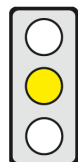


KEY ISSUES

Objective of the Regulation: The Commission wants to facilitate the scaling up of crowdfunding services in the internal market.

Affected parties: Crowdfunding service providers and their users.



Pro: (1) The establishment of an EU crowdfunding framework in the form of an optional 29th regime makes it easier for crowdfunding service providers (CSPs) to be active on a cross-border basis.

(2) The regulation opens the door for productive regulatory competition between the 29th regime and the national rules.

Contra: (1) The Regulation cannot be based on Art. 114 TFEU.

(2) Investors have to be properly informed about whether they are dealing with a European Crowdfunding Service Provider (ECSP) or with a CSP. An obligation for both ECSPs and CSPs to provide information about their status and the applicable investor protection rules needs to be introduced.

The most important passages in the text are indicated by a line in the margin.

CONTENT

Title

Proposal COM(2018) 113 of 8 March 2018 for a **Regulation** of the European Parliament and of the Council **on European Crowdfunding Service Providers (ECSP) for Business**

Brief Summary

► Definitions, context and objectives

- “Crowdfunding” is a call to the public to raise funds for a specific project. This call is generally made via crowdfunding platforms on the internet. Crowdfunding is increasingly used as an alternative to unsecured bank lending, especially by start-ups and early stage companies. [p. 1 and 2]
- Crowdfunding usually involves three types of market actors [Recital 3, Art. 3 (1) (c), (f), (g)]:
 - a “project owner” in need of funds for his project,
 - “investors” who provide funds for the said project and
 - a “crowdfunding service provider” (CSP) operating an online platform on which project owners and investors can connect with each other (“crowdfunding platform”).
- Crowdfunding in the EU is currently concentrated in a few Member States – especially the UK and to a smaller extent in France and Germany – and is domestically oriented.
- The regulation aims to facilitate “the scaling up of crowdfunding services in the internal market” through [p. 2]:
 - lending-based crowdfunding platforms, that facilitate the granting of loans between investors and project owners [Recital 10, Art. 3 (1) (a) (i)].
 - investment-based crowdfunding platforms, that [Recital 11, Art. 3 (1) (a) (ii)]
 - place transferable securities – e.g. shares and bonds – issued by project owners, without “firm commitment” – i.e. the platforms sell the securities for and on behalf of the project owner – and
 - receive and transmit client orders with regard to those securities.

► Scope

- Crowdfunding service providers (CSPs) that provide lending- and/or investment-based crowdfunding platforms may apply for authorisation as “European Crowdfunding Service Providers” (ECSPs) [Art. 2 (1), Art. 3 (1) (a), Art. 10]. In this case, they will be subject to the Regulation.
- CSPs may also choose to operate their crowdfunding platforms under national law. In this case, the Regulation does not apply. [Art. 2 (2) (c)]
- The Regulation does not apply, if
 - crowdfunding offers exceed € 1 million for a given project calculated over a 12-month period [Art. 2 (2) (d)],
 - the project owner is a consumer [Art. 2 (2) (a)] or the CSP is an authorised investment firm [Art. 2 (2) (b)].

► Authorisation and supervision of ECSPs

- The European Securities and Markets Authority (ESMA) is in charge of authorising ECSPs [Art. 10 (1)].
- It may do so only for platforms with an “effective and stable establishment in the EU” [Art. 4(1)], whose management [Art. 10 (1–3)]
 - is of sufficiently good repute,

- has a clean criminal record with respect to convictions or penalties of national insolvency law, financial services and anti-money laundering legislation, and
- is able to prove sufficient knowledge, skills and experience.
- The authorisation is valid in all EU Member States (“EU-Passport”) [Art. 10 (8)].
- The host Member State cannot require an ECSP, which is established in another Member State, to have a “physical presence” within its jurisdiction [Art. 10 (9)].
- ECSPs must comply with the obligations provided for in this Regulation. ESMA is responsible for supervising ECSPs. [Art. 12 (1–3)]
- ▶ **Organisational and operational requirements for ECSPs**
 - ECSPs must act “honestly, fairly and professionally” and in the best interests of their clients [Art. 4 (2)].
 - ECSPs are not allowed to pay or receive any “remuneration, discount or non-monetary benefit” for directing investors to specific crowdfunding offers [Art. 4 (3)].
 - ECSPs must have effective rules to prevent conflicts of interest and have to take “all appropriate steps” to prevent, identify, manage and disclose them. If deemed necessary by ECSPs, (potential) clients must be informed about the “general nature and sources” of the conflicts of interest and about the steps ECSPs take to mitigate conflicts of interest. [Art. 7 (3–5)]
 - ECSPs may provide asset safekeeping. They may also provide payment services and hold clients’ funds. [Art. 9]
 - If so, they must inform their clients about these services and about whether they carry them out themselves or outsource them to a third party.
 - ECSPs or respective third parties may only provide payment services or hold clients’ funds if [Art. 9 (1) and (2)]
 - the holding of funds is necessary to provide payment services which are connected to their crowdfunding business, and
 - they are authorised as payment service providers.
 - Otherwise, ECSPs must ensure that project owners only receive funds or payments from payment service providers [Art. 9 (4)].
- ▶ **Transparency and information requirements for ECSPs**
 - Information from ECSPs, including marketing communications to potential clients, inter alia, about [Art. 14]
 - themselves,
 - costs and charges and crowdfunding conditions, and
 - the nature and risks of their crowdfunding services.
 - must be “clear, comprehensible, complete and correct”.
 - ECSPs must provide (potential) investors with a “key investment information sheet” of a maximum of six pages for each crowdfunding offer [Art. 16 (1) and (3)]. It must be
 - drawn up by the project owner [Art. 16 (1)] and
 - contain, inter alia, information about the project owner, the crowdfunding project, risk factors, investor rights as well as an explanatory statement and a risk warning expressly mentioning the possible risk of losses of the money invested [Art. 16 (2), Annex].
 - The information sheet does not require ex ante notification or approval by the competent national authorities [Art. 16 (8)].
 - ECSPs have to check the “completeness and the clarity of information” in the key investment information sheet. They are not allowed to make a crowdfunding offer available to investors as long as significant omissions, mistakes or inaccuracies in the information sheet, although signalled by ECSPs, have not been corrected by the project owner. [Art. 16 (5) and 6)]
- ▶ **Entry knowledge test and loss-bearing simulation**
 - Before an investor can access the crowdfunding platform of an ECSP, the ECSP has to assess the profile of the investor through an “entry knowledge test” in which the ECSP must ask the investor in particular about [Art. 15]
 - his past investments in transferable securities and loan agreements and
 - his knowledge and professional experience with respect to crowdfunding investments.
 - The entry knowledge test must be repeated every second year (Art. 15 (3)).
 - If investors either fail to provide enough information about themselves or lack the necessary knowledge, ECSPs must “inform” them that the offer “may be inappropriate” for them and give them a “risk warning”. Investors may nevertheless invest on the platform of the ECSP. [Art. 15 (4)]
 - ECSPs must provide investors with a tool enabling them to simulate their ability to bear losses – amounting to 10% of their net wealth – based e.g. on information about their income and assets [Art. 15 (5)].
- ▶ **Marketing communications**
 - Marketing communications to investors must be “clearly identifiable as such” [Art. 19 (1)]. They are not allowed to include information about planned or pending crowdfunding projects [Art. 19 (2)]. They do not require ex ante notification or approval by the competent national authorities [Art. 19 (4)].

- National laws, regulations and administrative provisions may apply to marketing communications. They must be published by the national competent authorities and ESMA must be notified of them [Art. 20 (1) and (2)]. ESMA must publish summaries of them on its website [Art. 20 (4)].
- National competent authorities must report to ESMA at least once a year about enforcement actions they have taken with respect to marketing communications [Art. 20 (7)].

► Trading on ECSPs platforms

ECSPs may offer investors the possibility of interacting directly with each other to buy and sell loan agreements or transferable securities of projects that have already been crowdfunded. In this case, however, the ECSP must clarify that investors act based on their “own discretion and responsibility” and that the ECSP platform is not a “trading system” as defined in MiFID II [Directive 2014/65/EU]. If reference prices are suggested by an ECSP, they are non-binding and must be substantiated by the ECSP. [Art. 17]

Policy Context

This regulation is part of the Commission's agenda to establish a Capital Market Union (CMU) [see [cepPolicyBrief](#)]. Crowdfunding regulation was also addressed by the Commission in its FinTech Action Plan [COM(2018) 109, see [cepPolicyBrief](#)].

Statement on Subsidiarity by the Commission

Member States have taken various approaches in regulating crowdfunding activities in the past. According to the Commission, increasing differences between national regimes constitute a major hurdle for platforms and prevent them from going cross-border. A common EU framework allowing ECSPs to passport crowdfunding activities within the internal market would increase competition and allow smaller Member States to seize the benefits of this alternative funding mechanism.

Legislative Procedure

8 March 2018	Adoption by the Commission
Open	Adoption by the European Parliament and the Council, publication in the Official Journal, entry into force

Options for Influencing the Political Process

Directorates General:	Directorate-General for Financial Stability, Financial Services and Capital Markets Union (DG FISMA)
Committees of the European Parliament:	Economic and Monetary Affairs (leading), Rapporteur: Ashley Fox (ECR, UK)
Federal Germany Ministries:	Finance (leading)
Committees of the German Bundestag:	Finance (leading)
Decision-making mode in the Council:	Qualified majority (acceptance by 55% of Member States which make up 65% of the EU population)

Formalities

Competence:	Regulation: Art. 114 TFEU (Internal Market)
Type of legislative competence:	Shared competence (Art. 4 (2) TFEU)
Procedure:	Art. 294 TFEU (ordinary legislative procedure)

ASSESSMENT

Economic Impact Assessment

The establishment of an EU crowdfunding framework in the form of an optional 29th regime – CSPs may choose either to opt for the EU framework or to stick to national crowdfunding rules – **makes it easier for CSPs that offer lending- and/or investment-based crowdfunding services to be active on a cross-border basis**. The EU regime allows for EU-wide activity with only one request for authorisation and only one set of common organisational or investor protection rules, except for those on marketing communications, which remain partially national.

Thus, for CSPs that opt for the EU regime, market-entry barriers are removed and economies of scale may be realised. This offers advantages to investors as well as to project owners: for investors, ECSPs are more likely to offer access to projects from different Member States, increasing choice and allowing for a diversification of investments. At the same time, investors will also profit from a homogenous level of investor protection, irrespective of the location of the project invested in. As for project owners, ECSPs may provide access to a large pool of investors, which could lower their financing costs.

The regulation opens the door for productive regulatory competition between the 29th regime and the national rules.

It remains to be seen, who will “win” this competition. If market actors prefer the EU regime to current national regimes, the former will prevail and national regimes will become less important. On the other hand, market actors may prefer existing national regimes, e.g. where they offer more favourable investor protection or less restrictive remuneration rules for project owners. **However, for this regulatory competition to function, investors and project owners must be able to make informed decisions. They have to be properly informed about whether they are dealing with an ECSP following EU rules or with a CSP following national rules.** Otherwise, retail investors in particular may fail to realise that the level of investor protection could vary, even within one Member State and even for the same project. Consequently, **an obligation for both ECSPs and CSPs to provide information, about their status and the applicable investor protection rules, needs to be introduced into the regulation.**

Making ESMA the responsible authority for authorising and supervising ECSPs is doubly flawed. First, it means that crowdfunding platforms will have to cope with different authorities depending on the size of their offers: below € 1 million, ESMA; above € 1 million, national authorities, since here the regulation does not apply. Second, credit-based crowdfunding, at least, is closely linked to the banking business, therefore an authority with expertise in banking business would be a more suitable authority than ESMA. For both reasons, national authorities should be competent for authorising and supervising ECSPs.

The inclusion of both credit-based and investment-based crowdfunding platforms within one EU regime is appropriate as it offers both types access to an EU passport. However, the investor protection rules should differ as investment-based crowdfunding is perceived as more risky than lending-based crowdfunding because returns on investment are less predictable than interest on loans.

Investors need reliable information about project owners and projects. Crowdfunding platforms have an interest in collecting such information from project owners and passing it on to investors because, otherwise, their business model might collapse. The need for prescriptive transparency and information requirements is thus reduced.

Crowdfunding investments are typically more risky than investments in established firms as e.g. little or no information about the company’s business history is yet available. Entry-knowledge tests and loss-bearing simulations are thus reasonable as long as investors are not forced to abstain from any investments. Professional investors, on the other hand, should be able to abstain from any investor protection safeguards.

Legal Assessment

Legislative Competence

Art. 114 TFEU cannot be considered an appropriate legal basis for the proposed regulation.

However broad the discretion granted to the EU legislature for identifying the most appropriate method of approximation [Germany v. Parliament and Council, C-380/03, para. 42], a measure will only be “of approximation” under Article 114 TFEU if it is fit to harmonise. “Harmonising” means moulding national legal systems in such a way as to eliminate the obstacles to the exercise of fundamental freedoms, or to remove appreciable distortions of competition. Producing a modification of national law is therefore an essential element of harmonisation and, consequently, a condition for the legitimate use of Article 114 TFEU as a legal basis, as confirmed by the CJEU in the SCE judgement [Case C-436/03, para. 44]. Arguing otherwise would make it impossible to distinguish the power to harmonise (which the EU has) from the power to regulate the common market (which has never been conferred in its entirety on the EU). In the light of the above, a piece of legislation setting forth a regulatory regime intended to be sealed off from, and unconnected to, national law, cannot be validly based on Art. 114 TFEU. This is, however, the case here, as the proposed Regulation offers a radical alternative to national law, whilst the latter remains unchanged [Art. 2 (c)].

Subsidiarity.

Unproblematic.

Proportionality with respect to Member States

Unproblematic.

Compatibility with EU Law in other Respects

Unproblematic.

Conclusion

Art. 114 TFEU cannot be considered an appropriate legal basis for the regulation. The establishment of an EU crowdfunding framework in the form of an optional 29th regime makes it easier for CSPs that offer lending- and/or investment-based crowdfunding services to be active on a cross-border basis. The regulation opens the door for productive regulatory competition between the 29th regime and the national rules. However, for this competition to function, investors have to be properly informed about whether they are dealing with an ECSP or with a CSP. An obligation for both ECSPs and CSPs to provide information about their status and the applicable investor protection rules needs to be introduced.