Crowdfunding: Untapping its potential, reducing the risks
European Commission Workshop, Brussels, 3 June 2013
Summary of discussion

This is an informal summary and does not represent the views of the European Commission. Not all comments/questions from the floor are noted here.

Commissioner Michel Barnier opened the workshop with his keynote speech, stating that the present workshop is to be seen in the context of the Commission's pro-active approach to find new, inclusive forms of growth and make financial markets work for the real economy. He referred to the potential of crowdfunding to finance projects that have difficulty accessing finance through traditional finance channels, to run a market testing, promote innovation – especially in the case of web entrepreneurs – and reinforce entrepreneurship and social cohesion in Europe. He recognised the diversity of crowdfunding models and called on speakers to explore its risks, its potential, and ways in which currently fragmented national frameworks could be made more coherent.

MEP Philippe De Backer in his keynote speech pointed out that the legal and regulatory framework surrounding crowdfunding was fragmented and called for a more harmonised approach at European and national levels. Mr De Backer emphasised that the diversity of different types of financing should be preserved, different models of crowdfunding should be allowed. He also referred to the risks of crowdfunding, among them the difficulty to carry out correct valuation and due diligence of projects, as well as the risks of project failure. He also pointed out that investor education was needed.

Ms Anna Maria Darmanin from the EESC proposed that EU and national authorities set up a code of ethics and good governance working together with industry. She also called for national authorities to set up favourable regulatory frameworks and share best practices. She proposed that crowdfunding should be eligible for co-financing under in EU funded projects, and suggested more communication on crowdfunding in general public language.

The first panel discussed the drivers of growth of crowdfunding and its limitations. Mr Saublens listed some of the main drives of growth: such as low transaction costs, market feedback (being advantages for entrepreneurs); the direct nature of the investment and interaction with entrepreneur (as advantages to crowd investors). Some of the risks mentioned were fraud, no proper delivery on promised products, limited exit options from the investment. Professor Belleflamme highlighted that smaller projects may be more suited for pre-sale, bigger projects for equity crowdfunding campaigns. He also pointed out that the more community benefits (i.e. a sense of creating a community with the crowd) a project can offer, the higher its chance for successful crowdfunding is.

Mr Koren referred to lack of awareness, the fragmented legislative framework and the relatively small size of platforms within Europe today. Mr Lampinen emphasised the diversity of actors and crowdfunding models and said this was necessary as different crowdfunding models are best fit for different types of projects. Crowdfunding is not only access to finance, but also access to a potential market. Europe is a big economy but legally fragmented, fostering cross-border development of crowdfunding platforms to achieve a more unified European market would be good. Mr Galveias warned about the risks of crowdfunding for investors, and pointed to the potential in angel investors co-investing in projects to send a signal to crowd investors about the quality of the project. Mr Peca thought the limitations to the growth of crowdfunding were regulatory aspects, such as the fragmentation of the rules on prospectus, the challenge of product valuation, fraud, money laundering, lack of exit. He explained that universities were attempting to crowdfund their research projects and raised the possibility of co-funding. He also explained the action taken by DG CNECT to support access to finance for web entrepreneurs.

The second panel discussed reward-based crowdfunding and the role of social media. Mr Vincent listed the advantages of reward-based crowdfunding: fundraising; raising awareness and building community; unleashing innovation. He pointed out that reward-based crowdfunding was much simpler than financial forms of crowdfunding and therefore contained lower and fewer risks.. Mr Vincent referred to nationally segmented payment providers, the fact that in UK there is no tax deductibility for reward-based crowdfunding, that there is 20% V AT on the transactions. Mr Boucherot recalled that contributors on average gave 50 Euros to projects. Reward based platform do not need special authorisation; the main issue is preventing money laundering. He explained that fraud was not a significant risk on his platform.

Ms Castrataro spoke about the impacts of social media on crowdfunding: it offers community engagement and crowd validation. Crowdfunding is the democratisation of financing and innovation. Intangible returns: recognition, collective returns are important. Social capital (number of interactions) and relationship capital (quality of interactions - reciprocity) both matter. Most immediate community has a crucial role in validating a project before the wider community contributes Social networks can identify and prevent fraud. Finally, Mr Caballero explained that his project chose crowdfunding for the advantages this offered to them in terms of market insight, market testing, access to funds, good exposure, fast results. He presented detailed analysis of his campaign and the relative return on various promotion activities. He described the follow-up steps his project would take in terms of transparency, accountability, engaging the community.

The third panel discussed equity- and lending-based crowdfunding. Mr Gajda emphasised the diversity of crowdfunding models, describing the main features of equity- and lending crowdfunding. He referred to its potential for innovation and the role financial literacy plays in investor protection. He said the existing legal regime was very complicated and hard to navigate in and called on regulators to step out of existing schemas.

Mr Dardier presented his company as being a broker dealer, operating an MTF, cooperating with a large crowdfunding platform, to build trust as a regulated actor. Trust is essential for the growth of crowdfunding, and the current regulatory framework is there to protect investors. Clearing & settlement and accreditation of companies as well as investors are the main points. But he also referred to discrepancies between national rules (e.g. prospectus rules).

Mr Silva said “nothing will make this industry die faster, he said, than investors not being protected”. The platform verifies whether listings are fair, clear, not misleading; it performs a simple appropriateness test with investors to make sure they understand the risks; it makes full disclosure of the risks; and act as nominee for all investors. He pointed out the significance of scale at a European level. Platform wants to expand in Europe, but lack of common regulatory framework and legal uncertainty is a barrier.

Mr Poissonnier stressed that for social business crowdfunding is one of the best ways to raise money. 20% of crowdfunding is dedicated to impact investing, His platform is a social lending platform (at no interest) dedicated to micro credit beneficiaries. It obtained an agreement to its activities in France, but Belgian and German authorities require it to have a banking license. We should have a common regulatory framework in Europe.

Mr Boillot introduced his firm as an investment firm that is among the top ten lenders of a US lending platform, looking to engage with European platforms in the future. Currently EU is at about one third of US P2P lending market. In Europe, platforms should do more credit analysis, credit scoring and interest rate setting in order to attract institutional investors. There is huge disparity in Europe on what information is available to a lender. Crowdfunding can be a great replacement for banks, but credit information is essential, as well as a simpler and more consistent regulatory framework.

Mr Prache acknowledged that there is a change of culture towards innovation and internet, that in a crisis retail investors are also looking for positive return investment possibilities and are not against innovation. Big advantages exist (less intermediation, competitive pressure, opportunity to go for a horizontal, non-fragmented regulation), but big risks also. He called for an analysis on what can be gained; is the model sustainable? Opportunity for European authorities to go for a bold, simpler, but horizontal regulation on all investment products that a retail investor can touch.

Panel four dealt with the regulation of financial forms of crowdfunding. Mr Degabriel said that some national authorities have already issued communication on how they apply the rules. Much of these national rules are in the areas that are exempt from EU level rules (MiFID, PD). There is high interest in crowdfunding, but high risks are attached. ESMA could identify differences and similarities across national rules and possibly publish national practices.

Ms Giusto explained that in Italy only innovative strat-ups can ask for this sort of financing. Platforms either have to be registered with Consob, or be regulated entities under MiFID. Received orders will have to be executed through an authorised service provider. CONSOB will define conduct of business rules, regulate offer side: information provided to evaluate the proposal. All offers going through the system need to have at least one professional investor – someone able to analyse proposal. It will be the first specific regulation to be put in place in Europe, thus Consob would appreciate some coordinated direction, but has to comply with deadline. Start-ups facilitated, but SMEs also need finance. She pointed to the risks of huge disintermediation without advice, clients buying directly.

Mr Geale explained that in the UK currently marketing and selling of "designated investments" is regulated. FCA is working out rules now on peer-to-peer lending, the loan agreements will become 'designated investments' from April 2014. Currently FCA has a consumer alert to help people understand risks (risk to capital, liquidity, no compensation scheme) and benefits. Minimum level of investment of £1000 to deter the mass market temporarily, until regulations are not yet in place. Level of complaints are quite low; platforms also do more control than required by law. Three or four platforms have failed so far, but investments can continue.

Mr Benois raised the need to identify better the actors, not to disincentives crowdfunding activities, but ensure sufficient investor protection. AMF issued 2 guides. Donations and rewards – may have to be approved payment institution or may need to have a partnership with a payment services agent. Lending platforms might fall under the banking monopoly rules or operate as an agent of a credit or payment institution. Next step is investment advice and consumer protection especially for platforms with cross boarder status. Identify where regulation could be adapted: reception and transmission of orders, investment advice, public offering But next step is to take action at European scale cross-border status, lighter requirements for various services, KIID.

Mr Blass said international cooperation and international dialogue is helpful. The crowdfunding regime in the US will be inserted into the current private placement regime. The JOBS act that eliminates the ban on solicitation will have an impact on the accredited investor's area as it will allow much more solicitation activity. The SEC is about to make a proposal for setting up the conditions to protect the investors, starting with transparency. There is an offering size limitation in the US of $1 million over a 12-month-period. The issuer of the securities must have audited financial statements. There is also an individual limit on what investors can invest, based on the investor's net worth: the maximum anyone can invest is up to $100 000 in the 12 month period. There is reliance on a professional broker dealer or a new SEC regulated entity, which is basically the CF platform. They are tasked with due diligence, monitoring for fraud, educating investors.

Mr Lallemand said CF showed that there was consumer confidence and consumer engagement; it is not just about financial return but it is also about the community and the social benefits. CF will not replace banks or markets – but it certainly proves that it is possible to form allocated capital in a much cheaper way. The key will be to maintain the smaller projects; often the one with the most positive externalities on society (like social businesses). People want transparency, security and they want fairness, but they are primary looking for local projects that they understand, that they can identify with, that they can be proud of and extract the sense of community.

Ms Calvino closed the event with some concluding remarks. She noted that crowdfunding has the real potential to facilitate access of finance. There have been very different suggestions how to deal with these different forms of CF – from not regulating them at all to looking carefully into how to protect investors and entrepreneurs in this process. All models share some of the challenges (risk or fraud, property rights protection). There was discussion on the potential regulation of financial CF. One thing we have learned is that it is not a crowd but a community, an ecosystem, and what we have to do is to nurture allowing it to thrive within an organised system. Some of the challenges that regulators are facing are the prevention of fraud, protecting transparency, requirements of execution of orders, potential limits for investors, conditions for exit of the investment. Common features we are all facing will also be the reference to taxation, payment services, and fight against money laundering. Some also talked about the EU-passport, further coordination with Europe, self-regulation has been defended, the potential of a European label, and further analyses of the current legal framework was called for.

The common goal that we all are pursuing is to ensure that financial markets serve real economy and contribute to growth and employment. The risks that arise with CF are not different from the risks we are facing from other forms of financing. We need to make sure that our legislation is adjusted to the different systems. One of the lessons that we have drawn today is that we should not be trapped by existing rules and ensure that rules are connected with the reality. We have to nurture the economic forces that come from crowdfunding. Reality requires us not to be too late this time and striking the right balance will be quite challenging.