Briefing

March 2018

Cross-Border Crowdfunding: *Commission proposes 'opt-in' regulatory regime*

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An opt-in regulatory regime for crowdfunding platforms that want to operate on a cross-border basis has been proposed by the European Commission.

As mentioned in our January 2018 Crowdfunding Update, the Commission had signalled its plan to publish a proposal to address the potential regulation of crowdfunding.

The Commission published its proposal on 8 March 2018.

The Commission had considered four options:

» no EU regulatory framework;

» a non-binding regime;

» an EU regulatory framework;

» an opt-in framework for cross-border platforms.

The Commission selected the fourth option.

The draft Regulation provides for an opt-in regulatory regime for crowdfunding platforms (which match borrowers with potential lenders, or which match businesses with potential investors) that want to operate on a cross-border basis across the EU. Those platforms are referred to, in the Commission's proposal, as *'crowdfunding service providers'*.

KEY ASPECTS OF THE PROPOSAL

» There will be uniform rules at EU level, but crowdfunding service providers (**CSPs**) can instead opt to provide their services on a domestic basis under national law.

» If a CSP applies for EU-level authorisation, it will be able to passport its services into other EU Member States.

» If a CSP is authorised at EU-level, it will not need to comply with national rules.

The draft Regulation covers the operation, organisation, authorisation and supervision of CSPs. It also deals with transparency and marketing.

WHO IS IN-SCOPE?

The proposal applies to CSPs that are legal persons, involved in either:

- peer-to-peer business lending where the investor has an expectation of financial return (i.e. that the loan is repaid with interest); or
- the *'investment'* crowdfunding model, where investors receive shares or bonds in return for their investment.

WHO IS OUT-OF-SCOPE?

The proposal does not apply to:

- crowdfunding services provided by MiFID investment firms;
- crowdfunding offers where the consideration exceeds €1 million per offer, calculated over a 12 month period;
- peer-to-peer consumer lending (on the basis that consumer investors already benefit from the protections afforded by the Consumer Credit Directive and the Mortgage Credit Directive);
- *'donation'* or *'reward-based'* crowdfunding (as this does not involve an expectation of financial return).

WHO WILL REGULATE CSPs?

The Commission has proposed that CSPs be authorised and supervised by ESMA, and that ESMA maintain a public register of authorised CSPs.

MANAGEMENT OF CSPs

The draft Regulation proposes that CSPs:

- put policies and procedures in place to ensure effective and prudent management, and business continuity;
- put complaint-handling procedures in place;
- ensure that reasonable steps are taken to avoid additional operational risk if they plan to outsource some of their functions; and
- hold client funds in accordance with specific requirements.

National competent authorities will be required to notify ESMA of any potential money laundering issues involving a CSP.

HOW WILL INVESTORS BE PROTECTED?

- *Conduct of business:* CSPs will be required:
  - to obtain the best result possible for their clients where they are able to exercise discretion when carrying out client orders;
  - to avoid and prevent conflicts of interest;
  - not to accept inducements;
  - to provide potential investors with a Key Investment Information Sheet, containing prescribed information about the offer, and containing various risk warnings;
  - to enable investors to simulate their ability to bear losses, based on certain information; and
  - to include specific information and disclaimers on their websites.
- *Knowledge tests:* Potential investors will need to take a knowledge test before investing, to assess their understanding of financial products.
- *Payments:* All payments will need to be processed via an authorised payment services provider.

COMMENT

The Department of Finance had decided not to introduce Irish legislation on the regulation of crowdfunding for the time being, and to instead monitor the Commission's proposal and implement it into Irish law.

The shape of the draft Regulation may change as it moves through the EU legislative process however, the initial draft does appear to envisage a proportionate framework (albeit that the cost to a CSP of EU regulation is not yet clear). Now that the Commission has confirmed which regulatory framework it favours for cross-border crowdfunding, it will be interesting to see what framework the Department of Finance will choose for purely domestic crowdfunding.

Ireland is an attractive location for crowdfunding platforms and for peer-to-peer lending more generally, so the crowdfunding industry here should not fear the proposed regulatory regime. The enhanced investor confidence, and the ability to operate on a cross-border basis, should result in continued growth. Ireland is also well positioned to act as a crowdfunding hub and to benefit from a passporting regime, particularly in a post-Brexit environment.

We will publish further updates and analysis as the proposal progresses.

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