Briefing

EU Legislation in Progress

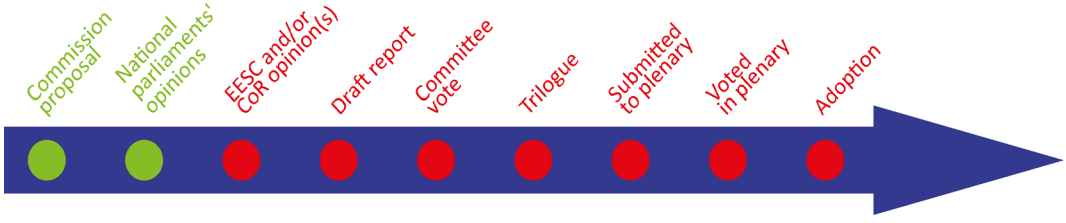
European Parliament

CONTENTS

Establishing a basis for European crowdfunding service providers

Crowdfunding, an open call to the wider public for raising money online, can help ensure that both individuals and companies get access to finance, especially in the seed and early growth stages of their projects or business. Member States with a developed crowdfunding market have designed bespoke regulatory regimes that differ from each other with regard to the conditions under which platforms can operate, their scope of permitted activities and the licensing requirements applicable to them. As a result of this diversity, cross-border flows remain limited and crowdfunding service providers face challenges in scaling up their operations. To remedy this, the Commission has proposed a regulation providing for uniform, proportionate and directly applicable requirements for the authorisation and supervision of crowdfunding platforms, together with a single point of supervision, and a directive exempting crowdfunding service providers from the scope of MiFID II.

Proposal for a Regulation of the European Parliament and of the Council on European Crowdfunding Service Providers for Business **Proposal for a Directive of the European Parliament and of the Council amending Directive 2014/65/EU on markets in financial instruments**	
COM(2018) 99, COM(2018) 113, 8.3.2018, 2018/0047(COD), 2018/0048(COD), Ordinary legislative procedure (COD) (Parliament and Council on equal footing – formerly 'co-decision')	
Committee responsible:	Economic and Monetary Affairs (ECON)
Rapporteur:	Not yet appointed
Shadow rapporteurs:	Not yet appointed
Next steps expected:	Initial consideration in committee



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First edition

The 'EU Legislation in Progress' briefings are updated at key stages throughout the legislative procedure.

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Introduction

A company can be financed internally or externally. Internal financing is done through owners' own contributions or through reinvesting the company's retained earnings. External financing can take various forms, such as loans from banks, investments from 'business angels' or venture capitalists, or funds raised through crowdfunding campaigns.

According to a recent European Central Bank survey on the access to finance of enterprises in the euro area, external financing (mainly short- and long-term bank-related products) remains the main source of financing for small and medium-sized enterprises (SMEs), which use it mainly for fixed investments and inventory.[1] Even though bank financing has become more available across firm sizes and countries in recent years, and banks' willingness to provide credit to SMEs has continued to increase, many SMEs that are either in the start-up phase or are seeking further expansion still find it challenging to secure investment finance. Crowdfunding represents a viable option for ensuring them access to such finance.

The impact assessment accompanying the European Commission's two proposals – for a regulation on crowdfunding platforms and for a directive amending Directive 2014/65/EU on markets in financial instruments (MiFID II) – defines the basic function of **crowdfunding** as an open call for the collection of resources (funds, money, tangible goods or time) from the population at large through an internet platform. In return for their contribution, people can receive a number of tangible or intangible rewards depending on the type of crowdfunding. Crowdfunding generally takes place on online platforms that link fundraisers to funders.

Crowdfunding campaigns can raise funds for both not-for-profit and for-profit projects or organisations. Consulting agency Massolution has developed one of the most commonly used classifications (also used by the Commission in its work) at present, which distinguishes between four categories of campaigns:

> donation-based, where people do not receive any reward for their contributions (although depending on the project and the jurisdiction, they can be entitled to tax deductions);

> reward-based, where people receive goods or services in exchange for their contributions;

> lending-based, where people receive interest payments in exchange for financing a project, with an associated rate of return and maturity date;

> equity-based, where people receive shares in the venture, in exchange for their contributions.

The International Organization of Securities Commissions (IOSCO) refers to the first two categories as 'crowd sponsoring' and to the latter two as 'crowd investing'. The Commission proposals relate to crowd investing.

1 Despite recent initiatives under the capital markets union, the EU system remains predominantly bank-centered, contrary to the US one. This results in fewer opportunities for securing financing for companies going through the initial stages of development.

Existing situation

According to the Commission proposals, some Member States have already introduced their own crowdfunding regimes, each tailored to the domestic legal context and reflecting the needs of local markets and investors. This has resulted in differences in the way the rules on the operation of crowdfunding platforms, their scope of permitted activities and the licensing requirements applicable to them are designed and implemented. This, in turn, has rendered platform business models less easily 'passportable' across the EU. Given this regulatory diversity and high compliance costs, cross-border flows remain limited, and crowdfunding services providers face major challenges in scaling up their operations.

Parliament's starting position

In its resolution of 9 July 2015 on Building a capital markets union (CMU) (2015/2634(RSP)), the European Parliament stated that the CMU should create 'an appropriate regulatory environment that enhances cross-border access to information on the companies looking for credit, quasi-equity and equity structures, in order to promote growth of non-bank financing models, including crowdfunding and peer-to-peer lending'. In its resolution of 26 May 2016 on the Single Market Strategy (2015/2354(INI)), Parliament called on the Commission 'to make sure that crowdfunding can be done seamlessly across borders'. Furthermore, in its resolution of 15 September 2016 on How best to harness the job creation potential of small and medium-sized enterprises (2015/2320(INI)), Parliament called on the Commission to create a European framework regulation 'to facilitate the creation of pan-European crowd-funding and crowd investing markets'. Finally, in its resolution of 17 May 2017 on FinTech: the influence of technology on the future of the financial sector (2016/2243(INI)), Parliament noted that, while regulatory and supervisory authorities receive a lot of information from established financial institutions on the implementation of numerous regulatory frameworks ... 'in the case of non-banking lending entities in such cases as crowdfunding and Peer-to-Peer (P2P) it is difficult to obtain sufficient information on the financial intermediary activities of their balance sheets; therefore urges the regulatory and supervisory authorities to consider how they could obtain the appropriate supervisory information for maintaining financial stability'. Furthermore, Parliament called on the Commission to 'pay specific attention, in designing its FinTech action plan, to the needs of retail consumers and investors and the risks to which they might be vulnerable, in the light of growing expansion of FinTech in services to non-professional clients, for example in crowdfunding and peer-to-peer lending'.[2]

2 FinTech (short for financial technology) is a term that is mainly used to refer to companies that use technology-based systems either to provide financial services and products directly, or to try to make the financial system more efficient.

Proposal

Preparation of the proposal

The Commission has been monitoring crowdfunding market developments for some years. Two related documents – a communication from March 2014 and a staff working document from May 2016 – concluded that there was no strong case for EU-level policy intervention at that juncture. At the same time, the Commission committed to monitoring this market and, since then, has gathered significant evidence on barriers to cross-border activity and internal market development through stakeholder consultations and external studies.

The above-mentioned impact assessment concluded that EU crowdfunding markets for business finance are largely underdeveloped compared to their counterparts in other major economies and, most importantly, that they are unable to properly operate across borders. Due to fragmented and conflicting regulatory regimes, crowdfunding platforms are unable to scale up and freely provide their services on a pan-European level. Likewise, investors refrain from engaging across borders, due to a lack of trust in the platforms there and to the fact that the regulatory frameworks applicable to the services they provide are so fragmented. To address these problems, the impact assessment identified and examined several policy options, and selected from among them one involving the introduction of an EU label for crowdfunding service providers, which would be authorised and supervised at EU level under an EU regime. This option combines a flexible attitude towards business models (as national regimes would run in parallel to the EU label), with proportionate investor protection and organisational rules.

EPRS has conducted an initial appraisal of the Commission's impact assessment (IA) and concluded that it provides useful qualitative and quantitative information on the EU's developing crowdfunding sector. Furthermore, the initial appraisal found that the IA clearly identifies the main problems and develops specific, but not operational, objectives to tackle them. The assessment of the options could have been more specific and complete, for example regarding social or territorial implications. Moreover, an analysis of the effects on the main targets – SMEs and start-ups in particular – is missing. In the same vein, the concrete relevance of the UK's impending withdrawl from the EU for the Union's crowdfunding sector could have been explained in greater detail, taking into account the fact that the UK holds a very large share of the EU's crowdfunding market.

The initial appraisal noted that the IA remains general and brief as regards the supervision of the preferred option, in particular the power and competences of ESMA, which constitute an important part of the legislative proposal. It furthermore pointed out that the quantified estimates of the IA could have been presented in a more transparent and coherent manner. Finally, the appraisal highlighted the voluntary and proportionate character of the preferred option, which would affect only enterprises choosing to use it to increase their cross-border crowdfunding activities across the EU.

The changes the proposal would bring

The proposal for a regulation provides for uniform, proportionate and directly applicable requirements for authorisation and supervision, together with a single point of supervision.

Subject matter, scope and definitions (Chapter 1)

The proposed regulation establishes uniform requirements for the operation, organisation, authorisation and ongoing supervision of crowdfunding service providers (CSP), as well as for the transparency of, and marketing communications related to, crowdfunding services (Article 1). It applies to legal persons who choose to seek authorisation pursuant to Article 10 and to CSPs who have been authorised in accordance with that article. It does not apply to:

> crowdfunding services that are provided to project owners who are consumers;

> crowdfunding services that are provided by legal persons that have been authorised as investment firms in accordance with Article 7 of MiFID II;

> crowdfunding services that are provided by natural or legal persons that have been authorised for that purpose by national law;

> crowdfunding offers with a consideration of more than €1 million per offer, calculated over 12 months (Article 2).

Article 3 provides definitions for terms such as 'crowdfunding services', 'crowdfunding platform', and 'crowdfunding service provider'. It furthermore empowers the Commission to adopt delegated acts specifying further the technical elements of these definitions as a way to take into account market- or technology-related developments.

Provision of crowdfunding services and organisational and operational requirements of service providers (Chapter 2)

This chapter regulates the provision of crowdfunding services. Accordingly, it specifically identifies the persons eligible to provide such services, the way they should provide them and the potential use of special-purpose vehicles for the provision of such services (Article 4). It further obliges CSP management bodies to implement adequate policies and procedures for ensuring effective and prudent management (Article 5), as well as effective and transparent procedures for handling complaints (Article 6). With respect to conflicts of interest (Article 7), crowdfunding service providers:

> could not have any financial participation in any crowdfunding offer on their platforms;

> could not accept any manager, employee or any shareholder holding 20 % or more of the share capital or voting rights (or any person linked to the above-mentioned persons) as a client;

> would have to maintain and operate effective internal rules to prevent conflicts of interest, as well as to take appropriate steps to prevent, identify, manage and disclose conflicts of interest between themselves, their shareholders, managers and employees, and their clients, or between two clients.

When outsourcing operational functions, CSPs would have to take all reasonable steps to avoid additional operational risk and to ensure that the outsourcing does not impair materially either the quality of internal

control or the ability of the European Securities and Markets Authority (ESMA) to monitor the CSP's compliance with the obligations laid down in the regulation (Article 8).

The chapter closes with provisions regarding client-asset safekeeping (the obligation to inform clients about particular aspects related to this service), the holding of funds and the provision of payment services (Article 9).

Authorisation and supervision of crowdfunding service providers (Chapter 3)

Article 10 stipulates that any legal person intending to provide crowdfunding services must apply to ESMA for authorisation. The article further lists the contents of the application for authorisation (among other things, the address and legal status of the prospective provider, a description of its governance arrangements and business continuity arrangements, the identity of the managers and proof that they are of good repute[3]) and sets out procedures for granting and refusing applications for authorisation.

ESMA is tasked with supervising CSPs during their provision of services. In this role, it would have to assess their compliance with the obligations provided for in the regulation. Furthermore, CSPs would have to notify ESMA of any material changes to the conditions for authorisation (Article 12). In addition, ESMA would establish a register of all CSPs, which it would make publicly available on its website and update on a regular basis. It would have to publish any withdrawal of an authorisation in the register for a period of five years (Article 11). The situations in which ESMA would have the power to withdraw an authorisation are listed in Article 13. This article also provides that the national competent authorities (NCAs) would have to notify ESMA if a CSP or third-party provider acting on its behalf has lost its authorisation as a payment institution, or if a CSP or its managers, employees or third parties acting on its behalf have breached the national provisions implementing the Anti-Money-Laundering Directive.[4] Additionally, Article 13 provides that ESMA would have to notify the relevant Member State's NCA to which a CSP is accountable, in case it withdraws that CSP's authorisation.

Requirements for crowdfunding service providers to maintain transparency and to pass an entry knowledge test (Chapter 4)

Pursuant to Article 14, all information CSPs provide to clients (and to potential clients) about themselves, about the costs related to the services, and about the crowdfunding conditions or the nature and risks of their crowdfunding services, would have to be complete, clear and correct.

Article 15 provides that, before giving prospective investors access to their services, CSPs would have to assess whether and which services offered are appropriate for them. For that purpose, CSPs would have to request information about the clients' basic knowledge and understanding of risk in investing in general, and of the products offered in particular. Article 15 furthermore provides that, in case the clients do not provide adequate information or the CSPs consider that they have insufficient knowledge, they would

3 Insisting that CSP management bodies need to prove that they have a clean record in the relevant fields, possess sufficient knowledge, skills and experience to manage the CSP, and commit sufficient time to performing their tasks.
4 In those cases, the Commission proposal states that ESMA would withdraw the authorisation when it is of the opinion that the aforementioned facts affect the good repute of the CSP management or indicate a failure of the arrangements or mechanisms referred to in Article 5.

have to inform investors that the services they offer may be inappropriate for them, although this does not prevent investors from going ahead and investing.

Article 16 elaborates on the details, content, form and requirements related to the key investor information sheet (KIIS), and specifies that investors could ask the CSP to translate it. In case the CSP identifies a material omission, mistake or inaccuracy in the KIIS, it would have to complement or amend the information; otherwise, the CSP would not make (or cancel) the crowdfunding offer until the KIIS has been brought into compliance with the requirements of the article. Article 17 states that, in case CSPs allow investors to interact directly with each other, they would have to inform them that if they (in their capacity of clients) buy or sell loan agreements and transferable securities, this activity would be at their own discretion and responsibility. Lastly, CSPs would have to keep all records related to their services and transactions for five years, to ensure immediate access of their clients to those records at all times, and to maintain for five years all their agreements with clients.

Marketing communications (Chapter 5)

Article 19 sets detailed requirements for marketing communications. For instance, they would need to be clearly identifiable and to be drafted in one of the official languages of the Member State in which the CSP is active, or in a language customary in the sphere of international finance). Article 20 focuses on the national competent authorities. They would have to publish and maintain on their websites national laws, regulations and administrative provisions applicable to marketing communications of CSPs. They would further have to notify ESMA of these laws, regulations and administrative provisions, and of any changes to them. ESMA would have to publish and maintain on its website a summary of the relevant provisions and hyperlinks to the NCAs' websites.

Powers and competences of ESMA (Chapter 6)

This chapter sets out detailed provisions on ESMA's powers and competences with regard to the request for information (Article 22), general investigations (Article 23), on-site inspections at the business premises (Article 24), and the exchange of information between ESMA and the national competent authorities (Article 25).

It is however specified that the powers conferred on ESMA (or on persons authorised by ESMA), would not be used to require the disclosure of information that is subject to legal privilege (Article 21). Article 26 further provides that the obligation of professional secrecy (Article 76 of MiFID II) would apply to ESMA and to all of the persons working or having worked for ESMA, or for any other person to whom ESMA has delegated tasks.

Article 27 specifies the forms of action ESMA could take if it finds that a person listed in Article 22(1)(a) has committed one of the infringements listed in Chapters I to V. It specifies further that in taking such action, ESMA would have to take into account the nature and seriousness of the infringement. It finally stipulates that when ESMA takes action, it would have to inform the person responsible for the infringement and the NCA(s) of the Member State(s) concerned, and to publicly disclose its decision on its website. Furthermore, ESMA could impose fines (a maximum of 5 % of the annual turnover of the CSP) in particular situations

(listed in Article 28), or effective and proportionate periodic penalty payments,[5] for a maximum period of six months (Article 29). ESMA would have to disclose to the public every fine and periodic penalty payment that has been imposed pursuant to the aforementioned articles, unless such disclosure can seriously jeopardise the financial markets or cause disproportionate damage to the parties involved (Article 30). The procedural rules for taking supervisory measures and imposing fines are laid out in Article 31. Before taking any decision pursuant to the articles referred to in this paragraph, ESMA would have to give the persons subject to the proceedings the opportunity to be heard on its findings.

The Court of Justice of the EU would have unlimited jurisdiction to review decisions where ESMA has imposed a fine, a periodic penalty payment or any other sanction or administrative measure (Article 33).

ESMA would charge the CSPs fees to cover its expenditure relating to their authorisation and supervision. Those fees would be capped to an amount proportionate to the size of the CSPs' activities (Article 34).

Article 35 sets out the possibility for ESMA to delegate specific supervisory tasks to the Member States' competent authorities in accordance with the ESMA guidelines.

Delegated acts (Chapter 7)

The exercise of delegation with a view to adopting the Commission's delegated acts is covered in Chapter VII. The proposed regulation empowers the Commission to adopt delegated acts specifying certain details, requirements and arrangements as set out in its text.

Final provisions (Chapter 8)

Article 38 provides that, within two years after the regulation has started being applied, the Commission would consult ESMA and then present a report to the Parliament and the Council on the application of the regulation, accompanied where appropriate by a legislative proposal. The article further specifies the elements to be assessed by the report.

The changes the proposed directive would bring to MiFID II

In addition to the above, given the need to ensure a clear separation of services in order to manage conflicts of interest and ensure effective supervision, a person authorised as a CSP under the above-mentioned proposed regulation should not be authorised under MiFID II, and vice versa. In the interest of legal certainty and in order to avoid the application of requirements stemming from MiFID II to the provision of crowdfunding services, the Commission thus concluded that it is necessary to explicitly specify that MiFID II does not apply to persons authorised as CSPs as defined in the proposed regulation. To this end, Article 1 of the proposed directive modifies the scope of MiFID II by adding CSPs authorised under the proposed regulation to the list of exempted entities to which the scope of MiFID II does not apply.

5 According to the Commission proposal, the periodic penalty payments would amount to 3 % of the average daily turnover in the preceding business year, or, in the case of natural persons, to 2 % of the average daily income in the preceding calendar year.

Views

Advisory committees

Thus far, neither of the two advisory bodies to the EU – the EESC and the CoR – has adopted an opinion on the Commission's proposals.

National parliaments

The two proposals are currently being examined by the national parliaments of 14 Member States. None has submitted a reasoned opinion yet. The subsidiarity deadline was on 11 May for the proposed directive and 14 May 2018 for the proposed regulation.

Stakeholders' views[6]

On 19 March, the European Crowdfunding Network (ECN) published a statement in which it noted that, while it finds that the proposed regulation is balanced and specific in its current form and that its provisions would ensure a high degree of transparency, customer protection and efficiency in the way platforms operate, it is of the view that some aspects of the proposal could challenge the development of alternative financing and therefore be contrary to the stated objectives. To this end, it proposed a set of modifications or clarifications.

6 This section aims to provide a flavour of the debate and is not intended to be an exhaustive account of all different views on the proposal. Additional information can be found in related publications listed under the Section on 'EP supporting analysis'.

Legislative process

The legislative process is still at a very early stage. Within the Parliament, the Economic and Monetary Affairs Committee (ECON) has been entrusted with the file, while the Industry, Research and Energy Committee (ITRE), the Committee for Internal Market and Consumer Protection (IMCO) and the Committee on Legal Affairs (JURI) were asked for opinions. ITRE and JURI have since decided not to give an opinion. The ECON rapporteur and shadow rapporteurs are yet to be named. Within the Council, the working groups have not yet started working on the topic.

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