
Unleashing the potential of Crowdfunding in the European Union
Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions

"Unleashing the potential of Crowdfunding in the European Union"

1. **INTRODUCTION**

Crowdfunding generally refers to an open call to the public to raise funds for a specific project. In 2012 about €735 million\(^1\) was raised for all forms of crowdfunding in Europe and the predicted figure for 2013 is around €1 billion. This figure is rather marginal compared to retail bank lending to non-financial institutions (€6 trillion in 2011), but it is promising compared to the financing provided by business angels (visible market segment estimated at €660 million in 2010) or venture capitalists in seed, start-up, later and growth stages (€7 billion in 2012).\(^2\)

Crowdfunding is an important source of finance to some half a million European projects\(^3\) each year that otherwise may not obtain the necessary funds to be realised.

There is great potential in crowdfunding to complement traditional sources of finance and contribute to the financing of the real economy. The Green Paper on Long Term Financing of the European Economy\(^4\) initiated a broad debate on the different factors that enable the European economy to channel funding towards the long term investments needed to ensure economic growth. The follow-up Communication outlines a number of priority areas where the Commission intends to take initiatives to help SMEs attract funding.

Crowdfunding is part of this work plan. It is one of the newly emerging financing models that increasingly contribute to helping start-ups move up the "funding escalator"\(^5\) and contribute to building a pluralistic and resilient social market economy. Crowdfunding has real potential to finance different types of projects, such as innovative, creative and cultural projects, or activities of social entrepreneurs, that have difficulties in accessing other forms of financing.

While crowdfunding is a promising new form of fundraising, responses to the Commission's public consultation on crowdfunding\(^6\) as well as the Startup Europe Crowdfunding Network survey\(^7\) highlighted a number of issues which will be decisive if its potential benefits are to be released. These range from lack of...

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\(^3\) Industry estimates show that in 2012 some 470 000 European projects were financed successfully through crowdfunding. Massolution (2013)

\(^4\) COM(2013) 150 final 25.3.2013

\(^5\) Crowdfunding can be followed by other forms of financing, such as bank financing, angel or venture capital, or an Initial Public Offering (IPO).

\(^6\) Held between 3 October and 31 December 2013.

\(^7\) [http://www.crowdfundingnetwork.eu/](http://www.crowdfundingnetwork.eu/)
awareness and understanding, challenges of protecting intellectual property, through fraud and consumer protection concerns, to issues of legal uncertainty and burdensome regulatory requirements. Many of these issues relate to other forms of finance as well. In the following, this Communication focuses on those issues that are particularly relevant for crowdfunding.

What is crowdfunding?

The term emerged from the field and generally refers to open calls to the wider public to raise funds for a specific project. Often these calls are published and promoted through the internet and with the help of social media, and are open only for a specified time period. The funds are typically raised from a larger number of contributors in the form of relatively small contributions, but exceptions exist.

The expression "crowdfunding" refers merely to a channel of financing, which can be used in many different ways. Donations can be collected from people, which would qualify as donation-based crowdfunding if collected for a specific project during a specified time period promoted through internet and social media. But crowdfunding campaigns can also offer contributors something in exchange. We can talk about rewards-based or pre-sales crowdfunding when contributors get in return something symbolic, like the opportunity to participate in the cultural experience they finance (e.g. appearing as an extra in a film), or a product that was developed and produced with the funds raised. All of the above forms of crowdfunding can be described as "crowd sponsoring".

Other crowdfunding campaigns offer some form of financial return. Profit-sharing schemes would promise a part of future profits made by the project that is being financed. Securities-based crowdfunding involves issuing equity or debt to contributors. The difference from an IPO for example is that the shares issued are typically not traded on a secondary market and there is no underwriting involved. Profit-sharing and securities-based crowdfunding can be described as "crowd investing". Finally "crowd lending" campaigners borrow money from the people and promise to pay back the capital on specified terms with (or in certain cases without) interests. Examples include consumers borrowing lower amounts of money from the crowd to renovate their home, finance studies, etc., or businesses borrowing to finance some new operations.

These are the main models used by crowdfunding campaigns today. But crowdfunding is still in its early stage of development and therefore these models might evolve in the future.

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8 Such donations are monetary contributions, typically – but not exclusively – for charitable purposes.
9 For example future profits from the sales of a new mobile application, the development of which was financed by crowdfunding.
10 For example an environmental project might issue debt instruments to build renewable energy generators or an innovative start-up might issue shares to raise the necessary funds to start the business.
This Communication seeks to contribute to support the emergence of crowdfunding activities, with the following priorities:

- Establishing an Expert Group on Crowdfunding to provide advice and expertise to the Commission in this area. In particular, the Expert Group should provide advice to the Commission to explore the potential of establishing a "quality label" to build trust with users and provide expertise to the Commission in promoting transparency, best practices and certification;
- Raising awareness with regard to crowdfunding, promoting information and training as well as raising standards; and
- Mapping national regulatory developments and holding regulatory workshops to ensure an optimal functioning of the internal market, and to assess if regulatory intervention is necessary at EU level.

2. WHY CROWDFUNDING?

Crowdfunding can offer various benefits to a large spectrum of users. This is partly explained by its flexibility, community engagement, and the variety of financing forms it can offer. While donations, rewards and pre-sales models do not entail any financial return to contributors, profit-sharing, lending and investment in securities models involve the prospect of financial return. The first category can be referred to generally as crowd sponsoring, while the latter can be described as crowd lending or crowd investing (including profit sharing). The campaigners collecting funds can include SMEs, startups, micro-entrepreneurs, social entrepreneurs, the self-employed, the cultural and creative sectors, public authorities, innovative or environmental projects, public interest bodies, researchers, consumers or the unemployed.

Access to finance is one of the most pressing problems for SMEs who report a deterioration in public financial support (-13%), access to loans (-11%), trade credit (-4%) and the willingness of investors to invest in equity (-1%).

Many projects' demand for financing is not met by any existing sources of finance, which is referred to generally as the financing gap. Some segments of the economy, such as social enterprises or the cultural and creative sector, do not find many responses tailored to their needs, due to their specific characteristics including social objectives or the dependence on intangible assets and the high uncertainty of market demand.

Crowdfunding matches small - or even bigger – contributors and investors directly with the projects in need of funds, mainly in the early stages.

Crowdfunding can foster entrepreneurship not only in terms of increased access to finance, but also as an additional market testing and marketing tool, which can help

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11 ECB-European Commission SMEs’ Access to Finance survey 2013

12 COM(2012)537, Communication on promoting cultural and creative sectors for growth and jobs in the EU.
entrepreneurs acquiring relevant knowledge of customers and media exposure. The experience with such campaigns also build employability skills\textsuperscript{13} while successful campaigns provide a valuable role model to other ‘entrepreneurs to be’.

From the contributors' perspective, this new form of financing offers direct choice over where to put one's money and a sense of involvement with the project. People who contribute might also get a different perspective on - and more direct contact with - entrepreneurs, which may further promote a culture of entrepreneurship. Contributors often also form a community to back the financed project, or might supply non-financial resources in the form of crowd-sourcing.\textsuperscript{14}

Crowdfunding has also high potential benefits for innovation, research and development, and it could contribute to growth, community development and job creation\textsuperscript{15} while financing innovative projects that do not have the level of maturity that traditional financial market sources require. Compared to other types of finance, it can also reduce costs and administrative burden for enterprises, notably SMEs.

3. **KEY CHALLENGES FOR CROWDFUNDING IN THE EU**

3.1. **Lack of transparency on the applicable rules**

3.1.1. All types of crowdfunding

The different forms of crowdfunding referred to above show differences in user groups, risks, complexity and purpose, which warrant a distinction among these various forms, and, importantly, a distinction between financial and non-financial return models. Crowdfunding with financial returns is slightly less well-known and is considered to carry higher risks for contributors who take the position of investors.

The main issues EU legislation addresses with regards to all types of crowdfunding include anti-money laundering, advertising, consumer protection and – where relevant – intellectual property protection.

A number of stakeholders referred to a potential uneven playing field as a result of current differences in anti-money laundering rules. Depending on where the payment service provider is located, the platform may be required to perform checks on the flow of funds at different transaction thresholds. Proposed amendments to the Anti-Money Laundering Directive and Regulation 1781/2006 are currently under negotiation by the co-legislators.\textsuperscript{16} These amendments are expected to address the above issue through a uniform transaction threshold across all Member States.


\textsuperscript{14} Calls to the public to supply non-monetary contributions to the realisation of a project (such as skills, commercial networks, etc.)


\textsuperscript{16} Based on Commission's proposals COM (2013) 44 and COM (2013) 45
currently still under discussion, for customer due diligence measures in the case of transfers of funds.

20% of project owners responding to the questionnaire signalled that the risks of insufficient intellectual property protection were too high. Innovative projects have to disclose their ideas in order to attract contributors. However, by disclosing an invention without sufficient patent protection they run the risk of someone making use of their ideas. One of the major issues encountered is the current fragmented patent system in Europe. Once the current reform of the patent system\textsuperscript{17} is in place, it will be possible to obtain a European patent with unitary effect on a one-stop shop basis, providing cost advantages and reducing administrative burdens.

Further EU legislation may be applicable to crowdfunding, depending on the actual business model used. For example platforms charging money to successfully financed projects may engage in e-commerce and thus fall under the E-commerce Directive\textsuperscript{18}. The Directive on misleading and comparative advertising\textsuperscript{19} provides minimum harmonisation for misleading marketing practices in a business to business context. Consumers are protected against misleading and aggressive crowdfunding practices by the Directive on unfair commercial practices\textsuperscript{20}, prohibiting certain marketing practices. If standard terms and conditions used by crowdfunding operators contain unfair clauses, then these are not binding on participating consumers under the Unfair Contract Terms Directive\textsuperscript{21}. Further, EU state aid and competition rules also apply to crowdfunding activity.

Even where EU legislation does not apply, different national rules might be in place. This is the case in particular for charitable giving and donations, rewards-based and pre-sales models of crowdfunding.

\subsection*{3.1.2. Financial return crowdfunding (crowd lending and crowd investing)}

Financial returns campaigns and platforms may be subject to further rules at both EU and national level, again depending on the specific business model used.

\begin{itemize}
\item \textsuperscript{17} On 17 December 2012, the Regulations creating unitary patent protection in the EU were adopted in enhanced cooperation between 25 Member States. An international agreement among the Member States setting up a Unified Patent Court is currently in the process of ratification.
\end{itemize}
The relevant EU regulatory framework includes: the Directives on Prospectus\textsuperscript{22}, Payment Services\textsuperscript{23}, Markets in Financial Instruments\textsuperscript{24}, Capital Requirements (CRD IV)\textsuperscript{25}, Alternative Investment Fund Managers\textsuperscript{26}, Consumer Credit\textsuperscript{27} and Distance Marketing of Financial Services\textsuperscript{28} and the Regulations on Capital Requirements\textsuperscript{29}, European Venture Capital and European Social Entrepreneurship Funds\textsuperscript{30}.

At national level different additional rules may apply. The European Securities and Markets Authority (ESMA) and the European Banking Authority (EBA) carried out an information gathering exercise in 2013 to better understand how the current regulatory framework applies to crowdfunding in each Member State.

Several Member States have sought to address concerns around crowdfunding with financial return through guidelines (e.g. in Germany, the Netherlands, Belgium). Others (Italy, the UK, France and Spain) are considering, or have already taken, regulatory action to facilitate this new form of financing\textsuperscript{31} while also aiming to adequately protect investors. The danger is that too burdensome and premature regulatory action could stymie the development of crowdfunding, while too lax policies could lead to losses to investors, harming consumer confidence and trust in crowdfunding. Issues here include whether existing national or EU legislation is adequately tailored to the needs of crowdfunding, or are there rules that are unnecessarily burdensome in the crowdfunding context and should be adapted to the needs of users to help crowdfunding fulfil its potential, in particular for SMEs. For the moment Member States with legislative initiatives propose different solutions to


\textsuperscript{29} Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (OJ 27.06.2013, L176/1)


the above challenges. Without prejudging how best to strike the right balance, the different approaches may create legal uncertainty as to what rules apply to which forms, despite recent initiatives that aim to gather legal information. The public consultation confirmed the importance of legal clarity for all stakeholders. In addition divergent approaches among national frameworks might also fragment the internal market by limiting the provision of services across Member States by crowdfunding platforms and harm the potential growth of crowdfunding in Europe.

The Commission will continue to monitor the market and, based on the different experiences, assess the need for regulatory action as a response to changing circumstances. Information sharing about national regulatory practices could both help to spread best practices and potentially identify discrepancies among national approaches which could generate obstacles.

3.2. How does crowdfunding work in the Internal Market?

3.2.1. Crowdfunding with non-financial returns (crowd sponsoring)

The consultation results showed that the internal market for crowdfunding with non-financial returns works quite well. 81% of non-financial returns platforms already operate cross-border, while 14% would like to do so in the future. Only about one-third of stakeholders expressed support for EU action on non-financial return crowdfunding to facilitate market access (around 35%) or to better protect contributors (below 30%). Those stakeholders who expressed support for EU measures to facilitate cross-border activity for non-financial return models often referred to legal uncertainty as the main obstacle.

3.2.2. Crowdfunding for financial returns (crowd lending and crowd investing) – market access with a high level of investor protection

The public consultation seems to indicate that the internal market may work less well for financial-return platforms. Only 38% of financial return platforms answering the consultation operate cross-border while almost half of them would like to extend their business to other EU Member States in the future. 44% of all financial returns platforms claim the lack of information about applicable rules prevents them from operating in more than one EU country. 27% of them also quoted the high costs of getting an authorisation in another Member State as a reason for only domestic operations.

Half of respondents recognised the need for EU action on financial return crowdfunding. Market access and investor protection appear to be equally important considerations: 49% called on the EU to promote the single market for financial return crowdfunding and 51% saw a need for EU action to ensure appropriate investor protection for lending and securities crowdfunding. Respondents also highlighted the risks for contributors in the crowd lending and crowd investing

models (e.g. loss of invested capital, risk of fraud), as well as the need for transparency on platform charges, interest rates, and on the expected yields. A large majority of stakeholders' agreed that platform managers involved in lending- and investment models should be required to inform contributors of investment and credit risks and provide advice on investment diversification. Potential contributors might not get involved in crowdfunding activity because of concerns over risks. The main issues here include different individual investment limits in different countries, the exercise of shareholder voting rights, the threshold for prospectus requirements, the rules concerning transparency, investment suitability tests, client money protection and investment advice.

3.3. How does crowdfunding work within the financial ecosystem?

Crowdfunding is still a young and evolving form of finance that should be further explored in the context of the financial ecosystem. While crowdfunding with non-financial returns is important in both its volume and impact (most crowdfunding campaigns take this form, with many having social objectives), financial return crowdfunding is also expanding and caters for the specific financing needs of many entrepreneurial projects or private consumers.

Crowdfunding is an alternative form of financing that can complement other forms of traditional financing. As it was referred to above, it can contribute to addressing access to finance problems and help start-ups move up the "funding escalator". A quarter of established banks replying to the consultation stated an interest in engaging in crowdfunding in the future, which offers the possibility of a regulated financial institution giving credibility to a platform and its projects, increasing trust. However, it also raises the questions of increased costs and decreased competition between traditional and new actors in the financing sphere.

Stakeholders responding to the public consultation thought that crowdfunding could deliver significant benefits for innovation. There is currently little information available on the role crowdfunding could play in financing research and innovation.33

A widely discussed issue in this regard is the divergent tax treatment of contributions across Member States and the influence this may have on people's and companies' choice of where to put, invest or donate money. Donations and certain forms of financial investments (start-ups, research and development (R&D) activities, etc.) are tax deductible in some Member States, but not in others. The effectiveness and use of tax incentives throughout the EU should be better understood.

The European Commission has commissioned a study on the exchange of good practices on R&D tax incentives' effectiveness and design of tax incentives, foreseeable for 2014. This study will provide an overview of R&D tax incentives schemes for EU Member States and selected members of the OECD, give an assessment of the effectiveness of R&D tax incentives by reviewing existing empirical evidence, and promote the exchange of knowledge about good practices. This might be of

particular relevance for crowdfunding and promoting research, development and innovation through CF platforms.

3.4. **Promoting crowdfunding through raising awareness and building confidence**

There is still a general lack of awareness about crowdfunding in Europe. Almost half of respondents favour some form of awareness-raising at EU level. Stakeholders also showed an interest in a single source of information on the opportunities of crowdfunding, to enhance its visibility.

Increased awareness is not the only factor needed for crowdfunding to succeed. A good understanding of how crowdfunding works, what it can deliver and what the risks might be is also key to establishing trust with both contributors and campaigners. Sustainable growth in crowdfunding is only possible if users have confidence in it. Running successful crowdfunding campaigns also depends on campaigners having the necessary skills and training, as well as support offered by platforms and other actors. Project owners may need education about the use of crowdfunding, about its potential risks, and potentially also about planning or project management.

Given that there are certain risks in crowdfunding, in this early stage of development there is also a need to enhance the recognition of platforms. Establishing a quality label would help this recognition and build confidence. A label would signal compliance with certain standards, for example to reduce the risks of fraud, and would build trust with users. In some countries, such as the UK, self-regulatory bodies have already put in place rules that platforms can comply with and obtain the quality label of the association.

3.5. **Possibilities for matched (public and private) financing**

Due to its limited size, crowdfunding cannot be expected to solve all various forms of access to finance issues on its own. Possibilities for public funding alongside crowdfunding could therefore be further explored at both national and EU level in duly justified cases where a market failure can be demonstrated. Matched financing could be provided either in the form of co-investment in projects alongside private contributors, as loan guarantees to crowd lending transactions, or directly to crowdfunding platforms. The newly adopted state aid rules applicable to risk finance extend the scope of eligible undertakings by including SMEs, small midcaps and innovative midcaps to improve access to funding for companies that though viable, are faced with a market failure in accessing the necessary finance. The risk finance rules applicable to alternative trading platforms can, by analogy, apply to certain types of crowdfunding platforms. Any support with state resources shall

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35 In such cases care should be taken that the popularity of a project as measured by its success in crowdfunding may not be the best selection condition for public spending.

4. **WAY AHEAD**

Crowdfunding offers numerous advantages to a variety of user groups and it is a promising source of funding for many types of actors that do not find solutions suited to their financing needs.

Considering the potential and the key challenges of this emerging phenomenon, the European Commission would like to develop, in cooperation with stakeholders, a common understanding at EU level and prepare the ground for possible future actions.

To get a better overview on how crowdfunding fits in the wider financial ecosystem and which projects use what type of crowdfunding, the European Commission will carry out a study in 2014. In a separate study the Commission will explore the potential of crowdfunding to support research and innovation, and in the context of this study it will reflect on the role which tax incentives could play in relation to crowdfunding for R&D and innovation.

To support policy development in this area, the Commission will set up the European Crowdfunding Stakeholder Forum as an expert group of high level representatives of associations of concerned stakeholder groups and national authorities to help it in raising awareness, providing information and training modules for project owners, promoting transparency and exchange of best practice, and identifying issues that may need to be addressed in order for crowdfunding to flourish while taking into account the interest of contributors.

The Commission will closely follow efforts by industry associations to develop standards at national and at European level on transparency and best practices, with the aim of informing users (both project owners and contributors), to protect contributors from fraud and to ensure an adequate complaint handling mechanism. The European Commission will launch a study to examine the existing national self-regulatory bodies and their rules, as well as their effectiveness and limitations, and will explore the potential of establishing a European quality label.

The Commission will closely monitor developments around crowdfunding in the context of the good functioning of the internal market. It will hold regulatory workshops with a view to discussing obstacles to cross-border activities. Where relevant, the Commission will examine the need to issue recommendations through the Single Market Report or the Network of the SME Envoys which monitors the implementation of the Small Business Act, or the Digital Agenda for Europe, to invite Member States to avoid inconsistencies in national approaches that might hinder the Internal Market.

Crowdfunding as an emerging but still relatively small source of private financing cannot be expected to replace public funding for projects having difficulties in accessing finance. The new European state aid rules facilitate the matching of public funding with private resources into companies. Therefore, consideration could be given to the possibility of using public funds co-invested with private funds channelled via crowdfunding, provided that State aid rules, in particular the Guidelines on State aid to promote risk finance investments, and the

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legal conditions of transparency and accountability for the use of public funds are met, and, where applicable, in accordance with the requirements of the Financial Regulation.

The Commission will keep this emerging sector under close monitoring with the support of the Forum, and will regularly assess - based on the results of the studies, the work of various stakeholders and the regulatory workshops - the state of EU and domestic regulatory frameworks applicable to crowdfunding, and consider whether further EU action is necessary. In particular at the time of scheduled reviews of existing legislation, the Commission will consider whether it may be appropriate to calibrate requirements to the specific features of crowdfunding with financial returns. Any future EU legislative action or other type of action with significant impact would be subject to a prior public consultation and impact assessment.

Finally, since crowdfunding is a global activity and other jurisdictions, such as the US, have also started regulating it, the Commission will closely follow international developments and will support efforts to promote regulatory convergence of approaches at international level.\(^{38}\)

The Commission will report back on progress in the course of 2015.

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