

FINANCIAL REGULATION

Crowdfunding

Crowdfunding has gathered pace in recent years as an attractive alternative to traditional forms of finance typically offered by banks. Despite increasing demand, there has been a notable lack of a harmonised regulatory regime across the EU.

As a result, crowdfunding service providers (“CSPs”) have been prevented from efficiently scaling their services. This is set to change with the introduction of a new framework across the EU for the regulation of crowdfunding service providers.

4 MIN READ

The new regulatory framework

The harmonised framework will consist of:

- Regulation (EU) 2020/1503 (the “**Crowdfunding Regulation**”); and
- Directive (EU) 2020/1504 (the “**MiFID Amending Directive**”).

The Crowdfunding Regulation will apply to CSPs who facilitate:

- peer-to-peer business lending (consumer lending is not within scope); and
- investment based crowdfunding ie where transferable securities are issued/ transferred.

The new regime does not apply to crowd funding offers of more than €5,000,000 calculated over a 12 month period. Crowdfunding service providers may, however, in respect of offers which exceed that threshold fall to be regulated under the MiFID regime. The MiFID Amending Directive provides that CSPs covered by the Crowdfunding Regulation are excluded from the scope of MiFID II. The main requirement of the new regime is that within scope CSP’s must be appropriately authorised to provide crowdfunding services.

The Crowdfunding Regulation applies from 10 November 2021. However, CSPs already providing crowdfunding services have until 10 November 2022 to obtain authorisation.

It is worth noting that where a crowdfunding service provider is also providing payment services, separate authorisation may be required under the Payment Services Directive.

Benefits

The new rules are expected to increase the availability of crowdfunding which will assist companies, particularly start-ups and small and medium-sized enterprises (“**SMEs**”), who are seeking alternatives to traditional bank financing.

Simplified licensing requirements across the Union are also a welcome introduction. Due to the fragmented approach to regulation, crowdfunding activity has been largely confined to national markets with very little cross border activity. This has resulted in the scale of platforms remaining relatively small. The Crowdfunding Regulation will allow CSPs to apply for an EU passport based on a single authorisation, which makes it easier to offer their services across the EU.



Authorisation and regulatory regime

The Central Bank of Ireland (the “CBI”) will be the designated competent authority in Ireland for the supervision of CSPs. A CSP established in Ireland must therefore obtain authorisation from the CBI before facilitating crowdfunding activities which fall within the scope of the Crowdfunding Regulation.

A regulatory regime, which includes requirements in respect of provision of information to clients; prudential; outsourcing; record keeping and operational and investor protection requirements including the following:

Operational and reporting requirements

Operational requirements The Crowdfunding Regulation introduces a new set of operational requirements which CSPs will need to comply with. These include requirements to:

- implement effective policies and procedures to manage credit risk
- operate minimum levels of due diligence in respect of project owners
- avoid conflicts of interest
- handle client complaints efficiently by ensuring that clients can make complaints free of charge and are provided with a complaints template to do so

Reporting requirements CSPs will be required to submit an annual report to the CBI on a confidential basis specifying the details of all projects funded through their platform. ESMA will also establish and maintain a public register of all authorised CSPs in the EU which will include details of any authorisations which have been withdrawn.



Investor protection

The Crowdfunding Regulation introduces a suite of measures designed to ensure investor protection. The measures capture a wide scale in terms of the obligations imposed on CSPs and include the following:

Marketing

All marketing communications from CSPs must be fair, clear and not misleading.

The CBI will publish national marketing requirements for such communications. It recently initiated a public consultation (CP141) on this topic which includes its proposals to impose advertising requirements from the Consumer Protection Code on CSPs. The consultation closes in July 2021 and we are monitoring developments in this area.

Non-sophisticated investors

The Crowdfunding Regulation also provides for additional protections in respect of non-sophisticated investors. Where a prospective client is a non-sophisticated investor a CSP must conduct an assessment of that investor's experience, financial situation and understanding of risk before allowing them access to invest in projects. This assessment must be reviewed every two years.

Next steps

The Crowdfunding Regulation will enter into application on 10 November 2021, applying directly across the EU. Firms are advised to consider whether they fall within the scope of the Crowdfunding Regulation in advance of this date. A&L Goodbody can advise on any queries in relation to the scope of the legislation. We have experience in assisting clients on all aspects of applications for authorisation to be made to the CBI including strategy for obtaining best outcome.

Key contacts

For further information in relation to this topic, please contact Kevin Allen, Partner, Patrick Brandt, Partner, Peter Walker, Partner or any member of ALG's Financial Regulation Advisory team.



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