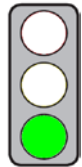


## KEY ISSUES

**Objective of the Communication:** The Commission wants to facilitate project financing via the internet ("crowdfunding").

**Affected parties:** Companies, entrepreneurs and private individuals in need of finance, financial backers, crowdfunding platforms.



**Pro:** (1) Crowdfunding promotes both competition on the funding market and innovations in all areas of the economy.

(2) The Commission seeks to clarify the legislation applicable to crowdfunding.

**Contra:** –

## CONTENT

### Title

**Communication COM(2014) 172** of 27 March 2014: **Unleashing the potential of Crowdfunding** in the European Union

### Brief Summary

#### ► Definition and context

- "Crowdfunding" is a call to the public to raise funds for a specific project (p. 2). This call is generally made via crowdfunding platforms on the internet.
- Up to now, there have been the following forms of crowdfunding (p. 3):
  - Crowdfunding with no expectation of financial return:
    - Backers provide donations ("donation-based crowdfunding").
    - Backers receive a symbolic reward ("rewards-based crowdfunding") or a product which has been produced with their funds ("pre-sales crowdfunding").
  - Crowdfunding with expectation of financial return:
    - Backers receive a share in profits, shares or "securities" ("crowdinvesting").
    - Backers are repaid their capital on specified terms and generally with interest ("crowdlending").
- The Commission refers to industry figures which state that in 2012 in Europe, crowdfunding raised approx. € 735 million and that € 1 billion is expected for 2013 (p. 2).
- Between October and December 2013, the Commission held a consultation on crowdfunding.

#### ► Objective and content of the Communication

- The Commission's objective is to facilitate crowdfunding (p. 4).
- The Commission
  - explains the advantages of crowdfunding (p. 4-5)
  - highlights the need for action in the areas of legal uncertainty, internal market, financial system, confidence and interaction with public financing (p. 5-11), and
  - sets out its future action (p. 11-12).

#### ► Advantages of crowdfunding

- According to the Commission, crowdfunding can (p. 4-6)
- facilitate access to start-up financing particularly for small and medium-sized enterprises (SMEs) and thereby promote innovation, research and development,
  - reduce financing costs and the administrative burden particularly for SMEs,
  - represent an additional tool for market analysis such as market testing for a new product, and
  - promote "a culture of entrepreneurship" since the backers have a choice over which project to invest in and more contact with companies.

#### ► Legal uncertainty

- According to the Commission, there is uncertainty about which legislation is applicable to crowdfunding (p. 6).

- Depending on the actual business model, the following Directives may be relevant to all types of crowdfunding (p. 6):
  - Directive on electronic commerce (2000/31/EC),
  - Directive concerning misleading and comparative advertising (2006/114/EC),
  - Directive on unfair commercial practices (2005/29/EC),
  - Directive on unfair contract terms (93/13/EEC),
- For crowdfunding with expectation of financial return, depending on the actual business model, the following provisions may also be relevant (p. 7):
  - Prospectus Directive (2003/71/EC; see [cepPolicyBrief](#)),
  - Payment Services Directive (2007/64/EC, PSD I; see [cepPolicyBrief](#)),
  - Directive on markets in financial instruments (2004/39/EC, MiFID I) [or rather, since 2 July 2014, its successor: MiFID II (Directive 2014/65/EU; see [cepPolicyBrief](#)) and MiFIR [Regulation (EU) No. 600/2014; see [cepPolicyBrief](#)],
  - Directive on access to the activity of credit institutions (2013/36/EU, CRD IV; see [cepPolicyBrief](#)) and Regulation on prudential requirements for credit institutions [(EU) No. 575/2013, CRR; see [cepPolicyBrief](#)],
  - Directive on alternative investment fund managers (2011/61/EU, AIFMD),
  - Consumer Credit Directive (2008/48/EC),
  - Distance Marketing Directive (2002/65/EC),
  - Regulation on European venture capital funds (EU) No. 345/2013 and
  - Regulation on social entrepreneurship funds (EU) No. 346/2013.
- Some Member States are trying to create a framework for crowdfunding with financial return by way of guidelines or regulatory action (p. 7). "Without prejudging" how best to strike the right balance between promotion of crowdfunding and investor protection, national regulatory action may increase legal uncertainty still further (p. 8).

#### ► Internal market

- 81% of crowdfunding platforms offering no expectation of financial return, who took part in the consultation, already operate cross-border whereas only 38% of crowdfunding platforms with expectation of financial return do (p. 8).
- 44% of crowdfunding platforms with expectation of financial return claim the lack of information about applicable rules prevents them from operating cross-border. For 27%, the high cost of getting an authorisation in another Member State is an obstacle. (p. 8).

#### ► Financial system

- The Commission classifies crowdfunding as an alternative form of financing that can complement traditional forms of financing (p. 9).
- A quarter of the "established banks" who took part in the consultation are interested in crowdfunding. The Commission therefore believes there is a possibility that the involvement of "regulated financial institutions" will increase trust in crowdfunding platforms. On the other hand, it fears that the costs of crowdfunding will increase and competition between traditional and alternative "actors in the financing sphere" will decrease. (p. 9)

#### ► Confidence

- According to the Commission, there is "still a lack of awareness about crowdfunding" in Europe (p. 10).
- In addition, a "good understanding of how crowdfunding works, what it can deliver and what the risks might be is [...] key". This is the only way to establish the confidence in crowdfunding that is necessary for sustainable growth. (p. 10)
- The Commission wants to enhance the "recognition" of platforms. Introducing a quality label may build confidence. (p. 10)

#### ► Interaction with public funding

- The Commission calls for thought to be given, at national and EU level, to using public funding in parallel to crowdfunding to provide financing "in duly justified cases where a market failure can be demonstrated" (p. 10).
- These could be co-investments by public and private backers, government loan guarantees for crowdlending transactions and payments made directly to crowdfunding platforms (p. 10).
- The new Guidelines on State aid to promote risk finance investments (2014/C 19/04) "extend the scope of eligible undertakings by including SMEs, small midcaps and innovative midcaps" (p. 10).
- The provisions contained in these guidelines relating to alternative trading platforms, can, by analogy, apply to "certain types" of crowdfunding platforms (p. 10).

#### ► Future action by the Commission

- The Commission will regularly assess whether national and EU legislation on crowdfunding is appropriate and whether EU action is necessary. In particular, at the time of scheduled reviews of existing legislation, it will examine whether special provisions on crowdfunding with financial returns should be adopted. (p. 12)

- In 2014, it will commission a study to shed light on the role of crowdfunding in the financial system (p. 11). In addition, it has already commissioned a study on the impact which tax incentives for crowdfunding may have on research and development (p. 9 and 11).
- It will set up an expert group. This is to help in "raising awareness of crowdfunding", providing "information and training modules for project owners", promoting "the exchange of best practice" and identifying barriers to the development of crowdfunding (p. 11).
- The Commission will commission a study on self-regulation in the industry and explore the "potential" of a quality label (p. 11).
- It is considering adopting recommendations on crowdfunding in order to avoid "inconsistencies" in the national legislation and thereby promote the functioning of the internal market (p. 11).
- It will promote regulatory convergence at international level (p. 12).
- It will publish a progress report in 2015 (p. 12).

## Policy Context

In 2013, the Commission published the Green Paper on "Long-term financing in the European Economy" [COM(2013) 150, see [cepPolicyBrief](#)]. The aim was to promote a discussion on the provision of funds for long-term investments necessary for economic growth in the EU. It also referred to the promotion of "non-traditional" sources of funding such as crowdfunding. In March 2014, the Commission published the follow-up Communication [COM(2014) 168, see [cepPolicyBrief](#)], in which it sets out, inter alia, how it will facilitate access to funds for SMEs.

## Options for Influencing the Political Process

Directorate General:

DG Internal Market

# ASSESSMENT

## Economic Impact Assessment

### Ordoliberal Assessment

The Commission correctly recognises crowdfunding as an alternative source of funding in addition to the traditional financing possibilities such as bank loans.

**Crowdfunding promotes both competition on the funding market and innovations in all areas of the economy** because it enables, in particular, young companies and start-ups to get onto the "funding escalator" with low transaction costs and using new communication media. In addition, it allows small or "exotic" projects, in particular, to obtain finance which banks sometimes erroneously regard as unworthy of financing, although here too, there is certainly a risk that resources will be misallocated.

The current legal uncertainty as to which legislation applies to crowdfunding, whilst typical for innovative services offered on the internet, is a barrier to the potential of crowdfunding. **It is therefore necessary to establish clarity about the applicable** (Member State and EU) **provisions**. Since crowdfunding via the internet can, at minimal cost, activate backers from all Member States, there is also good reason for refraining from individual national rules. The planned mapping of existing national legislation by the Commission is the logical approach in this regard. **This must be followed by harmonised EU legislation**.

Although crowdfunding can, to a certain extent, be seen as an alternative to traditional bank funding, one cannot infer from this that crowdfunding backers (as lenders) or the crowdfunding platforms (as credit brokers) should be subject to the same regulation across the board as is sometimes demanded.

**The capital requirements** applicable to banks **are not appropriate, either for crowdfunding backers or crowdfunding platforms**. The vast majority of backers are neither banks nor insurance companies. Although they bear the whole risk of loss they do not have investors in need of protection. Crowdfunding platforms, as credit brokers, do not bear any credit risk themselves. They simply preselect projects which they offer to potential backers on their platform and broker loans or other investments. The backers bear the entire risk of any loss.

Crowdfunding platforms – like banks – operate as investment brokers. The regulation of brokerage by banks is aimed primarily at investor protection. This should be available for all brokerage channels. But the investor's need for protection – and thus the need for regulation, in the case of crowdfunding, differs from that applicable to banks in several respects. Although the typical crowdfunding backer only invests comparatively small sums of money, the investments are generally quite risky involving start-ups with no historical income data available for valuation. In addition, there is often no secondary market for the shares acquired so that, even in the event of a successful outcome, backers do not recover their initial investment until the end of the contractual investment period. This gives rise to a need for separate investor protection.

**For crowdfunding platforms** – in view of the difficulty of forecasting revenue and the high default risk of the investment – **duties of disclosure and documentation should be brought in above a specified minimum investment sum or specific level of complexity**. This is not necessary for small sums or a low level of complexity. There are, after all, exemptions to the disclosure and documentation obligations also for banks,

particularly in the case of simple products such as overnight money and fixed-term deposits. **In concrete terms, crowdfunding platforms should have to keep minutes of meetings and hand out prospectuses, provide objective and comprehensible information about the investment on their website and be liable in this regard for obvious errors.** The standard quality label put up for discussion by the Commission could serve as an indication of the necessary quality of this information.

## Legal Assessment

### Legislative Competency

The legal basis for EU measures to promote crowdfunding is provided by the internal market competence (Art. 114 TFEU) and by the competence to coordinate the legal and administrative provisions concerning the taking-up and pursuit of self-employed activities (Art. 53 (1) TFEU).

### Subsidiarity

Unproblematic due to the cross-border character of the internet.

### Proportionality with Respect to Member States

Dependent on the actual design of the measure.

### Compatibility with EU Law in other Respects

Dependent on the actual design of the measure.

### Impact on German Law

There have not yet been any special rules on crowdfunding in Germany. Depending on the actual business model, the following provisions under banking, capital market and commercial law may apply to crowdfunding with expectation of financial return.

The operator of a crowdinvesting platform providing financial services, basically requires a licence from the German Federal Financial Supervisory Authority (BaFin) [Section 32 German Banking Act (KWG)]. The licence requirement does not apply, however, if the platform operator only brokers specific investments such as e.g. participations between backers and providers and does not gain either title to or possession of the customers' money or shares (Section 2 (6), sentence 1, No. 8 e KWG). If operators have no licence under Section 32 KWG and are brokering investments, they need a licence from the competent authority [Section 34f Trade, Commerce and Industry Regulation Act (GewO)] which, depending on the Bundesland, will be the Chamber of Commerce (IHK), the Trade Licensing Office or the local authority. The conditions for this are "reliability", "orderly financial circumstances", professional indemnity insurance and successful completion of an examination of expertise by the Chamber of Commerce.

The operator of a crowdlending platform that brokers loan agreements and does not have a licence under Section 32 KWG, requires a licence from the competent authority pursuant to Section 34c GewO. For this the broker must be "reliable" and living under "orderly financial circumstances".

Providers of crowdfunding investments, dependent on the actual model, may be obliged to publish a prospectus [Section 6 Investment Products Act (VermAnlG), Section 3 (1) Securities Prospectus Act (WpPG)]. This obligation does not apply if, within the period of one year, shares sold do not exceed € 100,000 (Section 2 No. 3 b VermAnlG, § 3 (2) No. 5 WpPG).

Under the competent Ministers' draft bill to amend the VermAnlG, its scope is to be extended and in future will also cover participating loans, subordinated loans and other investments with rights to interest, repayment or cash settlement. Investor protection will also be increased, in particular, by banning asset investments which can give rise to an additional funding commitment (Section 5b VermAnlG as amended). These will continue to be allowed, however, if within the period of one year shares sold do not exceed € 100,000 (Section 2 (1) No. 3 b VermAnlG as amended).

Crowdinvesting by way of participating loans and subordinated loans will be exempt from some of the provisions of the VermAnlG. In particular, the prospectus obligation will not apply if the total amount to be generated does not exceed € 1 million and the investment of each investor does not exceed € 10,000. (Art. 2 (2) VermAnlG as amended)

## Conclusion

Crowdfunding promotes both competition on the funding market and innovations in all areas of the economy. Due to the cross-border nature of the internet, clarity is required about the legislative provisions applicable to crowdfunding. This must be followed by harmonised EU legislation. Capital requirements are not generally necessary for crowdfunding backers or crowdfunding platforms. Above a specified minimum investment sum or level of complexity, crowdfunding platforms should have to keep minutes of meetings, hand out prospectuses and provide objective and comprehensible information about the investment on their website, as well as being liable in this regard for obvious errors.