

EU CROWDFUNDING REGULATION

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Abstract

Considering the recent application in all EU Member States of Regulation (EU) 2020/1503 of 7 October 2020 on European crowdfunding service providers for business (the “Regulation”), this article aims to address the main aspects and concepts which are to be used by small-medium enterprises (SMEs) and start-ups, in order to improve access to this innovative form of finance.

The necessity of this legal analysis stems from the direct compulsoriness of the Regulation and from the increasing trend of innovative peer-to-peer economy, in which start-ups shall be able to efficiently support themselves by means of access to several investors whose purpose shall focalize on the potential financial growth of said start-up.

The objectives of this study are to determine the grounds which led to the adoption of this Regulation, to identify the entities to whom the Regulation is destined for and who are allowed to provide crowdfunding services and to establish the differences between the concepts of “crowdfunding service” and “loan”. Additionally, this study shall address the obligation of crowdfunding service providers to perform annual reports to the competent authority that granted authorization and the conditions in which such authorizations may be withdrawn. Also, the article aims to clarify what the key investment information sheet must comprise.

Keywords: *crowdfunding services, SME financing, the key investment information sheet, transferable securities.*

1. Introduction

This paper covers the analysis of the main aspects and concepts which are to be used by small-medium enterprises (SMEs) and start-ups, as per the provisions of Regulation¹ (EU) 2020/1503 of the European Parliament and of the Council of 7 October 2020 on European crowdfunding service providers for business, and amending Regulation (EU) 2017/1129 and Directive (EU) 2019/1937

The matter is of utter importance, since as of the date of effect, the provisions of the Regulation are mandatory for EU entities and in the context of the recent pandemic crisis which led to unfortunate economic effects, knowing how to address financing from a crowdfunding perspective is extremely relevant for smaller businesses, especially.

I intend to analyse the basic principles of the Regulation, and the grounds for its enactment, to provide a more in-depth approach to how its applicability could be tailored to Romanian business environment.

Up to present, there is little to no specialized literature on the future applicability of this Regulation, at least in Romania, which seems to be at least peculiar, considering that the Regulation provides an easy and accessible alternative to common financing for start-

ups and small and medium-sized enterprises, typically relying on small investments.

2. The opinion of the European Economic and Social Committee with respect to the utility of a Crowdfunding regulation

The Opinion² of the European Economic and Social Committee (the “EESC”) on the 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 final — 2018/0047 (COD)] — Proposal for a Regulation of the European Parliament and of the Council on European Crowdfunding Service Providers (ECSP) for Business [COM(2018) 113 final — 2018/0048 (COD)] (the “Opinion”) was published in the Official Journal C 367, 10.10.2018, p. 65.

The EESC’s Opinion follows the 2014 Juncker Commission’s ‘investment plan for Europe’ with a view to achieving its top priorities: growth, jobs and investment. One of the plan’s main goals was the gradual pursuit of a capital markets union, alongside a digital single market and an energy union. The aim is to develop a well-functioning and integrated capital markets union, encompassing all Member States, which lead to more than 33 initiatives and actions at an European level. Further to the investment plan for Europe, in 2018 the EU Commission published a

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¹ <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32020R1503>.

² https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv%3AOJ.C_.2018.367.01.0065.01.ENG&toc=OJ%3AC%3A2018%3A367%3ATOC#tr1-C_2018367EN.01006501-E0001.

communication in which it made reference to the Action Plan on Financial Technology (FinTech) seeks to give voice to the ambition to turn Europe into a global FinTech hub, where businesses and investors in the EU are able to derive maximum benefit from the advantages of the single market in this fast-evolving sector.

The European Economic and Social Committee was designated to analyse the Proposal for a Crowdfunding Directive, and emphasized, even from the dawn of the Opinion, that it was a very positive fact that the financing of small, young and innovative enterprises has been taken into consideration.

The EESC ascertained that crowdfunding is an important part of the funding escalator of small, young and innovative enterprises, particularly when they move from a start-up to an expansion phase and traditional financing is not always available. Also, the EESC considered that more financing opportunities are being created for investors, so the world itself shall benefit from innovative products and solutions, supported by modern technology.

Even though the Opinion also expressed the concerns that there might be risks for crowdfunding operations and markets, the EESC mentioned that the focus should be on how to mitigate those risks, related especially to transparency and protection of investors, possible areas of tension in the status of providers and the services they offer, supervision.

At concerns supervision, the EESC specified that it would be of interest to have a better representation of national authorities and to focus on the cooperation between national and European level consultations, since national supervisors are closer to national markets and can assess local circumstances better than EU authorities, for example.

The EESC also mentioned that crowdfunding is underdeveloped in the EU as compared to other major economies, which entails a higher degree of preparation on behalf of the EU of measures allowing crowdfunding to be more accessible and for platforms to provide high-quality services.

One of the most relevant points raised by EESC was the fact that crowdfunding activities were to be implemented by means of a Regulation, which implies the importance of the project itself and the necessity to align national norms with EU standards.

The EESC also addressed the matter of the fight against money laundering and terrorism financing, which needs to be tackled with more active measures. On this subject, the EESC drew attention of the power given to the Commission to potentially subject crowdfunding service providers to the relevant rules

and whether this decision should fall to the Commission. The Committee believes that crowdfunding service providers should be subject to these rules and that their obligation should not be the sole competence of the Commission. Moreover, the conditions and criteria under which it is possible should be made clear.

3. Crowdfunding rules in USA

Across the ocean, at the historical and initial promoter of crowdfunding legislation, it seems that things are already working well insofar as crowdfunding legislation is concerned. US Congress passed detailed rules specifically tailored to equity crowdfunding. On April 5, 2012, the JOBS Act was signed into law, so the existing exemptions for raising capital under Section 4(6) of the Securities Act were thoroughly amended. According to Title III of the JOBS Act (also referred to as CROWDFUND Act), issuers could raise an overall amount of up to \$1,000,000 during a 12-month period without filing a registration statement with the SEC or at the state level. For clarity purposes, as a principal rule of the US securities law, securities that are offered to the general public must be registered with the SEC. So the US legislator tied this exemption related to crowdfunding, however, to three conditions: the usage of a broker-dealer or funding portal, limitations on the amount that can be sold to individual investors, and disclosure requirements for the issuers.

As per to Section 4(6)(C) of the Securities Act, issuers can now offer or sell securities without a registration statement if the transactions is conducted through a broker-dealer or funding portal as defined in Section 3(a)(4) and Section 3(a)(80) of the Securities Exchange Act. In this way, the JOBS Act actually set out a private gatekeeper for equity crowdfunding issues, which is supposed to ensure the correctness and completeness of the securities offered. However, the JOBS Act did not make explicit that funding portals would be liable for material misstatements or the omission of material facts by the issuer. While the JOBS Act explicitly states that equity crowdfunding issuers will be liable for such offenses, it could be argued that the liability of the funding portal can be derived from Rule 10b-5 of the Code of Federal Regulations (CFR) as well as the previous Supreme Court decisions (Knight et al. 2012).

In reference to these provisions, studies³ showed that too strong investor protection may harm small firms and entrepreneurial initiatives, which contrasts

³ Hornuf, L., Schwienbacher, A., *Should securities regulation promote equity crowdfunding?*, Small Bus Econ 49, pp. 579-593 (2017), <https://doi.org/10.1007/s11187-017-9839-9>.

with the traditional “law and finance” view that stronger investor protection is better.

4. The basic principles of the EU Crowdfunding Regulation

Until 10.11.2021, Romanian legislation required inventivity from investors and companies, as crowdfunding activities were concerned. Building on the a desire to create a more accessible market with a single EU regime, thereby removing diverging national rules with respect to crowdfunding service providers within the European Union, the EU adopted the EU Crowdfunding Regulation.

Starting from the application date of 10.11.2021, the fully-welcomed EU Crowdfunding Regulation introduced the crowdfunding services as a new category of regulated services at EU level and established the basic principles for crowdfunding activities, which will also be eligible for the European passporting regime.

As per art. 1 of the EU Crowdfunding Regulation, the “*Regulation lays down uniform requirements for the provision of crowdfunding services, for the organisation, authorisation and supervision of crowdfunding service providers, for the operation of crowdfunding platforms as well as for transparency and marketing communications in relation to the provision of crowdfunding services in the Union*”.

A crowdfunding service, under the EU Crowdfunding Regulation, is defined as being the matching of business funding interests of investors and project owners through the use of a crowdfunding platform and which consists of any of the following activities:

- (i) the facilitation of granting of loans;
- (ii) the placing without a firm commitment basis,

as referred to in point (7) of Section A of Annex I to Directive 2014/65/EU, of transferable securities and admitted instruments for crowdfunding purposes issued by project owners or a special purpose vehicle, and the reception and transmission of client orders, as referred to in point (1) of that Section, in relation to those transferable securities and admitted instruments for crowdfunding purposes.

The EU Crowdfunding Regulation established the necessity for crowdfunding services performed by legal persons that are based in the Union to be authorized and to be governed by the principles of honesty, fairness and professionalism.

The crowdfunding service provider must perform a due diligence in respect of the project owners that propose their projects to be funded through the crowdfunding platform of the crowdfunding service

provider, as per art. 5 of the EU Crowdfunding Regulation, with the following minimum requirements:

- no criminal record of the project owner in respect of infringements of national rules in fields of commercial law, insolvency law, financial services law, anti-money laundering law, fraud law or professional liability obligations.

- no establishment of the project owner in a non-cooperative jurisdiction, as recognised by the relevant Union policy, or in a high-risk third country pursuant to art. 9(2) of Directive (EU) 2015/849.

The EU Crowdfunding Regulation establishes also a definition of the loan, to be applicable for cases when the crowdfunding service provider offers loans, in addition to crowdfunding services. For the purpose of the Regulation, ‘loan’ means an agreement whereby an investor makes available to a project owner an agreed amount of money for an agreed period of time and whereby the project owner assumes an unconditional obligation to repay that amount to the investor, together with the accrued interest, in accordance with the instalment payment schedule.

The Regulation requires robust internal processes and methodologies and appropriate data to be used by crowdfunding service providers who also offers individual portfolio management of loans, for which it is obliged to keep records of the mandate given and of every loan in an individual portfolio.

Since crowdfunding services are destined facilitate the access of project owners to alternative financing, the Regulation includes certain rules related to complaints against such services, which must be performed by means of effective and transparent procedures, free of charge, based on standard templates of complaints, and with a reasonable period of solving guaranteed by the service provider, as per art. 7 of the EU Crowdfunding Regulation.

Since crowdfunding service providers are under close scrutiny, the EU Crowdfunding Regulation stipulates particular conditions for their authorization, such as, for example:

- the submission of a detailed authorization request, accompanied by the description of the prospective crowdfunding service provider’s systems, resources and procedures for the control and safeguarding of the data processing systems, a description of the prospective crowdfunding service provider’s operational risks, a description of the prospective crowdfunding service provider’s prudential safeguards, a description of the prospective crowdfunding service provider’s business continuity plan which, taking into account the nature, scale and complexity of the crowdfunding services that the prospective crowdfunding service provider intends to provide, establishes measures and procedures that ensure, in the event of failure of the prospective

crowdfunding service provider, the continuity of the provision of critical services related to existing investments and sound administration of agreements between the prospective crowdfunding service provider and its clients,

- proof of absence of a criminal record in respect of infringements of national rules in the fields of commercial law, insolvency law, financial services law, anti-money laundering law, fraud law or professional liability obligations for all the natural persons involved in the management of the prospective crowdfunding service provider and for shareholders who hold 20 % or more of the share capital or voting rights;

- proof that the natural persons involved in the management of the prospective crowdfunding service provider collectively possess sufficient knowledge, skills and experience to manage the prospective crowdfunding service provider and that those natural persons are required to commit sufficient time to the performance of their duties.

As per art. 17 of the EU Regulation, the competent authorities which granted authorisation shall have the power to withdraw the authorisation in certain situations, including but not limited to when where the crowdfunding service provider is also a payment service provider in accordance with Directive (EU) 2015/2366 and it, or its managers, employees or third parties acting on its behalf, have infringed national law implementing Directive (EU) 2015/849 in respect of money laundering or terrorist financing; or where the crowdfunding service provider or a third party acting on its behalf has lost the authorisation allowing the provision of payment services in accordance with Directive (EU) 2015/2366 or investment services under Directive 2014/65/EU, and that crowdfunding service provider or third party has failed to remedy the situation within 40 calendar day.

Insofar as prospective investors are concerned, crowdfunding service providers shall supply a key investment information sheet drawn up by the project owner for each crowdfunding offer, which shall include a set of standard details, a disclaimer that the offer has not been verified or approved by the competent authorities or the European Securities and Markets Authority (ESMA) and a risk warning. Standard information refers to identity, legal form, ownership, management and contact details, a responsibility statement, the principal activities of the project owner; products or services offered by the project owner, a hyperlink to the most recent financial statements of the project owner, if available, Key annual financial figures and ratios for the project owner for the last three years,

if available, description of the crowdfunding project, including its purpose and main features. Other mandatory sections of the key investment information sheet, as per Annex 1 to the EU Crowdfunding Regulation, refer to main features of the crowdfunding process and, as applicable, conditions for the capital raising or funds borrowing, risk factors, Information related to the offer of transferable securities and admitted instruments for crowdfunding purposes, information on special purpose vehicles (SPV), investor rights, disclosures related to loans, fees, information and legal redress and information on individual portfolio management of loans to be provided by crowdfunding service providers.

As per art. 22 of the EU Regulation, crowdfunding service providers shall provide for a pre-contractual reflection period, during which the prospective non-sophisticated investor may, at any time, revoke his or her offer to invest or expression of interest in the crowdfunding offer without giving a reason and without incurring a penalty. Such a reflection period is deemed to protect the potential investor, who can decide, in certain conditions, to revoke its offer, in full application of a sanction.

In compliance with art. 25 of the EU Regulation, crowdfunding service providers may operate a bulletin board on which they allow their clients to advertise interest in buying and selling loans, transferable securities or admitted instruments for crowdfunding purposes that were originally offered on their crowdfunding platforms.

Until 10 November 2023, the EU Crowdfunding regulation shall apply in Romania to crowdfunding offers with a consideration of up to EUR 1,000,000 computed over a period of 12 months. As of 10 November 2023, the threshold will increase up to EUR 5,000,000.

5. Conclusions

Although Romania elaborated⁴ a draft crowdfunding law, which was under public consultations until 9 September 2021, such law was not yet adopted, which currently leads to an objective obstacle in implementing the EU Crowdfunding Regulation in Romania.

While Romania is still to clarify its priorities in adopting the implementing norms for the Regulation, other Member states are registering a high degree of expansion of the Regulation's applicability. For

⁴ The Draft Crowdfunding Law was published on 10 August 2021, by the Romanian Ministry of Finance - <http://e-consultare.gov.ro/w/proiect-lege-privind-stabilirea-unor-masuri-de-punere-in-aplicare-a-regulamentului-ue-2020-1503-al-parlamentului-european-si-al-consiliului-din-7-octombrie-2020-privind-furnizarea-europeni-de-servici/>.

example, in Italy, a study⁵ shows that equity crowdfunding represents a funding method that is rapidly increasing in Italy, despite rather rigid regulation. Among the various sectors involved, the study showed that real estate sector could benefit from the crowdfunding models and, specifically, from the equity one. The development of new real estate equity crowdfunding portals that allow diversification of investment (by reducing the typical entry barriers for real estate investment) could guarantee greater investment transparency and simplicity.

Considering that Romania is deemed to be one of the largest fintech hubs in Europe, focus should be on

adopting the crowdfunding law as soon as possible, since it would allow crowdfunding service providers to be able to authorize before the relevant competent national authority, Financial Supervision Authority - ASF, and to commence supporting small and medium businesses and start-ups, for the purpose of obtaining financing for their daring projects.

Also, business environment representatives should lobby on the adoption of this law, in a form compatible with the provisions of the EU Regulation, in order to make financing more accessible and to create business opportunities for innovative project to come.

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⁵ Battisti, E., Creta, F. and Miglietta, N., *Equity crowdfunding and regulation: implications for the real estate sector in Italy*, Journal of Financial Regulation and Compliance, vol. 28, no. 3, 2020, pp. 353-368, <https://doi.org/10.1108/JFRC-08-2018-0109>.