



Identifying market and regulatory obstacles to cross-border development of crowdfunding in the EU

Executive Summary
December 2017



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Abstract

[EN] This report identifies potential barriers to cross-border transactions that prevent securities-based and lending-based crowdfunding from scaling up across Europe. We look at the divergent regulatory approaches to crowdfunding across EU Member States, consider microstructural features of crowdfunding that may give rise to transaction costs that are beyond the immediate reach of regulators, and analyse the implications of these features from the perspective of consumer and investor protection and the importance of appropriate disclosures and safeguards.

Our analysis draws on extensive desk research on state of the art, in-depth legal analysis of regulatory context in all Member States and with focus on the six most significant national contexts (France, Germany, Italy, the Netherlands, Spain, and the UK), a bespoke survey targeted at European crowdfunding platforms active in cross-border crowdfunding, an analysis of a combined European user survey, and in-depth interviews with industry executives, regulators and other experts.

We find that the European crowdfunding sector is characterised by its highly heterogeneous nature, shaped by the different starting points of nascent national crowdfunding sectors across the EU, and largely determined by the incumbent regulatory frameworks as they pertain to crowdfunding as a novel form of technologically mediated market exchange.

[FR] Ce rapport vise à identifier les obstacles potentiels aux transactions transfrontalières qui empêchent le financement participatif de s'étendre à travers l'Europe. Nous examinons les approches réglementaires dans les États membres de l'UE, les caractéristiques microstructurelles qui sont hors de la portée immédiate des régulateurs et qui peuvent donner lieu à des coûts de transaction plus élevés, et les implications de ces caractéristiques du point de vue de la protection des consommateurs et des investisseurs..

Notre analyse est basée sur une recherche documentaire approfondie sur l'état de l'art, une analyse juridique approfondie du contexte réglementaire dans tous les États membres, met l'accent sur les six contextes nationaux les plus significatifs (Allemagne, Espagne, France, Italie, Pays-Bas et Royaume-Uni), une enquête adressée aux plateformes européennes/actives dans le financement participatif transfrontalier et des entretiens approfondis avec des directeurs, régulateurs et experts du secteur.

Nous constatons que le secteur européen du financement participatif se caractérise par sa forte hétérogénéité, façonnée par les différents points de départ des nouveaux secteurs nationaux dans l'UE et largement déterminée par les cadres réglementaires qu'ils regardent au financement participatif comme une nouvelle forme d'échange de marché caractérisé par une particulière médiation technologique.

Executive Summary

Introduction

The aim of this report is to contribute to the policy discussion on crowdfunding across European borders by identifying the potential barriers that prevent it from scaling up. Prima facie, among the most significant barriers are the divergent regulatory approaches to crowdfunding across EU Member States. But it is equally important to consider microstructural features of crowdfunding that may give rise to transaction costs that are beyond the immediate reach of regulators, and to look at the implications of these features from the perspective of consumer and investor protection and the importance in this context of appropriate disclosures and safeguards.

Purpose

The results of our work assist the Commission, in the context of CMU Action Plan implementation, in fulfilling its commitment to monitor the development of the sector and the effectiveness and degree of convergence of national regulatory frameworks, as well as to promote convergence, the sharing of best practice and the importance of keeping developments under review, by assessing the development of cross-border business and the related investor protection aspects. This study addresses crowdfunding models that entail a financial return, notably security-based crowdfunding and lending-based crowdfunding.

Methodology

Our research design is based on a mixed-methods framework with an emphasis on interview-based research but incorporating desk research, comparative legal analysis, and questionnaire-based survey. We have proceeded by adopting an iterative process of team-based inquiry that allows for the incremental probing and clarification of the issue under examination, whereby an initial set of qualitative findings is analysed 'on the go' to help refine subsequent iterations of interviews, etc., and is aimed at yielding an insider perspective that is validated through triangulation from a menu of different research methods that are recursively employed.

Findings from qualitative approaches were analysed in a broadly inductive fashion, with affinities to Grounded Theory and similar interpretive approaches, with an emphasis on emergent conceptualisation. Quantitative survey work supplemented the qualitative data gathering strategies within the overall mixed-methods framework of analysis.

Market and regulatory barriers

Market barriers

The European crowdfunding sector is characterised by its highly heterogeneous nature. In many ways this state of affairs reflects the range of different starting points of nascent national crowdfunding sectors which have originated in EU Member States over the past decade, largely determined by the incumbent regulatory frameworks as they pertain or may conceivably pertain to crowdfunding as a novel form of technologically mediated market exchange.

The complexities that arise as a direct result of diverging regulatory frameworks applying in different Member States can be considerable in a cross-border context. This has to do with the nature of revenue-based crowdfunding as marketplace investing and lending, which at the very least involves three parties: a fundraising party that is looking for a loan or seeking equity in various forms, a funder willing to offer a loan or become an investor, and the online marketplace platform bringing those two parties together.

In addition to these barriers, there are others more closely related to wider structural features of the institutional context of the crowdfunding sector at both national and international level. One way to define these structural frictions is to address them against the backdrop of an ongoing process of digitalisation of financial transactions and their social context. The following table once more summarises the key infrastructure and information market barriers in order to facilitate the following comparison to regulatory barriers, which we shall discuss in terms of legal uncertainty, thus adding a third dimension of relevant barriers to the cross-border development of crowdfunding.

MARKET BARRIERS	DIGITALISATION	TRANSACTION COSTS
	Lack of trust	Information
	Data privacy	Measurement
	Electronic identity	Market making
	User readiness	

Regulatory barriers

We analyse the effect of fragmentation through the lens of the considerable legal uncertainty to which it gives rise, and which has direct implications as a cost driver and in terms of lost cross-border market growth. To better define the legal uncertainty arising from this fragmentation it is useful to distinguish between three sources of legal uncertainty: Uncertainty originating in national crowdfunding regulations; uncertainty arising out of otherwise well-intended EU legislation; and uncertainty relating to national laws applicable to crowdfunding.

It is worthwhile to expand in more detail on these kinds of legal uncertainty to allow the subsequent discussion to make most effective use of the key sources of uncertainty that we have identified, and which capture the behavioural effects of the underlying regulatory complexities that arise in cross-border constellations. We will do this, therefore, first by means of a taxonomy of three kinds of uncertainty, before tracing these kinds of uncertainty in the context of a simple analytical scheme that we introduce to more transparently distinguish inbound from outbound cross-border crowdfunding business. The table below outlines key regulatory barriers.

REGULATORY BARRIERS	COMPLEXITY	UNCERTAINTY
	Fragmentation	National CF regulation
	Divergence	EU legislation
	Applicability	National applicable laws
	Practicality	

User disclosures and safeguards in a cross-border context

We analysed three different sources of information: existing regulation, codes of conduct, and information on individual platforms. We thus follow a top-down approach, first by providing the general regulatory context within which platforms are operating, second by describing the main features of the national codes of conduct per Member State and third by looking at the specificities of several individual platforms, always from a “safeguards and disclosures” perspective and, where applicable, in relation to the dimensions of cross-border crowdfunding.

Regulatory assessment

We collated data from the six target countries and present here the results of a comparative analysis across all three levels of data gathering:

- Existing regulation, i.e. regulatory dimensions of disclosures and safeguards under the following four themes: Categorisation of funders, Assessment of funder competence, Due diligence, and Disclosures to funders from fundraisers.
- Codes of conduct: industry codes of conduct with national reach, often aligned with local laws. Four out of the six analysed countries have industry codes of conduct. The only two countries where no industry code of conduct exists are Italy and Spain, which are also the two smallest markets of the six examined.
- Individual platforms: the minimum legal requirements and the respective behaviour as described by the national codes can be perceived as a level playing field for all platforms. In addition to this, individual platforms have taken a series of interesting initiatives in response to their regulatory context. We review here noteworthy individual platform characteristics and approaches regarding safeguards and disclosures.

Platform and market insights on disclosures and safeguards

This section discusses platforms’ opinions and general input on safeguards and disclosures and respective cross-border issues. In terms of format, in the specific context of the questions raised, we identify ten key areas of interest of platforms (listed here in no particular order):

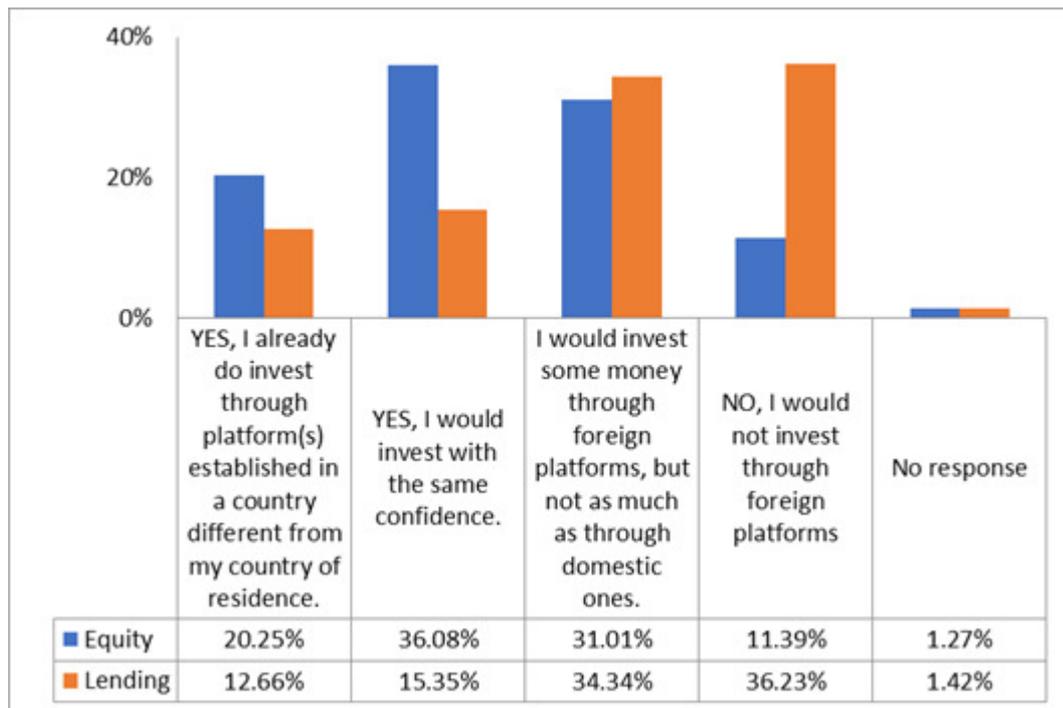
- Current national regulatory frameworks;
- Due diligence;
- Risk warnings;
- Redress;
- Information disclosures to funders;
- Availability and standardisation of market data;
- Financial literacy;
- Voluntary measures;
- Specific cross-border measures;
- Industry codes of conduct and self-regulation

User perceptions on cross-border crowdfunding regulation

The analysis of users’ perceptions of whether and how regulation can aid cross-border crowdfunding development is based on existing data from a unique database of answers from users (funders only) of crowdfunding with financial returns, where specific questions are being asked about the impact of regulation on cross-border activities. The survey was designed and implemented by Nikos Daskalakis in the

context of a cooperation between two expert groups of the European Commission: The Financial Services Users Group (FSUG) and the European Crowdfunding Stakeholders Forum (ECSF).

When asked “Would you invest with the same confidence through platforms established in another EU Member State?”, users of crowdfunding indicate that they do have interest and confidence in cross-border crowdfunding for both equity and lending.



Cross-border platforms: best practice case studies and innovative potential

The European crowdfunding sector is characterised by a great diversity of approaches and business models. This is now well-documented on the aggregate level. Equally well-documented is the diversity of platforms. For the return-based part of the sector, which is the focus of the present study, the diversity ranges from those oriented towards consumer or business lending, via securities-based and debt-based funding models, to real estate models and invoice trading.

The core of most business models is a fee-based revenue model, whereby the funded party and/or the investing party are charged fees for the market making services of the platform, both at the point of onboarding, and maintenance fees. Platforms are also increasingly devising add-on fees for ancillary services such as listing in a secondary market or more flexible payment schedules, as well as higher levels of support or notification. Beyond that, operation can be quite different, and often dictated not just by the kind of crowdfunding that the platform engages in but also by regulatory constraints and requirements.

The lending part of the sector operates with quite different requirements, for example depending on whether the platform is engaged in consumer finance or business finance. Loan-based consumer finance typically concentrates on unsecured loans.

Origination is either through established retail channels as personal loans, or as point-of-sale finance.

Turning to equity/securities-based crowdfunding, the scale of finance increases while the throughput becomes more limited. Securities-based crowdfunding is de facto business finance, and deal origination is largely focused on SMEs. However, the sources of revenue are similar in kind (if not in scale) to lending, and again include listing fees and add-on service and maintenance charges.

General issues in platform operations

Crowdfunding platforms aiming at cross-border transactions need to comply with different sets of national or EU regulation. As we have seen, the set-up of the platform is the dominant factor here, as well as the EU Member State that the platform is incorporated in and the specific financial deal structure offered. Following on from the regulatory set-up, platforms can operate cross-border to varying degrees. There is no one model that has proven itself beyond doubt and none of the models is without hurdles. Several approaches can be identified across the sector. From the sample we worked with, we can identify at least six different models.

- The platform operates via distinct subsidiaries or businesses in each Member State under local legislation.
- The platform acts via a partner to collect investment from investors outside the home Member State.
- The platform operates under some sort of EU licence (usually MiFID) which in theory allows the platform to have its status as a financial service provider accepted in other EU Member States but operating under the supervision of the regulator in its home Member State.
- The platform pools investments in special purpose vehicles (SPV) that under national rules can make cross-border investments on behalf of the crowd.
- The platform is allowed under local rules to accept cross-border investments for predominantly local deal-flow.
- The platform focuses on operating a brokering marketplace, accepting cross-border investments under national rules while partnering with locally licensed or approved deal originators in the target Member States.

How platforms currently expand cross-border: Best practices

For platform operators, each of these approaches presents market and operational hurdles which need to be successfully overcome. The decision if and what solution is possible depends on the national regulation and interpretation of EU rules, but even once a legal solution has been identified and all compliance issues have been dealt with, significant hurdles to market entry still exist.

The following overview outlines the main cross-border business models in use at the time of publication.

	Business Model	Approach	Pro	Contra
1.	Operation via distinct business in each Member State under local legislation	A separate legal entity or joint venture run by a local partner is launched or acquired under local regulation in each Member State in which the platform operates	<ul style="list-style-type: none"> a. Avoids compliance cost under EU regulation (MiFID etc.) b. Provides a local footprint for the platform brand 	<ul style="list-style-type: none"> a. Separate local regulatory approval process can be lengthy (up to 1 year) and thus costly b. Replication of all or some operations on the ground is thus

				dependent on the local team's ability to create success, at least with deal origination or customer support
2.	Operation via a partner platform to collect investment from investors outside the home Member State	A dedicated partnership with another platform in a different Member State is formed, where the investment opportunity is mirrored by the partner platform either via a special purpose vehicle or directly, if and where possible	<ul style="list-style-type: none"> a. No need for expansion of operations and expertise into new markets b. No need for additional compliance cost as both partner platforms already operate under the supervision of the relevant national regulators 	<ul style="list-style-type: none"> a. Time-consuming to identify a partner platform with trusted professional set-up b. Set-up of SPV at partner-level platform to pool investments and allow for cross-border transaction
3.	Operation via EU licence for the platform as a financial service provider	Platforms are MiFID-compliant and passport their national licence into other EU Member States to offer their services cross-border; MTF structures also possible	<ul style="list-style-type: none"> a. Added value of increased professional management b. Recognition with national regulators and related marketing 	<ul style="list-style-type: none"> a. Costly and time-consuming to set up, plus ongoing compliance cost b. Unclear benefits as some aspects of the platforms operations may remain under national rules and the replication of the home market business model is in most cases not possible cross-border
4.	Operation via special purpose vehicles (SPV)	Platforms structure special purpose vehicles under local regulation that allow the collection of funds (either local only or also from abroad) to make investments locally or cross-border	<ul style="list-style-type: none"> a. Bundled representation of diverse investor group within the target company b. Investor relations managed via the SPV (usually via the platform) 	<ul style="list-style-type: none"> a. Cost of setting up an SPV b. Additional management needs for the ongoing operations of the SPV c. National restriction regarding co-investments

5.	Accepting cross-border investments (for predominantly local deal-flow)	Platforms that are not restricted by Member State regulation allowing fund inflows to participate in investment opportunities	<ul style="list-style-type: none"> a. Low cost for set-up b. Better results in web searches 	<ul style="list-style-type: none"> a. No active cross-border marketing of financial services possible b. Uncertainty about what manifests active marketing in regulators' views c. Uncertainty about use of languages due to varying interpretations by Member States
6.	Brokering cross-border investments to local (and other) investors	Platforms that offer investment opportunities to local investors (and others) but refrain from engaging in deal origination and work with local partners in Member States	<ul style="list-style-type: none"> a. Low-cost set-up for the platform b. Limited regulatory compliance c. Benefits from cooperation with established local partners 	<ul style="list-style-type: none"> a. Focus on the brokerage of transactions restricts quality control in deal origination b. Not applicable for securities

Cross-border business: Remaining challenges

Crowdfunding platforms are exploiting a multitude of options to establish some form of cross-border market activity. The potential to replicate these platforms' approaches is questionable, as they largely stem from the regulatory environment in their home markets. Remaining challenges identified are:

- Increased competition in larger markets and resulting lower margins
- Cost of evaluating market opportunities from a legal and business point of view
- Managing different taxation and business conduct on a local level
- Cultural and language barriers regarding investor mentality, approach to SME finance and regulatory preferences and behaviour

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