuals for donations amount up to 0.5% of their yearly income. The recipient of funds, irrespective if it mobilised funds through crowdfunding or via traditional means, must register with the Ministry of Finance to be able to receive donations, which are then deductible from the income of individuals.

The assessed jurisdictions have thus decided to apply the general tax legislation applicable to donations, including the conditions these donations must comply with to deduct for tax purposes. As we can see the French and the Slovenian models allow deduction of donations which are made for a public cause and those funds must be implemented by a particular entity, which is both registered and is conducting public interest activities.

Applicability of anti-money laundering legislation

In the EU framework there is a rather detailed anti-money laundering legislation, applicable both for the financial institutions as providers of financial services and to the individuals who are beneficiaries of such services. Directive 2005/60/EC and 2006/70/EC set a list of thresholds for financial operations. These two Directives will be repealed by the newly adopted Directive 2015/849 on 26 July 2017. Below are some examples of how the EU anti-money laundering legislation was implemented in the context of crowdfunding:

The **Polish** experience says that the donation-based crowdfunding platforms are not subject to anti-money laundering legislation. The basis of this experience is that since the donation-based crowdfunding platforms are not essentially providers of financial services, they should not be subject to the anti-money laundering regulations. This is true only if the donation-based crowdfunding platform is not managing funds it receives from donors, but entrust that to an authorised entity (payment service provider). All the anti-money laundering requirements such as the customer due diligence and reporting is made by the financial institution themselves.

The **Romanian** experience is linking the anti-money laundering legislation to a minimum threshold of 15,000 EURO and applies the anti-money laundering legislation to all transactions which exceed that limit. The threshold is applicable not only to one-time transactions, but also to multiple transactions which come from the same source. Thus, the requirements of review of the customers are applicable for those smaller consecutive payments which in total may amount to 15,000 EURO.

Collection of personal data

The EU Member States are bound by *Directive 95/46/EC* on the protection of individuals with regard to the processing of personal data and on the free movement of such data. This means that all EU Member States are due to implement the EU harmonised legislation on the protection of personal data. It must be mentioned that the European Parliament and Council recently approved *EU Regulation 2016/679* on the protection of natural persons with regard to the processing of personal data and on the free movement of such data, which replaces the current personal data protection Directive and is due to enter in force in 2018. The new Regulation enhances protection of personal data and is to be considered as one of the elements the crowdfunding platforms will have to comply with in the EU Member States.

In this respect, the crowdfunding platforms, as for instance, the **Romanian** experience shows, are subject to the personal data protection legislation. That means that the crowdfunding platforms must register as processors of personal data with the national competent authority. All other EU Member States have also taken similar steps to implement *Directive 95/46/EC* and, as mentioned above, are due to ensure direct applicability of the recently approved *EU Regulation 2016/679*.

Applicability of consumer protection regulations

One particular jurisdiction – **Israel** – applied consumer protection regulations for donation-based crowdfunding. The logic behind it is that the consumer protection regulations are applicable, under Israel law, also for contracts which do not involve an immediate benefit to the donor, but is considered a consumer of

services provided to a third party – the beneficiary of donation-based crowdfunding in its relations with the provider of goods or services which are contracted using the crowdfunded money.

At the EU level there is general EU consumer protection regulatory framework, mainly *Directive 2005/29/EC* concerning unfair business-to-consumer commercial practices in the internal market and *Council Directive 93/13/EEC* on unfair terms in consumer contracts. These two pieces of legislation are not applicable to donation-based crowdfunding projects, as the contributors do not receive any returns from their contributions. However, these general consumer protection Directives should be considered when implementing the other forms of crowdfunding (reward, lending and equity based).

Use of donation-based crowdfunding as a marketing tool

The practice of some Member States (ex. **Germany**) is for commercial banks to launch donation-based crowdfunding platforms as a way to attract clients and increase their shares on the financial services markets in the rural areas. This is a practice and not a regulatory prescription, but it is seen by financial institutions as an additional marketing tool to attract clients once they become donors under the launched crowdfunding platforms.

The launch of the crowdfunding project

The registration of public collectors

Under some jurisdictions, such as **Czech Republic** and **Slovakia**, the donation-based crowdfunding platforms are considered collectors of funds and are thus subject to licensing and registration. The registration of public funds collections is with the local public authorities (herein after LPAs) and include the source of the income, i.e. all the donors and may be refused if the public funds collection initiative is not for the benefit of the public (humanitarian, charity, education, sports, protection of cultural heritage, environment). The crowdfunding platform operators must present relevant proof that the project they launch is indeed for the public benefit.

Although this model of regulation of donation-based crowdfunding is protecting the public interest via:

- a) Requiring a licensing of public funds collectors
- b) Prior reporting on public funds collections with the option to refuse registration by the LPAs if the project does not meet a public interest
- c) Record keeping of all public funds collected;

And it ensures higher scrutiny of donation-based crowdfunding projects and reduces the risk of fraud, keeps records of contributors and thus enforces anti-money laundering legislation and closely scrutinises public funds collectors by licensing them.

These safeguards:

- a) Limit donations for business purposes, such as support for start-ups

- b) If regulation is disproportionate with other forms of crowdfunding, such as reward-based, then the aims of protection of public interest are not functional, as crowdfunding operators use the less regulated form of crowdfunding.²

Opposite to the **Czech Republic** experience, **Poland** exempted the socially oriented crowdfunding initiatives only from the requirements of the newly adopted *Public Collections Act*, which imposes similar obligations of registration, record-keeping, publication and reporting of public collections of funds to the public authorities. The institution which is managing public collections initiatives is the Ministry of Public Administration Affairs. The decision taken by the Polish Government to exempt regulation of socially-oriented crowdfunding projects is due to the incipient stage of development of crowdfunding in Poland and it is based on the European Commission suggestions to leave the donation-based crowdfunding develop without significant regulation.³

The transfer of the funds from the crowd to the beneficiary

The licensing requirement as “payment services” provider

At the EU level there is harmonised legislation which regulates the subject of payment services – *EU Directive 2007/64/EC* on payment services in the internal market. Thus, all the 28 EU Member States are bound by the respective EU legislation, which requires authorisation of payment services providers.

To avoid the need to be licensed as providers of “payment services” in some member states of the EU, such as **Belgium**, the crowdfunding platforms use “*escrow accounts*”. These types of accounts essentially mean that the crowdfunding platform operator is strictly linked to offering information to the public about projects to be financed and does not mediate the transfer of funds from the crowd to the beneficiary. Also, the transfer of funds via *escrow accounts* is subject to two conditions: the funds are accessible only if the target budget is met and, in the process of use of funds, reporting is done on how the funds are managed.

Under the escrow account option (**Belgium**) the crowdfunding platform does not manage the funds at all and limits its intervention on placement of project data and funds transfer details.

Another option that is widely used by many Member States (ex. **Croatia, Germany, Slovenia**) is partnering up with an entity (such as credit institutions, payment service providers, banks etc.), which is already licensed to perform payment services to avoid the licensing requirement. Thus, as long as the crowdfunding platform cannot access the funds it receives, but merely is channelling the funds to the beneficiary, there is no need for a license as payment services provider.

² The example of Czech Republic shows that the Public Collectors Act no. 117/2001 overregulated the donation-based crowdfunding and left aside the regulation of reward-based crowdfunding. In the absence of any specific rules for reward-based crowdfunding, the crowdfunding operators have switched to reward-based model, which only entails a small additional expense (symbolic returns such as promotional material etc.), but which as a result diminished the intended effect the regulatory framework had to protect the public interest.

³ For more details please consult the European Commission Communication COM(2014) 172 final from 27.03.2014 to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions on “Unleashing the potential of crowdfunding in the European Union”, pages 7, 8, accessible at: http://ec.europa.eu/internal_market/finances/docs/crowdfunding/140327-communication_en.pdf

Reward-based crowdfunding

The operation of the crowdfunding platform operator

There are no substantial differences with respect to the legal requirements for the operation of crowdfunding platform operators for reward-based crowdfunding compared to the previously assessed donation-based crowdfunding. There are however a few differences, which will be assessed below:

Legal qualification of reward-based crowdfunding

Under **Lithuanian** jurisdiction, the reward-based crowdfunding is qualified as a contract of sale of goods and/or services. Other jurisdictions in the EU have somehow similar qualifications. The essential difference to the donation-based crowdfunding is that the contractual standing of the contributor of funds is no longer a donor, but a buyer, whilst the one of the beneficiary of funds is no longer the beneficiary, but the seller.

Reward-based crowdfunding is also seen in **Spain** as a contract of sale or a contract of provision of services. The funds are offered in advance to the beneficiary and in exchange the buyer receives the good or the service the beneficiary develops under its professional activity.

It must be highlighted that a key feature of the reward-based crowdfunding is the symbolic nature of the reward the beneficiary obtains in return to his/her financial contribution. The analysed jurisdictions are silent with respect to the general civil legislation provisions with respect to nullity of contracts with an abnormally inconvenient condition for one of the parties. As reward-based crowdfunding essentially entails a return which is less, at least in monetary value, to the offered funds, the author considers that this element must be somehow regulated. The use of the contractual provisions is not an option, because that limits the civil rights of the “buyer”.

Consumer protection legislation

All the above-mentioned jurisdictions have relevant general consumer protection legislation, as mentioned in the previous chapter (*Directive 2005/29/EC* and *Council Directive 93/13/EEC*). Besides general EU legislation on consumer protection, a recent Consumer Rights *Directive 2011/83/EU* was approved, which is providing for a series of obligations that may applicable in the case of reward-based crowdfunding projects. Some of the most important obligations applicable to the providers of goods and services are:

- a) Delivery of full data on the main characteristics of the goods and services, identity of the goods and/or service provider, the contact details of the trader, total price of the goods or services, including taxes, additional freight or postal costs, conditions of payment and delivery or performance, the provider’s complaint handling policy, duration of the contract etc.⁴
- b) Unconditional acceptance of the withdrawal from contractual relations by the consumer within 14 days from the conclusion of the distance contracts and off-premises contracts⁵

⁴ Article 6 of Directive 2001/83/EU

⁵ Article 9 of Directive 2011/83/EU

If the right to withdraw is used by the consumer, he/she must cover the costs of return of the received goods.⁶

The right of withdrawal of the consumer is not applicable if:

- a) the service was fully delivered with the prior express consent of the consumer and acknowledgement that he/she will lose the right to withdrawal once the service was fully delivered
- b) the goods or services delivered have a price which is dependent on fluctuations in the financial markets, which the provider may not control and which may take place within the withdrawal period
- c) the goods were delivered to the consumer based on his/her specifications or clearly personalised
- d) the goods delivered are liable to quick deterioration or expire very rapidly
- e) the goods delivered are not suitable if unsealed and after delivery they have been open
- f) the goods cannot be separated from other goods after they have been used
- g) the provider was asked by the consumer to conduct repairs within the specified 14-day period
- h) the provider supplies digital content not on a tangible medium if the delivery has begun and the consumer gave his/her prior consent of loss of the right of withdrawal.⁷

The EU Member States out to have implemented the EU Directive 2011/83/EU by the end of 2013.⁸

Taxation of reward-based crowdfunding

Reward-based crowdfunding is taxed under the **Slovak** and **Czech** jurisdictions. Other jurisdictions have not provided for an explicit tax waiving provisions for reward-based crowdfunding projects.

It is most likely that all of the jurisdictions are currently facing the cumbersome qualification as tax-payers for all reward-based crowdfunding initiatives. Under certain circumstances, based on the particular deduction rights available to individuals, the reward-based crowdfunding may be tax exempted. Taking into account that the intention of the reward-based crowdfunding is to collect funds for a particular aim which has a large public interest impact, additional regulation on particular application of tax legislation to reward-based crowdfunding is necessary.

The launch of the crowdfunding platform

Similar to the previous chapter, little difference was found with respect to reward-based crowdfunding compared to the donation-based. However, some small differences are available:

The registration of the project

Because reward-based crowdfunding does no longer qualify under the *public funds collections* as presented above under the **Czech Republic** and **Slovakia**, the reward-based crowdfunding is widely used in these jurisdictions to circumvent de cumbersome regulatory framework prescribed for public funds collection, which

⁶ Article 14 (1) of Directive 2001/83/EU

⁷ Article 16 of Directive 2011/83/EU

⁸ Article 28 of Directive 2011/83/EU

as the two jurisdictions have implemented, qualifies as donation-based crowdfunding under the respective regulatory provisions.

Other assessed jurisdictions have not mentioned any particular obligation to register with a public authority a reward-based crowdfunding.

Regional peculiarities

Due to cultural differences, in some jurisdictions such as **Portugal** and **Spain**, reward-based crowdfunding is very popular as it entails a strong public recognition component.

All the other aspects, with the exception of tax deduction, which have been highlighted in the donation-based crowdfunding chapter are equally applicable to reward-based crowdfunding, including: personal data protection, anti-money laundering, licensing requirements if payment services are provided etc.

Tax deduction may not be applicable for contributors if the funds offered to the entity which qualifies (ex. **France**) is no longer a donation, but a reward is instead offered to the contributor.

Lending-based crowdfunding

Provided that a lending-based crowdfunding is an activity which implies the attraction of funds from the crowd with an envisaged interest, intermediation of the funds to/from the borrowers (including interest) and disbursement of those funds, we are in the presence of a lending-based crowdfunding platform.

Unlike the case of donation-based and reward-based crowdfunding, lending-based crowdfunding implies a series of more prominent risks for both the lenders and the borrowers and is subject to both EU level and national level regulation of financial services.

So far, the EU Member States have taken one of the two possible approaches with respect to regulating the lending-based crowdfunding:

1. Have approved specific legislation for lending-based crowdfunding, thus providing different rules than the general ones applicable for financial services.

At the beginning of May 2016 four EU Member States have approved specific regulatory frameworks for lending-based crowdfunding – Spain, France, UK and Portugal.⁹ Based on other sources, additionally to the four mentioned EU Member States Germany, Italy and Austria have also enabled specific national crowdfunding legislation, and other states such as Finland, Sweden, Estonia, Latvia, Belgium, the Netherlands and Lithuania are taking steps to enable specific crowdfunding legislation.¹⁰

2. Have taken a wait and see approach (ex. Poland, Czech Republic, Slovakia), by means of which the industry was left regulated at national level with the currently existent framework, including the enforcement of relevant EU legislation for the financial sector.

Irrespective of the strategic approach taken by the EU Member States, all the national jurisdictions have taken steps to regulate somehow the industry, as, unlike donation-based and reward-based crowdfunding, the latter implies a series of risks, among the most prominent being the following:

- Partial or total loss of the lent funds
- Reduced or no interest contrary to initially agreed lending terms
- Insolvency of the crowdfunding platform
- Insolvency of the borrower
- Conflict of interest of the crowdfunding platform managers, the borrowers and the lenders
- No of insufficient resources of the lending guarantee funds to cover the amounts offered by lenders
- Little or no information about the borrowers' actual financial commitments and the structure of proposed projects
- Lack of credit record of borrowers

⁹ For more details please consult the European Commission Staff Working Document on “Crowdfunding in the EU Capital Markets Union”, accessible at: http://ec.europa.eu/finance/general-policy/docs/crowdfunding/160428-crowdfunding-study_en.pdf

¹⁰ For more details please consult: <http://eurocrowd.org/2016/04/12/finnish-crowdfunding-act-ministry-finance-provides-answers/>

- Use of crowdfunding platforms as a vehicle for fraudulent activity, including money-laundering
- Dissemination of personal data contrary to the interests of lenders and borrowers

Further below we shall describe the best regulatory practices to mitigate the above-mentioned and other aspects of operation of the crowdfunding platform operator.

Legal qualification of lent funds and of the status of the crowdfunding platform operators

All the assessed jurisdictions consider the lent funds as delivery of financial services, irrespective of the fact that there is a specific crowdfunding legislation or general authorisation provisions apply for particular financial services. Thus, one of the three options is applicable:

1. Licensing under specific crowdfunding legislation similar to those applicable to financial intermediaries
2. Licensing under general financial market regulations to provide consumer credits or credit brokerage services
3. Registration as payment services provider under *Directive 2007/64/EC* on payment services in the internal market (the Payment Services Directive)

The three available options are also possible to take place simultaneously. Thus, options 1 and 3 are possible if the lending-based crowdfunding platform is also acting as a payment service provider, or options 1 and 2 are available if the operators have as primary activity delivery of consumer credits or credit brokerage services and also are managing a lending-based crowdfunding platform.

All three forms of licensing or registration imply a national authority supervision, usually from the national financial markets commission or similar entity which is entrusting with regulating the financial markets services, capital requirements, certain professional qualification requirements and professional conduct.

Unlike the case of donation-based and reward-based crowdfunding, the operators of lending-based crowdfunding platforms must take the legal forms prescribed by the national jurisdictions and are all considered having a lucrative purpose.

Further below we shall review the main legal requirements the EU jurisdictions provide for lending-based crowdfunding, namely:

- a) business models for lending-based crowdfunding,
- b) authorisation requirements,
- c) handling of funds,
- d) minimum capital requirements,
- e) types of offered loans and their maximum ceiling,
- f) business continuity,
- g) customer due diligence and anti-money laundering regulations,
- h) verification of suitability and appropriateness,
- i) disclosure of the borrowers' details,
- j) consumer protection,
- k) professional requirements on the platform operators.

Types of business models of lending-based crowdfunding

There are four possible forms of lending services from the parties' perspective:

- a) Consumer to business,
- b) Business to business,
- c) Business to consumer,
- d) Consumer to consumer.

Consumer to business

Consumer to business lending essentially means attracting funds from physical entities in the interest of the businesses. This business model is already known to have been implemented via a number of tools, the main one being the issuance of various forms of equity to attract additional capital from the public. This form is already subject to regulation in all of the assessed jurisdictions and shall be reviewed in greater details under the equity-based crowdfunding.

As the **UK** example shows, for consumer to business model, the Financial Conduct Authority has developed a list of qualified consumers, which may enter into consumer to business lending-based crowdfunding. Imposing limitations to consumers is important as it provides additional protection to non-qualified ones and eliminates risks of fraud, loss of savings etc. Thus, only consumers who are:

- a) professional clients
- b) retail clients who confirm that they receive and will receive regular advice on the investment
- c) retail clients who are venture capital or corporate finance clients
- d) retail clients who self-certify or are certified as sophisticated clients
- e) retail client who are certified as high net worth investor client
- f) retail client who certify that they will invest up to 10% of their investible assets (which will not affect their primary residence, pensions, life insurance etc.)

are eligible for consumer to business lending-based crowdfunding model.

These safeguards are essentially directed to ensure the following:

- a) That the consumer is either a professional player (in this case this basically equals to business to business model)
- b) That if the consumer is not a professional player, which means that he is not certified so, he/she either has sufficient knowledge how to depict suspicious or risky investment, or receives sufficient advice to protect his/her investment
- c) That the consumer is not committing financial resources which are vital for his/her existence (ceiling of up to 10% of assets, venture capital, sophisticated investor, high net worth investor)

It must be also mentioned here, that this detailed experience **the UK** is promoting is due to the already existent complex legal framework on access to and support of financing. Thus, once the jurisdiction has specific

provisions on retail consumers who either have specific knowledge and experience or are properly advised, or are advanced consumers of financial services (venture capital investors or high net worth value investors), it is clear that they must provide with the respective options under the consumer to business lending-based crowdfunding business model.

Business to business

This model of lending-based crowdfunding is applicable under very limited circumstances, as the business to business lending-based crowdfunding is already available under the banking regulation. Many of the EU Member States encountered trouble in implementing this form of crowdfunding model, as their respective national legislation offered the monopoly to issue loans to banks alone (ex. **Belgium**).

Another solution to regulate the business to business crowdfunding is collection of funds to finance the own business of the crowdfunding initiator. The **Austrian** example shows that this activity is subject to licensing by the National Financial Markets Authority.

Other sub-forms of business to business lending-based crowdfunding are overlapping with existent legislation in some of the EU Member States, the US and Canada, such as venture capital. The major difference between the two forms is that in the venture capital case there is only one lender with multiple beneficiaries (usually start-ups, who cannot access the funds for themselves). In the business to business lending-based crowdfunding the main feature is that there are plenty of lenders and only one beneficiary per lending-based crowdfunding project.

Like with all other sub-forms, this one requires prudential rules, customer due diligence, anti-money laundering and other pertinent legislation in force. As of today, four of the 28 EU Member States have implemented specific crowdfunding legislation which allows business to business lending-based crowdfunding.

Business to consumer

This sub-form entails borrowing of funds from professional players to consumers through a collective participation. Depending on the market conditions, it may be much more attractive to obtain loans from professional players other than banks to support the consumer loans. Although this may be seen as a competitive market for banks and other financial institutions, the tendency in some EU Member States is that the banks open lending-based crowdfunding platforms, which could diminish the importance and the competitive advantage of crowdfunding (ex. **Belgium**).

At EU level at least three important Directives are applicable, as they regulate consumer protection and consumer service: *Directive 2008/48/EC* on credit agreements for consumers, *Directive 2002/65/EC* concerning the distance marketing of consumer financial services and *Directive 2005/29/EC* concerning unfair business-to-consumer commercial practices in the internal market.

Out of the four known EU jurisdictions to have approved specific legislation, only **the UK** has regulated this form of crowdfunding lending model. Other EU Member States have taken the option to use the already

existent legislation and apply consumer protection requirements emanating from the above-mentioned EU consumer protection Directives.

Consumer to consumer

Similar to the business to consumer model, the consumer to consumer model will most probably be subject to the same consumer protection requirements, as the consumer (beneficiary) rights are regulated extensively at EU level.

France limits the consumer to consumer loans for educational projects only. Other EU Member States do not have any consumer to consumer crowdfunding platforms due to the strict consumer protection regulation, as mentioned above (ex. **Belgium**). The access to funds via the lending model to consumers from physical entities, which are not in essence providers of financial services may be considered either by banks or by other financial institutions which are licensed to collect funds from the public. To avoid the risks of fraud, the specific national legislation of the EU Member States who have approved lending-based crowdfunding legislation, the types of loans collected by individuals from other individuals was limited to certain types of activities. The lending practice from individual to individual is also limited in amounts (i.e. 1000 EURO per project per year). These limitations however, require adequate verification of the debit and credit history of individuals, which implies a considerable effort from the national regulators and increases costs. Precisely because of these factors, the consumer to consumer lending-based crowdfunding is limited with maximum amounts per project per year and to types of activities, which in essence, are not of a lucrative nature, such as loans for education.

Authorisation requirements

The four jurisdictions which have adopted specific crowdfunding legislation all require an authorisation from their national regulatory bodies to be able to operate. The institutions entrusted with authorisation are those responsible for the financial markets, ranging from the Financial Conduct Authority in the **UK** to the National Financial Markets Commission in **Spain**. The authorisation procedure involves the review of the capacities, the internal business processes, including those related to customer due diligence, anti-money laundering and financing of terrorism, as well as a mandatory professional insurance, internal code of conduct, which excludes conflicts of interest.

Handling of funds

The EU Member States practice is to license the crowdfunding platforms if they handle funds. This is applicable for all forms of crowdfunding platforms and is in line with the *EU Directive 2007/64/EC* on payment services in the internal market (hereinafter the EU Payment Services Directive), which prescribes for proper prudential supervision, customer due diligence and other activity requirements. There are three main types of undertakings which fall within the scope of the Directive: *credit institutions*, *electronic money institutions* and *payment institutions*. Additionally, the post office giro institutions, the European Central Bank and the national

banks, as well as EU Member States' institutions (central and regional) when not fulfilling their statutory functions are within the scope of the Directive.

The EU Payment Services Directive provides both for its positive and the negative scope, i.e. for which areas the Directive is applicable and for which not.

Thus, payment transactions made exclusively in cash directly from the payer to the payee without any intermediary intervention are not within the scope of the Directive.¹¹

On the other hand, money remittances, which are payment services where the funds are received from a payer, without any payment accounts being created in the name of the payer or the payee, for the sole purpose of transferring a corresponding account to a payer or to another payment service provider acting on behalf of the payee, and/or where such funds are received on behalf of and made available to the payee, are within the scope of the EU Payment Services Directive, which means that authorisation and licensing is applicable.¹² The Annex to the Directive describes the types of payment services which the authorised entities are entitled to deliver. Among them are:

- Execution of direct debits, including on-off direct debits
- Execution of payment transactions through a payment card or a similar device
- Execution of credit transfers, including standing orders

The above mentioned forms of payment services may well fall under a lending-based crowdfunding model. If that is the case and the platform does not entrust the provisions of these services to a third party, it essentially is handling funds.

If the lending-based crowdfunding platform is handling funds, it is exposed to the authorisation requirement, which, among others, implies the review of the availability of a business plan, a programme of operations, minimum statutory fund (which ranges from 20,000 EUR to 125,000 EUR depending on the types of provided services), transparency of the beneficiaries and of the clients, description of internal control and conflict of interest avoidance mechanisms etc.¹³

As the **Spanish** experience shows, if the crowdfunding platform is managing its own funds and client's funds, those must be segregated into separate accounts. Also, the crowdfunding platform receives a hybrid form of authorisation – both as payment institution and intermediary of funds between the lender and borrowers.

In **the UK**, if the platform operates with clients' funds, it must comply with Financial Conduct Authority's Client Asset Sourcebook to ensure proper protection of client funds.

An alternative to direct management of funds, as provided above under the previous two forms of crowdfunding, is conclusion of partnership agreements with an entity which is operating with payment services. That will exempt the crowdfunding platform from the obligation to hold an authorisation.

It must be stressed here that the EU Member States which have adopted specific crowdfunding legislation, have, irrespective of the fact that the entity is processing funds, prescribed for internal regulations on the

¹¹ Article 3 of the EU Payment Services Directive

¹² Article 4 of the EU Payment Services Directive

¹³ Article 5 of Directive 2007/64/EC on payment services in the internal market

crowdfunding platform which oblige them to conduct customer due diligence, offer detailed information on the beneficiaries, bear responsibility, including via the use of an insurance policy and avoid any potential conflict of interest.

Minimum capital requirements

The EU Member States which have specific crowdfunding legislation impose a minimum capital requirement for the lending-based crowdfunding platforms. These regulations are different from the minimum statutory fund requirements available under the *EU Payment Service Directive*, mentioned above. Thus, the minimum capital requirements range from none (**ex. France**) to up to 2 million EURO (**ex. Spain**) for particularly high amounts of raised capital as loans – 30 million EURO and higher.

The minimum capital requirements are linked to the amounts of collected funds and to the professional liability insurance of the platform. The platform may not start operation until it proves the minimum capital requirement as described in the EU Payment Services Directive and it is linked to the types of services it provides. Thus, if the platform is performing only money remittances, its initial capital should not be less than 20,000 EURO. The French example of no capital requirement is applicable if the platform is not performing any of the services included in the Annex of the EU Payment Services Directive.

Other EU Member States such as Austria, Belgium etc. are applying their currently existent regulatory framework, which implies minimum capital requirements for known forms of capital markets undertakings – credit institutions and banks.

Types of offered loans and their maximum ceiling

The specific crowdfunding legislation is the most permissible one in the **UK**, with all forms of loans being permitted, including the fixed and variable rate loans, secured and unsecured loans. **France** and **Spain** impose certain limitations on the types of offered loans and the ceiling of both the accessed loan and the maximum participation of loans from consumers. Thus, the **Spanish** crowdfunding law does not allow securing loans on the main residence of the borrower, whilst **France** imposes limitation of participation of up to *1,000 EURO* for consumer to business loans per individual per year. As we have already mentioned above, there are also restrictions on the participation in consumer to business crowdfunding in the **UK**, which is determined based on the income of the individual investing into a lending-based crowdfunding.

Business continuity

All four jurisdictions with specific crowdfunding platforms in place provide for the obligation of the platforms to ensure continuity of the business if the crowdfunding platforms stops operating. The business continuity requirement is assessed by the national regulators when authorisation is issued. This implies that the national

financial markets regulators make sure that the platform operators have a back-up system in case the platform will stop operating at a later point in time, with projects still active. The operators must provide an agreement of take-over by another entity, which is on the market (bank, financial institution), including set up contractual obligations for both the current operator and the perspective one if the former is considering leaving the business. To guarantee the rights of contributors, the platform can use its professional insurance policy, which is mandatory for all lending-based crowdfunding platforms.

Customer due diligence and anti-money laundering regulations

All EU Member States, be it within their specific legislation on crowdfunding, or based on existent regulatory framework impose adequate customer due diligence and anti-money laundering procedures. That is due to the existent EU banking and anti-money laundering Directives and Regulations implemented by the Member States for some time already.

Verification of suitability and appropriateness

Within the lending-based platform there are, as we have seen above, risks associated with the non-return of investments. To mitigate that risk, some EU jurisdictions (ex. **Spain**) have imposed an obligation on the crowdfunding platforms to check the suitability and appropriateness of the borrowers and lenders. The national financial markets regulators have adopted comprehensive guidelines on the assessment of suitability and appropriateness of borrowers and lenders. The verifications include any past experience with the same or other platforms, or other payment services providers. If there are additional qualification requirements, these are verified by the platform (professional versus non-professional player, review of invested amounts and observance of the maximum admitted ceilings etc.)

Other jurisdictions chose to mitigate this risk via limitation of individuals who do not qualify as professional investors to participate in lending-based crowdfunding (ex. **UK**), whilst others have limited the maximum amount of participation as lenders in such platforms to *1000 EURO* (ex. **France** and **Belgium**).

If the taken choice is to limit from the start the participation of non-qualified individuals, then the jurisdictions tend not to impose an additional limit on the platform, but rather transfer the risk onto the lenders.

If, on the other hand, vulnerable participants are not excluded from the outset from participating as lenders, their participation is limited from the perspective of the maximum amount of investment possible within the platform and project.

Disclosure of borrower's details

All jurisdictions require a description of the project and main details of the borrower. Additionally, some jurisdictions impose additional obligations on the platform to review the genuine nature of the data. This

implies an internal set of rules of preselection of lending projects and reduces the risks associated with fraud or misleading information.

Consumer protection

All EU jurisdictions are bound to implement the above mentioned provisions of consumer protection: *Directive 2008/48/EC* on credit agreements for consumers, *Directive 2002/65/EC* concerning the distance marketing of consumer financial services and *Directive 2005/29/EC* concerning unfair business-to-consumer commercial practices in the internal market.

Professional requirements on the platform operators

The professional activity of the platforms, where specific legislation is in place, provide for a mandatory professional indemnity insurance policy. Additionally, all members of the platform should demonstrate knowledge, sound business plan, integrity, lack of previous suspicious activity and exclude, based on their internal regulations, any conflict of interest. The members of the platform are also subject to limitation in investing in the lending-based projects there are hosting under the platform to a maximum of 10% of the amount of the project.

The review of compliance with professional requirements, both at the registration and later on, at the active delivery of services stage is done by the national financial markets regulators.

Equity-based crowdfunding

Unlike the previous three forms of crowdfunding, the equity-based crowdfunding is exposed to an even larger amount of harmonised legislation at EU level. As we have identified above, the equity-based crowdfunding is much more complex in nature as it involves a large amount of risks associated with investment into equity

Thus, the equity market in the EU is regulated by the following:

- a) *Directive 2004/39/EC* on markets in financial instruments (herein after the MiFID)
- b) *Directive 2011/61/EU* on alternative investment funds managers (hereinafter the AIFMD)
- c) *Directive 2013/36/EU* on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms (hereinafter the CIIFPSD)
- d) *Directive 2003/71/EC* on the prospectus to be published when securities are offered to the public or admitted to trading (hereinafter the PD)

The above mentioned four EU Directives are supplemented by European Commission implementing and delegated Regulations and Directives to ensure the proper implementation of the former.

Before entering into the analysis of the various elements of the equity-based crowdfunding platforms, we shall first present the main definitions and the scope of the MiFID, AIFMD, CIIFPSD and PD.

The **MiFID** is addressed to credit institutions which provide one or more investment service and/or perform investment activities.¹⁴ The investment services and activities are listed in Annex I, sections A of the MiFID and include:

- Reception and transmission of orders in relation to one or more financial instruments
- Execution of orders on behalf of clients
- Dealing on own accounts
- Portfolio management
- Investment advice
- Underwriting of financial instruments and/or placing of financial instruments on a firm commitment basis
- Placing of financial instruments without a firm commitment basis
- Operation of multilateral trading facilities

The **AIFMD** is addressed to managers of Alternative Investment Funds which are collective investment undertakings, including investment companies which raise capital from a number of investors with a view to investing it in accordance with a defined investment policy for the benefit of those investors.¹⁵

¹⁴ Article 1 (2) of Directive 2004/39/EC

¹⁵ Article 4 (1) letter a) of Directive 2011/61/EU

The **CIIFPSD** provides for additional regulation for the credit institutions and investment firms, including prudential rules and the competences of the national regulators in monitoring the enforcement of those prudential rules. Thus, the initial capital of credit institutions shall not be less than 5,000,000 EURO¹⁶. For investment firms, the initial capital requirement is 730,000 EURO¹⁷. If the investment firm is not performing any financial instruments on its own account, but performs three main activities – receipt and transmission of orders for financial instruments, execution of investor’s orders for financial instruments and the management of individual portfolios of investment in financial instruments, the minimum capital requirement is 125,000 EURO¹⁸.

The **PD** is regulating the obligation of the issuers of equity to publish a prospectus before issuing the former. There are certain ceilings the Directive provides for, below which there is no obligation to have the prospectus published. The higher the ceiling, the less burden there is on the crowdfunding platforms to comply with an additional regulatory requirement. The ceilings are different for different types of equity, for instance for EU wide offers of securities, the obligation to publish a prospectus is applicable if the total amount of securities are 5 million EURO and above. The European Commission has recently issued a proposal for EU Regulation limiting the ceiling for securities trading amounting to less than 500,000 EURO and excluding for these cases the obligation to publish a prospectus by crowdfunding platforms, which among others, implies the disclosure of details of issuers.

As we can see, there is a great deal of regulation in the equity sector at the EU level, which is directed at ensuring transparency on the equity market, professional liability, prudential treatment and protection of the interests of consumers of financial services.

Now, we turn to the national special equity-based crowdfunding regulatory framework of the 7 EU Member States who have taken action to support equity-based crowdfunding. Similar aspects as those analysed under the lending-based crowdfunding shall be assessed. Also, additional elements relevant to equity alone will also be reviewed, such as types of provided services, financial instruments and sizes of offers, instead of handling of funds and maximum amount of lent funds. Thus, the proposed aspects for assessment are as follows:

- a) availability of specific national legislation on equity-based crowdfunding
- b) authorisation requirements,
- c) provided services,
- d) available financial instruments,
- e) minimum capital requirements,
- f) sizes of offers, including prospectus ceilings,
- g) maximum investible amounts,
- h) customer due diligence and anti-money laundering regulations,
- i) disclosure of the details of investors by the issuers,
- j) professional requirements on the platform operators,
- k) consumer protection.

¹⁶ Article 12 (1) of Directive 2013/36/EU

¹⁷ Article 28 (2) of Directive 2013/36/EU

¹⁸ Article 29 (1) of Directive 2013/36/EU

Availability of specific national legislation on equity-based crowdfunding

As of beginning of May 2016 seven EU Member States have adopted specific national legislation which addresses the equity-based crowdfunding: Austria, Spain, France, UK, Italy, Germany and Portugal.

Authorisation requirements

All 7 EU Member States which have adopted specific national legislation for equity-based crowdfunding require an authorisation from the national regulators. The national regulators are in all cases the ones responsible for the regulation and monitoring of the financial markets.

Under some of the jurisdictions, the authorisation requirement is waived if the entity has been already licensed as a bank or investment firm. However, they are obliged to register the crowdfunding platform with the national financial markets regulator. That is because the licensing under the banking or investment firm regulations already envisages the review of capacities, business plan, capital requirements etc. to deliver financial services. In the absence of the respective type of activity under the already licensed activity, an additional authorisation to trade with financial instruments would be necessary.

Provided services

The national jurisdictions limit the activity of crowdfunding platforms to reception and transmission of orders in relation to one or more financial instruments, investment advice and the reception, selection and publication of projects.

As we can see, the list of provided services is shorter compared to the one under Annex I, Section A of the MiFID, which is a natural consequence of the fact that equity-based crowdfunding platforms are not fully-fledged investment firms, credit institutions or alternative investment funds.

Available financial instruments

The solutions taken by the 7 Member States are rather different. Some jurisdictions chose to focus on equity issued by SMEs (ex. Austria, Spain).

Others chose to differentiate between “transferable securities” and other forms of financial instruments (ex. France) and hence the difference between authorisation – equity based crowdfunding platforms versus MiFID investment firms.

Italy chose to link the equity-based crowdfunding to shares in innovative start-ups and SMEs, or in shares of collective investment undertakings which invest at least 70% of their funds in innovative start-ups and innovative SMEs.

Minimum capital requirements

The EU Member States which have adopted national specific legislation on crowdfunding have opted to use the existent exemptions under the MiFID, AIFMD and CIIFPSD when designing the regulatory framework with respect to minimum capital requirements. As the above mentioned Directives offer exemptions if the investment firms, credit institutions or alternative investment funds operate nation-wide, instead of EU-wide, and allow limitation of certain activities provided less stringent capital requirements rules apply, the 7 EU Member States have either opted to exclude capital requirements altogether (ex. Austria, France, Italy) for services provided outside the MiFID regime or for business investment consulting, to a minimum of 50,000 EURO or a professional liability insurance policy covering at least that amount (ex. UK, Portugal, Spain).

Size of offers, including prospectus ceilings

As we have seen above, the **PD** is imposing an obligation for offers of 5,000,000 EURO and above to be subject to a prospectus publication requirement. To overcome the burden of prospectus requirement, a simplified procedure was approved by some EU Member States. Thus, for instance **Belgium**, although not having a particular national legislation on crowdfunding, used the exemption provided under **PD** and excluded the obligation of prospectus for projects amounting to up to 300,000 EURO. It must be mentioned that this step was taken to counterbalance previous regulation approved in Belgium, which imposed a prospectus requirement for public offers above 100,000 EURO.

The specific legislation of the 7 EU Member States also imposes limitations for a particular project. Thus, the maximum amount that can be collected per year per project ranges between 1 million EURO (France) to 2,5 million EURO (Germany). Spain and Portugal raised the upper ceiling of the project to 5 million EURO if the offer is directed to professional investors only.

It must be stressed here that once a limitation of the upper ceiling per project is regulated, this inevitably implies the registration of the projects. Since the prospectus requirement is waived, a special registry of equity-based crowdfunding projects is necessary to effectively enforce those limitations and exclude fraud. Further, the access to the platforms and of particular projects is limited if the amount is higher, which in turn entails differentiated access of non-professional and professional investors to equity-based crowdfunding.

Maximum investible amounts

The EU Member States have treated the investors into two groups: individuals and professional investors. Each of the 7 EU Member States have limited the investment of individuals from 500 EURO to 1000 EUR per order/project, from 1000 EURO per year to up to 5000 EURO per year (or up to 10% of the total net income). For professional investors there are usually no limits applied.

Customer due diligence and anti-money laundering regulations

As we have seen above, the Member States who have approved specific national crowdfunding legislation distinguish between non-professional and professional investors. This is an additional element crowdfunding platforms must comply with when identifying both the issuers and the investors. During the transactions the platforms either implement the anti-money laundering legislation themselves (if hold payment services authorisation) or by the bank or other payment service provider (if an agreement was reached with a partner).

In the identification process, the crowdfunding platforms also must confirm that the non-professional investors are aware of the existent risks and are properly informed of the possible consequences of investment into equity. The UK practice shows that for some complex forms of equity, investment advice is prescribed by the law. In this case, the crowdfunding platform performs a suitability test. If no regulated advice is foreseen, an appropriateness test is carried out by the crowdfunding platform. Germany also regulates the suitability and appropriateness tests for investors.

The crowdfunding platforms are also under the obligation to check if the issuers are not launching similar projects on a platform. This obligation is crucial and should be coupled with the monitoring obligation of equity projects from the national regulators, to avoid fraud.

Disclosure of the details of investors by the issuers

The national regulators have been entrusted to develop standardised templates for equity-based crowdfunding projects. The information must include the issuer, the nature of the project, the alternative financial instruments, the warnings of risks associated to the investment, the annual reports, opening balance sheet, the business plan, the fees applicable by the crowdfunding platform.

The issuer and the platform hold liability for providing false or misleading information. The platform must be thus backed-up with a mandatory professional liability insurance.

Professional requirements on the platform operators

The crowdfunding platforms are required to review at least if the information provided is complete and clear. Also, the platforms must take due diligence when selecting projects and have a list of predetermined criteria when selecting projects prepared by issuers. This acts as an additional filtering mechanism to avoid fraud and misleading data.

The platform operators cannot promote their own equity-based crowdfunding and cannot offer investment advice on projects they promote. The managers cannot invest more than 10% of the value of the project.

The platforms must also hold internal conflict of interest management manuals and procedures. Under some jurisdictions, regulators approve the standard rules and procedure of the platforms to exclude conflict of interest, due diligence, professional responsibility etc.

Consumer protection

The three EU Directives applicable to consumers of financial services are applicable to the same extent as in the case of lending-based crowdfunding.

Conclusions and recommendations

As we have seen from the best international practices analysis presented above, there is no standardised or at least partially harmonised practice with respect to crowdfunding regulation in the EU Member States, as well as in the US, Canada, Switzerland and Israel.

The regulation of four main forms of crowdfunding is different from one jurisdiction to the other. At the same time, there is no single approach of the European Commission with respect to crowdfunding regulation at the EU level.

The donation-based and rewards-based crowdfunding has been left to a large extent regulated to the current level, with application of the national legislation available when the two forms of crowdfunding have emerged on the national markets of the EU Member States, US and Canada.

There are however important features of the two forms of crowdfunding which deserve attention:

- a) The crowdfunding platform operators do not require a formal authorisation, provided they do not handle directly funds. If funds are managed by the platform, they qualify as payment service providers under EU legislation. Good examples to avoid licensing is partnering up with an entity which already provides payment services or the use of “escrow accounts”, which exclude any funds handling by the platform operator;
- b) The crowdfunding platform operators must ensure due diligence when accepting projects, to avoid misuse of the platforms for fraudulent activity. Although not part of a strict regulatory framework under national jurisdictions, there are already developed soft-law instruments, such as the recommended code of conduct and standard rules of procedure developed by the European Crowdfunding Network¹⁹;
- c) The projects promoted by the crowdfunding platforms must have a public interest objective;
- d) A degree of scrutiny of donation-based and reward based crowdfunding is necessary, but to the extent it does not overregulate donation-based and involves artificial use of reward-based crowdfunding;
- e) Tax deduction should be available for donors under the donation-based crowdfunding. This may involve additional effort, especially from the tax authorities, but would increase incentives for donation-based crowdfunding;
- f) Crowdfunding projects are subject to personal data protection requirements, as vast amount of personal data is processed in the course of the implementation of projects;
- g) Anti-money laundering and fight against financing of terrorism regulations are applicable for donation-based and reward-based crowdfunding platforms, either directly addressed to the platforms, if they handle funds, or indirectly if a partner entity is managing the payments;
- h) Consumer protection legislation could be applicable for reward-based crowdfunding projects, including extensive rights for consumers who act as beneficiaries of goods and services offered by the recipients of funds.

¹⁹ For more details, please consult: <http://eurocrowd.org/about-us/code-of-conduct-2/>

The lending-based and equity based crowdfunding is subject, as we have seen to a detailed level of regulation, which addresses various aspects of provision of financial services. At EU level there are actions taken to regulate them at the level of Member States and there is currently little indication that an EU Directive or Regulation would be soon available to harmonise the practices of lending and equity based crowdfunding.

Due to the risks associated with lending and purchasing equity and the different aims the Member States pursue when regulating these forms of crowdfunding, with an additional limitations of already existent EU legislation for the financial sector, it becomes less likely that the crowdfunding market will see soon a harmonised piece of legislation soon.

However, important good practices can be extracted from some of the evaluated jurisdictions and recommended for absorption, among them being the following:

- e) Platform operators are qualified as financial institutions which provide a limited amount of financial services and operate with a reduced list of equity
- f) Due to associated risks, the platform operators must comply with a set of rules, including on transparency, publication of minimum data on the projects, due diligence on the clients, anti-money laundering review procedures, minimum capital requirements and/or professional indemnity insurance
- g) The maximum ceilings for projects and the maximum amount for non-professional participants on lending and equity markets is indeed necessary to protect the interest of lenders and investors, allow unlimited participation for qualified investors or professional participants
- h) Depending on the primary aim a country looks to attain, crowdfunding may be successfully used to circumvent the cumbersome crediting with already existent entities (banks, credit institutions etc.) and mobilise funds particularly for innovative start-ups and innovative SMEs. As the study has shown, some jurisdictions direct crowdfunding to these forms of equity purchasing, supporting generally SMEs or particularly innovative start-ups and innovative SMEs. The limitation of forms of activity of equity-based crowdfunding to SMEs or to other identifiable transferrable securities must be accompanied by clear bylaws which clarify the criteria to be used to qualify as an innovative start-up or SME.

Particularly important for a jurisdiction which considers boosting up a crowdfunding market is to assess its current level of international commitments, including harmonisation of national legislation to the EU Acquis, available either under an Association Agreement or other internationally agreed documents.

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2. Mobilising new forms of finance for sustainable development: *Crowdfunding as a channel for transferring resources from transnational communities for their countries of origin*, International Organisation for Migration, Michaela Vanore, Vienna, March 2016
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8. Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and to the Committee of the Regions COM(2014) 172 final: Unleashing the potential of crowdfunding in the European Union, Brussels, March 2014, available at: http://eur-lex.europa.eu/resource.html?uri=cellar:3e0b89b3-b6eb-11e3-86f9-01aa75ed71a1.0002.01/DOC_1&format=PDF

EU legislation:

Alternative Investment Fund Managers:

9. Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010

Anti-money laundering:

10. Directive 2015/849 of the European Parliament and of the Council on the prevention of the use of financial system for the purposes of money laundering or terrorist financing, amending Regulation (EU) No 648/2012 of the European Parliament and of the Council, and repealing Directive 2005/60/EC of the European Parliament and of the Council and Commission Directive 2006/70/EC

11. Directive 2005/60/EC of the European Parliament and of the Council on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing
12. Commission Directive 2006/70/EC laying down implementing measures for Directive 2005/60/EC of the European Parliament and of the Council as regards the definition of 'politically exposed person' and the technical criteria for simplified customer due diligence procedures and for exemption on grounds of a financial activity conducted on an occasional or very limited basis

Personal data protection:

13. Directive 95/46/EC on the protection of individuals with regard to the processing of personal data and on the free movement of such data
14. Regulation 2016/679 on the protection of natural persons with regard to the processing of personal data and on the free movement of such data, and repealing Directive 95/46/EC (General Data Protection Regulation)

Consumer protection:

15. Directive 2011/83/EU of the European Parliament and of the Council on consumer rights, amending Council Directive 93/13/EEC and Directive 1999/44/EC of the European Parliament and of the Council and repealing Council Directive 85/577/EEC and Directive 97/7/EC of the European Parliament and of the Council
16. Directive 2008/48/EC of the European Parliament and of the Council on credit agreements for consumers and repealing Council Directive 87/102/EEC
17. Directive 2005/29/EC concerning unfair business-to-consumer commercial practices in the internal market and amending Council Directive 84/450/EEC, Directives 97/7/EC, 98/27/EC and 2002/65/EC of the European Parliament and of the Council and Regulation (EC) No 2006/2004 of the European Parliament and of the Council
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19. Council Directive 93/13/EEC on unfair terms in consumer contracts

Payment service providers:

20. Directive 2007/64/EC of the European Parliament and of the Council on payment services in the internal market amending Directives 97/7/EC, 2002/65/EC, 2005/60/EC and 2006/48/EC and repealing Directive 97/5/EC

Financial instruments, credit institutions, investment firms:

21. Directive 2004/39/EC of the European Parliament and of the Council on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC
22. Directive 2013/36/EU of the European Parliament and of the Council on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC

Prospectus requirements:

23. Directive 2003/71/EC of the European Parliament and of the Council on the prospectus to be published when securities are offered to the public or admitted to trading and amending Directive 2001/34/EC