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Regulation of Crowdfunding in Germany, the UK, Spain and Italy and the Impact of the European Single Market



June 2013

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Thomas Nagel, Umberto Piattelli, Laura Quintavalla
with a foreword by Oliver Gajda

In association with





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CONTENTS

CONTENTS.....	3
AUTHORS	4
FOREWORD	5
INTRODUCTION	7
GERMANY	9
1 Current Market of Crowdfunding platforms in Germany	9
2 Current Regulation of Crowdfunding platforms in Germany	10
3 Possible regulation of Crowdfunding platforms under the AIFMD regime in Germany	13
4 Conclusion	16
United Kingdom of Great Britain.....	17
1 Current Market of Crowdfunding platforms in UK	17
2 Current Regulation of Crowdfunding platforms in UK.....	18
3 Conclusion	22
ITALY.....	23
1 Current Crowdfunding Models in Italy.....	23
2 Current Regulation of Crowdfunding platforms in Italy	23
3 Possible regulation of Crowdfunding platforms under the AIFMD regime.....	26
4 Conclusion	27
SPAIN.....	29
1 Current Market of Crowdfunding platforms in Spain	29
2 Current Regulation of Crowdfunding platforms in Spain	29
3 Possible regulation of Crowdfunding platforms under the AIFMD regime.....	31
4 Conclusion	31
SUMMARY – Regulation of Crowdfunding in Germany, UK, Italy and Spain.....	32





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FOREWORD

The European Crowdfunding market is said to have more than doubled in value between 2011 and 2012, reaching a value of around EUR 1 billion in value in 2012¹ – a figure to be taken as indicative rather than absolute. This market comprises a variety of different funding forms, such as donations, rewards and pre-sales, consumer lending as well as debt and equity finance for small and medium sized enterprises. Through the funds raised in this way, entrepreneurs have access to capital, create social impact, innovative products and services, cultural variety, jobs and contribute to economic growth.

To put this into context, the European Commission estimates that there are some 23 million small and medium sized enterprises (“SME”s) in Europe, 90% of which have 10 or less employees. These SMEs account for around 67% of all jobs and some 80% of all new jobs created. SMEs are therefore of the utmost concern when discussing the economic recovery of Europe’s economy. It should be European and national policymakers’ top priority to enable SMEs to have adequate access to financial resources.

However, according to data from the European Investment Bank, only 30% of businesses are using bank loans while some 40% rely on short-term bank credit or overdraft facilities. On the investment side, venture capital, according to industry statistics, invests in less than 5,000 high-growth businesses a year and business angels in around 1,000. Of the millions of SMEs that are not accessing this formal supply of finance, some will be able to benefit from organic growth and profitability, others will be able to smooth income fluctuations - which are normal in seasonal businesses - through supplier credits or factoring, for example.

As a result, a very large number of SMEs, maybe as many as 10 million, rely on their own wealth, their family, friends and fans to invest in growth, support them through economic difficulties or help to purchase new equipment, finance stock and other operational needs. Crowdfunding is proposing to formalise this part of the financial services sector, to make it transparent and therefore accessible, and to combine it with aspects of co-creation and collaborative open innovation. The model can be used to lay the foundation for mobilising funding for SMEs and for sharing appropriate risk. Consequently, it is complementary to both the banking and the early-stage equity finance ecosystems.

The European regulatory framework addressing financial services has evolved over decades, even centuries. It has still to come to terms with the changes the digital economy, with its internet and computer-based technologies, is having on our society. Crowdfunding is one such occurrence. In this process, it is important to differentiate between regulatory frameworks on a European level and their actual implementation by

¹ Massolutions (2013)





the Member States. This is especially vital for those aspects, where European regulation does not harmonise the single market – or only does so above certain thresholds.

A comparative review of the implementation of European law at Member State level, with a focus on Crowdfunding, is thus of the highest importance in order to be able to understand the limitations that Crowdfunding – and SME finance in general – is facing in Europe. This paper is an important first step and we hope that we will be able to generate further and even more inclusive work to this end. But while in many cases European regulation is a temporary limitation for Crowdfunding and SMEs, it can and it will be circumvented and, over time, it will be changed.

The countries covered in this paper are diverse with regard to Crowdfunding industry and regulatory interpretation of European laws. The analysis on the following pages highlights this. Italy is of note because its financial services regulator, CONSOB (*Commissione Nazionale per le Società e la Borsa*), has, after extensive public consultation, now finalised Europe's first national Crowdfunding law. While this is focused on equity Crowdfunding for the time being, it is a first step that gives a very strong signal to its fellow European Member States.

In the UK and Germany the regulators are taking a step by step approach, dealing with each Crowdfunding platform individually, while advising caution in general. This will enable them to learn lessons important later on, but has so far not stopped the industry in both markets from being very progressive. Spain, often understated, has one of the most active Crowdfunding markets in Europe and political discussions regarding this new industry are on-going. There are relevant discussions on a political level in many other countries, for example France, the Netherlands and Austria.

All this makes this publication timely and relevant for every stakeholder interested in the political discussion on Crowdfunding, but especially to those working on regulatory issues. The European Crowdfunding Network would like to thank all the people involved and Osborne Clarke as a firm for their time and efforts in creating this first comparison of European regulation and its national implementation with regard to Crowdfunding. We believe that this paper will be an important contribution to building a positive framework for European Crowdfunding.

Oliver Gajda
Chairman and Co-Founder, European Crowdfunding Network





INTRODUCTION

Crowdfunding is an increasingly popular method of raising capital over the internet from the mass market. Its earliest successes have often been with social or art-based projects. But it is now emerging as a fund-raising method for start-up companies or other commercial projects (this kind of Crowdfunding is also called "Crowd Investing").

Crowdfunding can be very beneficial for both sides. It provides for an alternative method of financing which can be attractive where borrowers struggle to qualify for full funding from traditional sources, such as banks, private equity houses and angel investors. Crowd investors on the other hand can invest directly into enterprises/projects that have not previously been available to retail investors.

Due to the benefits Crowdfunding provides for the financing of small and medium-sized enterprises, the European Commission has indicated an intention to support Crowdfunding. For example in its recent Green Paper on long-term financing of the European economy published on 25 March 2013 the European Commission raises the question how *"non-traditional sources of finance, such as crowd-funding, can be supported"*. On the other hand, the Commission has traditionally displayed strongly consumer-protectionist tendencies and certain public pronouncements it has made indicate that any benefits it may be able to confer through the creation of a harmonised single market may well be outweighed by regulatory burden.

Crowdfunding is already restricted by national regulatory provisions, but the continuing development of the European single market in financial services has and will continue to ensure that there is a small degree of conformity between those national regimes, even absent any Crowdfunding-specific European regulation. It can be anticipated that Crowdfunding could be even more restricted under the future AIFMD regime.

This paper considers the varying applications of the single market legislation to CrowdFunders across Germany, the UK, Spain and Italy both now and in the foreseeable future.

Tanja Aschenbeck-Florange
Partner, Osborne Clarke







GERMANY



1 Current Market of Crowdfunding platforms in Germany

In Germany, there are three broad types of Crowdfunding:

1.1 The Equity Model (individuals make investments in return for a share in the profits or revenue generated by the company/project)

Currently there are two main kinds of Crowdfunding platform in Germany offering the Equity Model:

- First, platforms without any kind of licence – they are only active in the business of investment broking and/or contract broking mainly regarding silent partnerships. They operate outside the prospectus regime and must therefore comply with the very limited exemptions. The sole exemption that comes into consideration is that the offering of investments does not exceed EUR 100,000 during 12 months.
- Second, two Crowdfunding platforms currently operate within the scope of regulation (both with different approaches).

One simply offers securities. Therefore all companies seeking funding ("entrepreneurs") must transform to a (private) stock corporation first. This platform also offers a trade market for the securities. They have a licence for financial services under the German Banking Act (*Kreditwesengesetz*).

The other platform is more complicated and is structured similar to a fund. It does not have a licence, but has prepared an approved prospectus for the platform. They offer silent partnerships.

In summary, the most common and simple way of equity Crowdfunding in Germany is to only broker silent partnerships. The use of a licence (that enables the platform to offer additional services) is very rare in Germany.

1.2 The Lending Model (individuals lend money to a company or project in return for repayment of the loan and interest on their investment)

Recently Crowdfunding platforms are emerging which broker only subordinated loans (*Nachrangdarlehen*). In order to let the investors participate in the success of the funded project or company the interests are linked to the profit of the project or company. However, the investor does not share liability for any losses.





1.3 The Donations or Rewards Model (individuals provide money to a company or project for benevolent reasons or for a non-monetary reward)

In Germany the Donations or Rewards Models are used predominantly to finance social or creative projects or companies (e.g. NGOs). No financial investment or return is involved. Investors fund projects or companies and get no return at all or a non-monetary reward (e.g. tickets, CDs etc.). In some cases the rewards are of a symbolic value only.

2 Current Regulation of Crowdfunding platforms in Germany

2.1 Licence under the German Banking Act (*Kreditwesengesetz*)

Equity Model

General Rule

Pursuant to the German Banking Act (*Kreditwesengesetz*), anyone intending to provide financial services in Germany commercially or on a scale which requires a commercially organised business undertaking requires a written licence from the German Financial Supervisory Authority (*Bundesanstalt für Finanzdienstleistungsaufsicht* – "BaFin").

The provision of "financial services" includes the brokering of business involving the purchase and sale of financial instruments or their documentation (investment broking), the purchase and sale of financial instruments in the name of and for the account of others (contract broking) and the placement of financial instruments without commitment to take up those instruments (placement of financial instruments).

"Financial instruments" within the meaning of the German Banking Act (*Kreditwesengesetz*) include securities and investment products (*Vermögensanlagen*).

Securities include shares in stock corporations as well as debt securities including participation certificates. Investment products (*Vermögensanlagen*) under the German Investment Products Act (*Vermögensanlagengesetz*) comprise, inter alia, shares in other legal entities (such as limited liability companies, limited partnerships, civil law partnerships or silent partnerships (*stille Beteiligungen*), participation rights (*Genussrechte*) with regard to profits in those legal entities, shares in trust assets and in closed funds as well as registered bonds.

In summary, where an online Crowdfunding platform facilitates the offering of securities or investment products (*Vermögensanlagen*), the operator of the platform provides financial services within the meaning of the German Banking Act (*Kreditwesengesetz*) and therefore, as a general rule, requires a licence by BaFin.





Exemptions from licensing requirement

If securities (such as shares in stock corporations or limited liability companies) are offered, no exemptions are available from the licensing requirement.

However, as stated above – and as described by BaFin in its article on "Crowdfunding and supervisory law" dated 12 September 2012 – most German Crowdfunding platforms offer interests in silent partnerships and can therefore benefit from a statutory exception to the licensing requirement.

The following requirements must be met:

- only investment broking and contract broking are conducted,
- only newly issued investment products (*Vermögensanlagen*) within the meaning of the Investment Products Act (*Vermögensanlagengesetz*) (which includes silent partnerships) are offered;
- no acquiring of ownership or possession with regard to funds or shares of customers (unless a specific license to do so has been obtained).

Where these requirements are met, the operator need only obtain a licence under the German Trade, Commerce and Industry Regulation Act (*Gewerbeordnung*) (which is a relatively straightforward matter).

Making use of this exception comes with certain disadvantages. For example, such investment products (*Vermögensanlagen*) are rarely tradable and the operator of the Crowdfunding platform is not allowed to offer any trade market for such investment products (*Vermögensanlagen*).

Lending Model

Depending on the structure in detail subordinated loans (*Nachrangdarlehen*) are considered as "debt" (in contrast to equity) and do not qualify as investment products (*Vermögensanlagen*) under the German Investment Products Act (*Vermögensanlagengesetz*).

Brokering of such subordinated loans (*Nachrangdarlehen*) only requires a straightforward licence under the German Trade, Commerce and Industry Regulation Act (*Gewerbeordnung*).

Donations or Rewards Model

Depending on the structure in detail there are good reasons to state that these kinds of investments do not qualify as investment products (*Vermögensanlagen*). Therefore, it should fall outside of German financial services regulation.





2.2 Licence under the German Payment Services Act (*Zahlungsdiensteaufsichtsgesetz*)

In addition to the requirements set out above, any transfer of funds through the operator of a Crowdfunding platform will generally constitute money remittance services within the meaning of the German Payment Services Act (*Zahlungsdiensteaufsichtsgesetz*). Such transfer of funds could occur if the investors pay their investment amounts to the operator of the Crowdfunding platform who then passes the funds to the entrepreneur.

Although the platform operator may conceivably rely on the exemption for commercial agents under the German Payment Services Act (*Zahlungsdiensteaufsichtsgesetz*), recent BaFin decisions have shown that the German supervisory authority only permits a very limited application of this exemption.

As an alternative – in order to avoid such licensing requirements – the operator of a Crowdfunding platform could use an external provider or partner for processing payments rather than acting as an intermediary himself. However, even in this case the structure should be coordinated in cooperation with BaFin.

2.3 Prospectus requirements

General rule

Entrepreneurs issuing securities or investment products (*Vermögensanlagen*) to investors can be subject to a prospectus requirement, namely a requirement to publish a prospectus approved by BaFin under the German Securities Prospectus Act (*Wertpapierprospektgesetz*) where securities are offered (e.g. shares in stock corporations) or under the German Investment Products Act (*Vermögensanlagengesetz*) where investment products (*Vermögensanlagen*) are offered (e.g. silent partnerships).

The operator of a Crowdfunding platform is normally not subject to such a prospectus requirement since it will not be responsible for the "offering".

Depending on the structure, subordinated loans (*Nachrangdarlehen*) do not generally constitute investment products (*Vermögensanlagen*) under the German Investment Products Act (*Vermögensanlagengesetz*) and therefore no prospectus is required. The same should apply to investments where individuals provide money to a company or project for benevolent reasons or for a non-monetary reward (Donations or Rewards Model).

Exceptions from prospectus requirement

The general prospectus requirement does not apply where the offering of securities or investment products (*Vermögensanlagen*) does not exceed EUR 100,000 within a time period of 12 months. This applies to the issuing of securities as well as the issuing of investment products (*Vermögensanlagen*).





2.4 Possible additional Regulations

Other common regulations to which the operator of a Crowdfunding platform may be subject include:

- German Trade, Commerce and Industry Regulation Act (*Gewerbeordnung*);
- German Act on Money Laundering (*Geldwäschegesetz*);
- German Securities Trading Act (*Wertpapierhandelsgesetz*);
- Consumer Credit Regulation (*Vorschriften für Verbraucherdarlehensverträge*).

3 Possible regulation of Crowdfunding platforms under the AIFMD regime in Germany

3.1 Status of AIFMD implementation

All EU member states must implement the European Alternative Investment Fund Managers Directive ("AIFMD") before 22 July 2013.

As usual, in Germany this implementation goes much further than merely transposing the Directive into German law, imposing additional requirements to those required by the Directive ("gold plating").

On 16 May 2013 the German Federal Parliament (*Bundestag*) passed the Act implementing the AIFMD in Germany. This act includes a Capital Investment Act (*Kapitalanlagegesetzbuch*) which is intended to regulate all German fund structures and all fund managers.

The act is still subject to discussion in the German Second Chamber (*Bundesrat*) so it might still be subject to change.

3.2 Definition of an alternative investment fund ("AIF")

According to the Capital Investment Act the extensive AIFMD regulation of funds and fund managers applies when there is an alternative investment fund ("AIF") managed by an alternative investment fund manager ("AIFM").

Therefore, it is crucial to the impact of the national AIFMD regulations on Crowdfunding whether any of the participants qualifies as an AIF or an AIFM.



The Capital Investment Act (*Kapitalanlagengesetzbuch*) provides that AIFs include a collective investment undertaking which:

- raises capital from a number of investors,
- with a view to investing it in accordance with a defined investment policy for the benefit of those investors; and
- is not an operating company conducting business outside the financial sector and
- do not require authorisation pursuant to Article 5 of Directive 2009/65/EC (UCITS).

With regard to the requirement that the investment undertaking is not an *operating company*, the European Securities and Markets Authority (ESMA) in its consultation paper on "Guidelines on key concepts of the AIFMD" published 19 December 2012 ("ESMA Consultation Paper") considers that "*an ordinary company with general commercial purpose should not be considered a collective investment undertaking*".

BaFin further clarifies the term *operating company* in its consultation paper on the "Scope of application of KAGB-E / Interpretation of the term collective investment undertaking" dated 27 March 2013 ("BaFin Consultation Paper"). In this consultation paper BaFin only considers companies as *operating companies* if they *operate the facility or production themselves within their day-to-day business – without any outsourcing*.

3.2.1 *Operating company seeking funding*

As stated above, German AIFMD regulation does not apply to *operating companies outside the financial sector* which do not *invest in accordance with a defined investment policy*.

In light of the BaFin Consultation Paper, companies seeking funding by means of a Crowdfunding platform could only be *operating companies outside the financial sector* if:

- their business strategy is simply the commercial success of their business;
- they do not intend to follow any defined investment policy but want to finance their on-going day-to-day business; and
- they operate the facility, production or project themselves within their day-to-day business.

In general, these requirements are met by the "typical" start-up or developing company seeking funding for its general commercial business by means of a Crowdfunding platform. Such companies should therefore fall outside the scope of the German AIFMD regulation.





3.2.2 Project Company seeking funding

Equity Model

On the other hand, the BaFin Consultation Paper illustrates that companies cannot qualify as *operating companies* if they are established to finance a single project ("Project Company") such as a movie, a computer game, a wind farm or a solar park, and do not operate the facility or production themselves.

Accordingly, it cannot be excluded that this kind of "Project Company" might constitute an AIF within the meaning of the German AIFMD regulation if it seeks funding in return for a share in the profits or revenue generated by the project.

Lending Model

A subordinated loan (*Nachrangdarlehen*) should generally be capable of being structured as a non-AIF investment on the basis that the investor does not share liability for any losses. However, this is still under review by BaFin.

Donations or Rewards Model

Some of the Project Companies do not offer any kind of revenue but instead (often small) non-financial rewards in return. In the latter case (e.g. if the promised reward is a ticket or a copy of the movie or game) it can be argued that the funds are not invested *for the benefit of those investors* and the funding therefore contains no collective investment undertaking and no AIF. BaFin has not yet commented on a possible application to Rewards-based Crowdfunding.

3.2.3 Crowdfunding Platform

As a general rule the operator of a Crowdfunding platform does not raise capital from investors for its own business. Therefore, the operator of the Crowdfunding platform should not qualify as an AIF.

However, in any case – even if the underlying investment (e.g. a Project Company) qualifies as an AIF – there are sound arguments to state that the Crowdfunding platform does not "manage" this underlying investment. Instead the Crowdfunding platform merely arranges investment into it. The Manager of the AIF is typically the company seeking funding by means of the Crowdfunding platform.

As a conclusion, there are sound arguments that the Crowdfunding platform should not qualify as an AIFM.





4 Conclusion

In conclusion, Crowdfunding is already regulated extensively in Germany. In particular the prospectus requirements in respect of each funding over EUR 100,000 is very strict in comparison with other European jurisdictions.

The application of the AIFMD regime to companies seeking funds by means of Crowdfunding platforms (which appears likely if they are Project Companies) would make any attractive cost-reward ratio impossible. Projects like movies or games are likely to be completely prohibited under the German implementation of the AIFMD since they do not qualify as "material assets" (*Sachwerte*) within the meaning of the Capital Investment Act.

These strict regulations contradict the explicitly stated intention of the European Commission to support Crowdfunding. A large proportion of possible Crowdfunding projects could be rendered impossible in the future. Therefore, BaFin should explicitly exclude Crowdfunding from any possible application of the AIFMD regime.

United Kingdom of Great Britain



1 Current Market of Crowdfunding platforms in UK

There are three broad types of Crowdfunding, each distinguishable by the return that the funder receives:

1.1 The Equity Model (individuals make investments in return for a share in the profits or revenue generated by the company/project)

In the UK, the financial services regulatory regimes for corporate finance business and investment funds both tend to shape the structure of Equity-based Crowdfunding platforms. However, as both regimes generally only cater for professional investors, it appears likely that a new regulatory regime will be specifically designed for Equity Crowdfunding (separately from the proposals to create a regime for the Lending Model discussed below). At present some platform operators make use of exemptions from the regulatory regime, whilst others have obtained authorisation from the UK's competent authority, the Financial Conduct Authority ("FCA") (or its predecessor, the Financial Services Authority ("FSA")). A more consistent approach is likely to emerge as the FCA and the UK Government develop a regulatory strategy.

1.2 The Lending Model (individuals lend money to a company or project in return for repayment of the loan and interest on their investment)

The making of non-consumer loans has not, to date, been treated as a regulated activity (because loans are not typically regarded as "transferable securities") and so the Crowdfunding Lending Model has developed quickly as an alternative to bank lending. However, the UK Government has published its proposal to make peer-to-peer lending a regulated activity with effect from April 2014.

1.3 The Donations or Rewards Model (individuals provide money to a company or project for benevolent reasons or for a non-monetary reward)

The Donations or Rewards Model does not involve any form of financial investment or return and so it falls outside the scope of UK financial services regulation (although this too is under review). Crowdfunding originated from Donations or Rewards-based platforms, where the interest of participants was to help a worthy or interesting cause for the sake of being associated with it, rather than to profit financially. As the most established model, it is also the most popular, with platforms such as US-originated "Kickstarter" being the market leader. The idea of combining worthy causes with financial returns led to the development of the Equity and Lending Models, which are the focal points of several deep-pocketed institutions already operating in the financial services industry.



2 Current Regulation of Crowdfunding platforms in UK

2.1 Licence/approval requirements for Equity Platforms

2.1.1 *Financial promotions*

The offer of shares, depositary receipts or other securities will generally constitute a financial promotion, namely an invitation or inducement to engage in investment activity. A financial promotion cannot be made to a retail investment audience unless the promotion is communicated or approved by a firm authorised by the FCA or it benefits from an exemption from the financial promotion regime.

Much of the Crowdfunding website's contents will comprise an element of financial promotion. Accordingly, either the operator will need to be FCA-authorized or the operator of the platform will need to ensure that an FCA-authorized firm approves the financial promotion.

Where an exemption is not available, the contents of the website's financial promotions need to comply with the requirements of chapter 4 of the FCA's Conduct of Business Sourcebook to ensure that they are clear, fair and not misleading.

The approval of financial promotions entails costs and administrative burden. Accordingly, it is common for operators to engage an FCA-authorized firm to approve initial investor communications and procure that the promotion of specific investment opportunities fall within one of the two exemptions highlighted below:

- existing shareholders - the platform creates a shareholder relationship with all funding subscribers and a parent/subsidiary relationship with fund-seeking subscribers; and/or
- sophisticated, high net worth and professional investors - the platform assesses the investment sophistication of subscribers or requires the subscriber to certify their own net worth or investment experience.

If the Crowdfunding entails investing in a collective investment scheme, there is a more restrictive financial promotion regime (see below). For this reason, Crowdfunding platforms generally take all necessary steps to ensure that the investment does not constitute a collective investment scheme.

2.1.2 *Regulated activities*

The Financial Services and Markets Act 2000 requires platform operators to become authorised by the FCA in order to conduct regulated activities. Conducting a regulated activity without authorisation is a criminal offence. Regulated activities associated with Equity Crowdfunding may include:





- bringing about transactions in investments issued by the party seeking funding;
- making arrangements with a view to transactions in investments (which captures referral arrangements even where a specific issuer or investment is not identified); or
- safeguarding and administering investments (custody).

Less commonly, the platform operator could become involved in advising on investments, managing investments or dealing in investments, depending on the business proposition.

Where the party seeking funding does not issue shares in a company, platform operators may also need to consider whether they are carrying on the regulated activity of operating a collective investment scheme (see below).

Many Equity Crowdfunding platforms are structured using a combination of exclusions and exemptions from the regulated activities regime. Use of these exemptions, particularly where they apply the letter but not the spirit of the law, still carry a high degree of risk, because of the increasingly interventionist and judgemental approach to supervision and enforcement that has been adopted by regulators in the wake of the financial crisis.

However, seeking authorisation is a costly and time-consuming process and obliges the regulated firm to comply with the FCA's conduct of business obligations to ensure that the investments arranged through the platform are appropriate for the investor on a case-by-case basis. This can prove challenging when dealing with the low value investor base often associated with Crowdfunding.

2.1.3 *Collective investment schemes*

Where the profit share being offered to investors is not channelled through a standard corporate issuer/shareholder relationship (e.g. the investor receives a contractual entitlement to profits from a project) the investment may be characterised as units in a collective investment scheme. Crowdfunding generally entails the pooling of investor contributions or the pooling of profits and/or income prior to distribution to the investor, with no involvement in the day-to-day management of the proposition (or project), the two key components of a "collective investment scheme".

Operating a collective investment scheme is a regulated activity and must be conducted by an FCA-authorized firm (see the section on regulated activities above). There is potential for either the platform operator or the fund-seeking party to be a person that would conduct the regulated activity, depending on how the arrangements are structured.

The promotion of single-project collective investment schemes is subject to greater restriction than the promotion of shares, even when the promotion is communicated or





approved by an FCA-authorized firm. The FCA (under Consultation Paper CP12/19) is proposing to further reduce the scope for communicating with retail investors and increase the types of investment vehicle caught by the regime to include special purpose vehicles. CP12/19 is due to be developed in June 2013. Because of this, it is important for Crowdfunding platforms that wish to offer investment opportunities to retail investors to ensure that the offering does not entail a collective investment scheme. Depending on the consultation, existing structures that rely on the creation of a corporate investment vehicle to avoid the collective investment regime could also cease to be operable.

2.1.4 *Impact of the AIFMD*

From 22 July 2013, the Alternative Investment Fund Managers Directive ("AIFMD") will add a new layer of regulation on top of the collective investment scheme regime. The AIFMD will apply where the investment proposition involves an "alternative investment fund" ("AIF"), namely:

- a collective investment undertaking;
- which raises capital from a number of investors; and
- which invests in accordance with a defined investment policy for the benefit of its investors.

Most collective investment schemes will be AIFs, but the AIFMD is also capable of applying to a body corporate that falls outside the CIS regime. The AIFMD imposes a heavy regulatory burden above and beyond the CIS regime on fund operators falling within scope, for example, the requirement to appoint an independent depositary. These requirements are likely to outweigh the rights afforded to fund managers under the Directive to market their services throughout Europe.

There is a UK exemption from the AIFMD regime for managers with total assets under management of less than EUR 100 million, so the Directive is not likely to affect many UK-based platforms at this stage of its development. The impact of the Directive is reduced in the UK in comparison with other European jurisdictions because the UK will not radically amend the existing regulation applying to fund managers in respect of fund structures that fall within the EUR 100 million exemption (the UK's collective investment scheme regime will continue to apply to such structures).

2.1.5 *Prospectus requirements*

The UK Financial Services and Markets Act 2000 (as amended) requires a prospectus to be published where transferable securities are offered to the public. Most Crowdfunding offers fall within an exemption for offers worth less than EUR 5 million in a period of 12 months. There are other exemptions that may be of use if single issues exceed this level.





Section 755 of the Companies Act 2006 also prohibits the offer of shares in a private limited company to the public. The involvement of the platform can be structured so as to reduce the risk of breach.

2.2 Regulatory Regime for the Lending Model

The vast majority of lending platforms are not regulated as financial services businesses, although a small number deal in debentures (which are debt instruments subject to a similar regulatory regime to the Equity Model); others are regulated as mortgage brokers; and several lending platforms are regulated by the Office of Fair Trading as consumer credit brokers (see below for more details).

The FCA and the UK Government have published proposals to make "operating an electronic system in relation to lending" by peer-to-peer lending platforms a new regulated activity, covering arrangements with both consumer borrowers and lenders. A Crowdfunding platform operator intending to allow lending through its platform to consumer borrowers will therefore be required to become FCA-authorized unless an exemption applies. At the time of writing, the consultation has yet to develop detailed proposals for the conduct of business requirements associated with these activities, but HM Treasury and the FCA are liaising with interested parties with a view to publishing proposals in the autumn. The debate is focussed on the degree of responsibility a platform should take for vetting individual lenders and borrowers.

2.3 Possible additional requirements

2.3.1 *Payment services*

The transmission of funds between the investor and the crowd funded business may involve the platform operator providing "money remittance" services under the Payment Services Regulations 2012 (as amended) ("PSRs"). (The PSRs implement in the UK the Payment Services Directive.) A platform operator will require separate FCA authorisation if it is conducting payment services.

Operators should however normally be able to rely on the exemption for "commercial agents" under the PSRs on the basis that they have authorisation to negotiate or conclude contracts on behalf of the funder and the fund seeker.

Escrow arrangements pose particular payment services issues and have been the subject of specific European Commission guidance.

It is common practice for payment services providers (e.g. Paypal) to withhold a percentage of pledged funds pending satisfaction of any funding criteria stipulated by the fund raiser. This is because the payment services provider has a legal obligation to refund credit card payments in certain circumstances where the transaction is subsequently reversed.





2.3.2 Consumer credit

The Consumer Credit Act 1974 (as amended by the Consumer Credit Act 1986) ("CCA") applies to consumer credit or consumer hire agreements where the borrower/hirer is not a body corporate or a partnership of four or more persons. Some Crowdfunding platforms therefore restrict lending to bodies corporate. To the extent that consumer borrowers are permitted on a platform, however, a CCA licence will be required and there will be implications for the form and content of the lending agreements also.

Regulation of consumer credit is to be transferred from the Office of Fair Trading to the Financial Conduct Authority in April 2014, making consumer credit a mainstream financial services activity.

The application of the consumer credit regime also has implications for whether the platform will fall under the scope of the UK Money Laundering Regulations.

3 Conclusion

The UK Government has set out its proposals to regulate the Lending Model, however, the regulation of Equity and Debt-based Crowdfunding is in a state of flux and development.

To ensure the UK's competitiveness does not unduly eradicate the benefits of Crowdfunding, the UK will need to ensure that the regulatory regime it develops for Equity and Debt-based Crowdfunding platforms caters for a wide range of business propositions. Provided this enables execution-only services to run on a disclosure-based regime, this should permit investors and investees to continue to benefit from the pricing models that have seen Investment Crowdfunding to develop in the first place.



ITALY



1 Current Crowdfunding Models in Italy

In Italy, there are three types of Crowdfunding.

1.1 The Equity Model

According to this model, individuals make investments to subscribe share capital in the target company.

Currently a few platforms offering the Equity Model operate without any kind of licence and only engage in the business of investment broking and/or contract broking. They ensure security offerings comply with exemptions from the requirement to produce a prospectus.

1.2 The Lending Model

According to this model individuals lend money to a platform which in turn lends money to others in return for repayment of the loan and interest.

The two Italian platforms operating this model have been requested by CONSOB and the Bank of Italy to comply with the banking and financial institutions laws and regulations and both of them are operating with a banking/financial institution licence.

1.3 The Donations or Rewards Model

Under the Donations Model, individuals provide money to a company or project pro bono, for charity or for other purposes but in any case, without any monetary reward.

The Donations or Rewards Model is mainly used to finance social, charity or creative projects or companies and no financial investment or return is involved. Investors fund projects or companies and either get no return at all or only receive non-monetary rewards (e.g. tickets, CDs or rewards of a symbolic value).

2 Current Regulation of Crowdfunding platforms in Italy

2.1 Financial Service licence requirements

2.1.1 *Equity Model*

Pursuant to the Italian Consolidated Financial Law and Italian Consolidated Banking Law, anyone intending to provide investment services in Italy commercially or on a scale which





requires a commercially organised business undertaking requires a written licence from the competent authorities (CONSOB and/or Bank of Italy).

Investment services are, inter alia, the brokering of business involving the purchase and sale of financial instruments or their documentation (investment broking), the purchase and sale of financial instruments in the name of and for the account of others (contract broking) and the placement of financial instruments without commitment to take up those instruments (placement of financial instruments).

Financial products within the meaning of the Italian Consolidated Financial Act include securities and financial instruments.

Securities are, inter alia, (a) company shares and other shares equivalent to shares of companies, partnerships or other persons and share deposit certificates; (b) bonds and other debt securities, including certificates of deposit relating to such securities; (c) any other security normally negotiated which permits the purchase or sale of securities described in the preceding paragraphs d) any other security usually involving cash settlement determined with reference to securities described in the preceding paragraphs, to currency, interest rates, returns, commodities, indices or measures.

Financial instruments are, inter alia, securities, money market instruments, units in collective investment funds, options, futures, swaps, futures contracts on interest rates and other derivative contracts linked to securities, currency, interest rates or returns, or on commodities, derivatives for the transfer of credit risk, differential financial contracts.

Equity-based Crowdfunding has been identified as a model to raise financing and help a company to succeed in executing certain projects. Italy has regulated this matter pursuant to Law 221/2012 which permits the raising of money online to support the development of "innovative start-up companies", being companies which meet requirements specified under the same Law 221/2012².

CONSOB is due to prepare more detailed rules underlying the new regime and the draft of the regulation has been already published for comments although many points are still the subject of debate.

Law 221/2012 seems to restrict the possibility of raising money online to the Italian entities falling within the definition of "innovative start-up". However, whilst this is clearly a significant restriction, it may be that the categories of equity investee may be widened after an initial trial period.

The management of a platform for the collection of capital for innovative start-ups must be conducted by investment companies and banks that are authorised to provide the

² Article 25, paragraph 2 of Law 221/2012.





relative investment services to the subjects enrolled on a register to be created by CONSOB (the so-called register of the entities managing platform). In any case, these platforms are required to transmit the orders regarding the underwriting and trading of financial instruments representing capital exclusively to banks and investment companies.

The entity managing the platform will not have the right to collect the money from investors, unless it is authorised to act as a financial institution.

2.1.2 *Lending Model*

The two Italian platforms operating this model have been requested by CONSOB and the Bank of Italy to comply with the banking and financial institutions laws and regulations and both of them are operating with a banking/financial institution licence.

The same limitation is likely to apply to platforms lending to companies or other kind of entities.

2.1.3 *Donations or Rewards Model*

These kinds of contributions are structured so as not to constitute investment products and therefore the platform operating this model falls outside of the Italian financial services regulation.

2.2 License under the Payment Services regulation

Any transfer of funds through the operator of a Crowdfunding platform could constitute money remittance services and be subject to payment services regulation.

As an alternative – in a similar manner to a CONSOB proposal in respect of securities licensing for the Equity Model – the Crowdfunding platform could avoid being regulated as an intermediary by using an external financial institution for processing payments.

As already noted, the entity managing the platform cannot hold sums of money or financial instruments belonging to third parties, unless it is authorised as a bank or an investment company.

2.3 Prospectus requirements

The prospectus requirement does not apply to the offering of securities or investment products with a value of EUR 5 million or less within a time period of 12 months. Because the amounts raised are generally smaller, a Crowdfunding platform operating the Equity Model is unlikely to be subject to any prospectus requirement. However, it is not yet clear whether the platform will be responsible for the information made available to the investors individuals and concerning the "offering".



No prospectus requirement is likely to apply in respect of the Lending Model or the Donations or Rewards Model.

2.4 Possible additional requirements

The operator of a Crowdfunding platform could be subject to further regulations, in particular:

- Italian Money Laundering law
- Italian Data Privacy law
- Consumer credit regulation
- Italian Law 231/2001

3 Possible regulation of Crowdfunding platforms under the AIFMD regime

3.1 Status of AIFMD implementation

All EU member states must implement the European Alternative Investment Fund Managers Directive ("AIFMD") before 22 July 2013.

Implementation of the law has not yet occurred and no draft of the law has been published so far. The Bank of Italy, CONSOB and the competent Ministries are working in round table to draft the relevant implementing legislation.

The implementation of the directive was already in discussion by the Italian Parliament at the beginning of 2012, as part of the *Legge Comunitaria 2011*, a law enacted every year in order to implement all the pending directives. In that case, the Parliament would have enacted a law fixing the main principles of the provisions to be adopted and would have delegated to the Government responsibility for preparing and enacting the relevant final law.

3.2 Crowdfunding Platform

As a general rule the manager of a Crowdfunding platform does not raise capital from investors itself. Therefore, the operator of the Crowdfunding platform should not constitute an AIF.

Since it is a pre-requisite of the CONSOB regulation for the underlying investment under the Equity Model to be a company having the characteristics of an innovative start-up, it should follow that a Crowdfunding platform will not "manage" this underlying investment. Instead the Crowdfunding platform merely arranges investment into it. The innovative start-up should not normally constitute an AIF in the first place.





In conclusion, there are sound arguments that the Crowdfunding platform should not constitute an AIFM, although this matter has to be kept under review as the relevant Italian law develops.

4 Conclusion

The Lending Model is already subject to regulation and the Equity Model will become subject to its own regulatory regime once, once the relevant regulation is finalised.

Law 221/2012 seems to restrict the possibility of raising money online to Italian entities covered by the innovative start-up definition. These provisions could therefore be seen as a contradiction to the clear intention of the European Commission to support the Crowdfunding raising on a wider basis.

In a country like Italy in which 1,000 new companies start every day, this law could materially limit the application of the investment model and prevent the “crowd” from deciding which company to back for success in the future.

Another provision of the CONSOB draft regulation requires, as a condition precedent to commence the online offer, a 5% subscription of the share capital to be made by a financial investor. The reason behind this decision is the need to have at least one investor to professionally evaluate the business and the investment, in order to protect the other shareholders’ investment (i.e. those coming from the “crowd”).

This provision could again materially limit the raising of money, without bringing any actual protection of the public investors. The efficacy of this method of investor protection is questionable, but the limitations it imposes on Crowdfunding do not appear consistent with the European Commission's view.

Although it is not clear that the AIFMD regime does apply to companies seeking funds through Crowdfunding platforms (which needs to be further assessed) if it were to apply, it would make any attractive cost-reward ratio impossible.



MEMBERSHIP ENROLLMENT FORM

The European Crowdfunding Network AISBL accepts applications for two forms of Membership, the Full Member and the Associate Member.

- Full Members of the European Crowdfunding Network AISBL can be organisations that actively operate a crowdfunding platform.
- Associate Members of the European Crowdfunding Network AISBL can be any other organization or individual. Associate Members do not have voting right in the organisations General Assembly.

To enroll as a Member, please fill in the following information and provide us with as much additional detail as possible that supports your application for becoming a full member of The European Crowdfunding Network.

Company: ZIP Code:
Last Name: Country:
First Name: Fax:
Street: Tel:
City: Email:

- I am interested in becoming a **Full Member** paying an annual fee of €1,000 per calendar year
- I am interested in becoming a **Full Member** paying for two years upfront and receive a 50% discount on the first year an annual fee of €1,000 (only available in 2013)
- I am interested in becoming a **Associate Member** paying an annual fee of €650 per calendar year

The relevant annual fees and pro-bono contribution are needed from Members in order to ensure the success and longevity of the Network. I understand that I can cancel my commitment at any time, but that paid contributions will not be reimbursed. Please invoice me for the relevant amount.

Date: Place:
Signature:

Please fill in, sign, scan and email this form to info@europecrowdfunding.org





SPAIN



1 Current Market of Crowdfunding platforms in Spain

In Spain, there are three types of Crowdfunding.

1.1 The Lending Model

In this model, a person gives money as a loan to a project and their reward is to recover the economic value. Apart from recovering the money that has been lent, this type of Crowdfunding sometimes include interest, so that the "crowdworker" gets something more than what was paid. Also included in this type of Crowdfunding is the payment of an amount of money to buy a product that has not yet started to yield return. This is known as pre-sale lending model.

1.2 The Equity Model

The Equity Model is not viable in Spain without major adaptation. In Spain this model is based on Joint Accounts which implies a form of cooperation between individuals and companies, through which an account-participant contributes an amount of money to carry out an activity, foreign trade or business by receiving the participation-manager in property and its exclusive direction of the operation or activity, becoming participants in both prosperous and adverse outcomes in the proportion agreed upon.

1.3 The Donations or Rewards Model

Under the Rewards Model, individuals provide money to a project and the project offers "rewards". The rewards can be of any type: merchandising of a film, the use of a particular service, publically acknowledgement of their participation etc. The Rewards Model is the most common Crowdfunding model in Spain.

The Donations Model is run by platforms that are based in purely donations without rewards or money return. No financial investment or return is involved.

2 Current Regulation of Crowdfunding platforms in Spain

2.1 Lending Model

This model is based on loans between individuals. The platform is not formally a Crowdfunding platform, but it is consider as a financial intermediary. These platforms are governed by the Act 2/2009 regulating consumer contracting loans or mortgage and brokerage services for the conclusion of contracts of loan or credit. Prior to commencing business, companies must register in the local regional registry.





The platforms that use this model are not required to have a financial entity licence or any other kind of licence. They act as corporations but their activity is regulated by the Act 2/2009, and the Corporations Act.

2.2 The Equity Model

This model is not viable in Spain in the same form as in other countries. The formation of a Sociedad Anonima ("S.A.") as the investment vehicle would entail compliance with the requirements of the Companies Act and the Securities Exchange Commission ("CNMV"). The lack of speed and efficiency associated with this process appears to be incompatible with the aims of Crowdfunding. Similar procedural issues attach to the constitution of a Limited Liability Company or S.L.

Instead, the Equity Model used in Spain operates by means of "Joint Accounts". The joint accounts are regulated by the Spanish Commerce Code, articles 239 to 243. This provides a simple mechanism for establishing a collective funding vehicle. It can be formalised online, does not require publicity or formality and allows freedom of agreements.

There is an alternative to the Joint Accounts Model. Platforms that act as a financial intermediary between the investor and the project can use financial instruments to provide a return on investment. Such platforms would generally fall under the scope of the Markets in Financial Instruments Directive 2004/39/EC ("MIFID").

Alternatively, the platform may fall within the scope of Royal Decree 217/2008, of 15 February, on the legal regime for investment services entities and other entities that provide investment services and partially amending the Regulations to Act 35/2003, of 4 November, on Collective Investment Schemes, approved by Royal Decree 1309/2005, of 4th of November.

As a matter of practice, Spanish Crowdfunding platforms operate outside the scope of supervision by the CNMV or the Bank of Spain.

Neither regulator has made public pronouncements on this matter and Crowdfunding platforms are currently not considered to be financial entities in practice, even though there is a case for treating them as such as a matter of law.

2.3 Donations or Rewards Model

The Donations and Rewards Models are not subject to financial services regulation.

2.4 Possible additional requirements

The operator of a Crowdfunding platform could be subject to further regulations, in particular:

- Draft bill XX/2013, de XX, regulating the private equity and other investment companies and their management companies. AIFMD integration.





- Draft bill that supports Entrepreneurs.

3 Possible regulation of Crowdfunding platforms under the AIFMD regime

3.1 Status of AIFMD implementation

All EU member states must implement the European Alternative Investment Fund Managers Directive ("AIFMD") before 22 July 2013.

Currently the Spanish authorities have published in draft the XX/2013 Bill of XX, which regulates private equity and other investment companies and their management companies. This bill has been approved by the Spanish State but further supplementary provisions need to be approved in order to implement the Directive.

Any platforms following the Equity Model could fall within the scope XX/2013 bill of XX, because it regulates the marketing of venture capital or OSI managed by managers authorised under the AIFMD. In both cases such marketing shall be subject to the authorisation of the CNMV and the product in question subject to registration with the regulator.

We expect Parliament to approve the draft bill in the course of this year.

4 Conclusion

There is currently no regulatory regime that is specifically adapted to Crowdfunding in Spain. However, operating the Equity Model is subject to regulation designed for other activities, such as the Royal Decree 217/2008, of 15 February, on the legal regime for investment services firms and other entities that provide investment services and partially amending the Regulations to Law 35/2003, of 4 November, on Collective Investment Schemes, approved by Royal Decree 1309/2005, of November 4.





As a matter of practice, Equity Model platforms are structured so as not to be regulated by the CNMV or the Bank of Spain. However, as a matter of law, it appears that many such platforms could nonetheless be conducting activities that fall within the scope of the Markets in Financial Instruments Directive or, when implemented, the Alternative Investment Fund Managers Directive.

Platforms using the Lending Model generally fall within the scope of the Act 2/2009.





SUMMARY – Regulation of Crowdfunding in Germany, UK, Italy and Spain

Country Regulation	Germany 	UK 	Italy 	Spain 
General regulation	<ul style="list-style-type: none"> If Crowdfunding platform facilitates offering of securities or investment products (<i>Vermögensanlagen</i>), the operator of the platform provides financial services → BaFin authorisation required Exemption for investment broking and contract broking only regarding newly issued investment products (<i>Vermögensanlagen</i>) Depending on the structure in detail: sound arguments that subordinated loans (<i>Nachrangdarlehen</i>) and contributions under Donations/Rewards Model do not constitute investment products (<i>Vermögensanlagen</i>) 	<ul style="list-style-type: none"> Equity Model often entails conducting regulated securities business → FCA authorisation required Lending Model is due to become a regulated activity from April 2014 → FCA authorisation will be required Many Equity Model platforms use exclusions and exemptions from regulated activities regime → new regulated activity regime likely to be developed to close down loopholes Donations/Rewards Model is not subject to financial services regulation. 	<ul style="list-style-type: none"> Equity Model is potentially subject to regulated activities regime According to Italian Law 221/2012 platform must restrict offers of securities to shares in "innovative start-up Italian company" Many Crowdfunding platforms use exclusions and exemptions from regulated activities regime (acting as broker and not as offeror) → position to be cleared after the issuing of Law 221/2012 and the entering into force of the CONSOB regulation Platform operating Lending Model is subject to the Consolidated Banking Law and relevant regulation 	<ul style="list-style-type: none"> Crowdfunding platforms operating the Equity Model are not treated as performing financial services, even if a number of platforms appear to fall within the scope of MiFID and Spanish financial services law Crowdfunding platforms operating the Lending Model are generally regulated by the regime for corporations Crowdfunding platforms operating the Donations/Rewards Model are not subject to regulation. No Crowdfunding platforms are currently supervised by the Bank of Spain or the CNMV





		<ul style="list-style-type: none"> In Equity Model, where profit share is not channelled through a standard corporate issuer/shareholder relationship, investment may be characterised as collective investment scheme → prohibition on promoting collective investment schemes to retail investors 	<ul style="list-style-type: none"> Depending on the structure in detail: investments under the Donations/Rewards Model do not qualify as investment products 	
Prospectus requirement	<ul style="list-style-type: none"> Prospectus requirement for offering of securities or investment products (<i>Vermögensanlagen</i>) Threshold: EUR 100.000 per issuer within 12 months Depending on the structure in detail: no prospectus requirements for subordinated loans (<i>Nachrangdarlehen</i>) or contributions under Donations/Rewards Model 	<ul style="list-style-type: none"> Prospectus requirement for offering of transferable securities (such as shares) Threshold: EUR 5 million per issuer within 12 months 	<ul style="list-style-type: none"> Prospectus requirement for offering of securities Threshold: EUR 5 million per issuer within 12 months 	<ul style="list-style-type: none"> The companies regime in Spain does not lend itself to the offering of shares → the Equity Model is generally operated by means of joint accounts to which the prospectus regime does not apply
AIFMD-regulation	<ul style="list-style-type: none"> Typical start-up company in general does not constitute an AIF "Project Company" might constitute AIF 	<ul style="list-style-type: none"> Crowdfunding structure could constitute an AIF if it includes profit share arrangements otherwise than in a commercial company 	<ul style="list-style-type: none"> Depending on the structure in detail: funding by means of subordinated loans or contributions under the Donations/Rewards Model should not constitute AIF 	<ul style="list-style-type: none"> Crowdfunding platforms could entail offering an AIF, although the regulators have not yet made public pronouncements on the issue





	<p>→ extensive AIFMD regulation for AIF and its manager → manager (AIFM) requires BaFin authorisation</p> <ul style="list-style-type: none"> Depending on the structure in detail: funding by means of subordinated loans (<i>Nachrangdarlehen</i>) or contributions under Donations/Rewards Model should not entail an AIF Sound arguments that Crowdfunding platforms should not constitute AIFM 	<ul style="list-style-type: none"> EUR 100 million exemption means no UK Crowdfunding platforms will be affected by the AIFMD at this point → only likely to be relevant if e.g. real estate Crowdfunding develops significant scale 	<ul style="list-style-type: none"> Pursuant to draft Regulation issued by CONSOB, Crowdfunding platforms should not constitute AIFM 	
Possible additional regulation / requirements				
Payment service regulation	<ul style="list-style-type: none"> Transfer of funds through operator may constitute money remittance service → BaFin authorisation required "Commercial Agents" exemption probably not applicable to operators of Crowdfunding platforms 	<ul style="list-style-type: none"> Transfer of funds through operator may constitute money remittance service → FCA authorisation would be required Exemption for "Commercial Agents" likely to apply to operators of Crowdfunding platforms 	<ul style="list-style-type: none"> Transfer of funds through operator may constitute money remittance service → CONSOB authorisation 	<ul style="list-style-type: none"> Transfer of funds through operator does not constitute money remittance service





Consumer credit regulation	If consumer borrowers are permitted on a platform (Lending Model) there are implications for the form and content of the lending agreements	If consumer borrowers are permitted on a platform (Lending Model) a Consumer Credit licence is required → implications for the form and content of the lending agreements → Consumer Credit regulation is being transferred from Office of Fair Trading to FCA	If consumer borrowers are permitted on a platform (Lending Model) there are implications for the form and content of the lending agreements	If consumer borrowers are permitted on a platform (Lending Model) there are implications for the form and content of the lending agreements
Further possible requirements	<ul style="list-style-type: none"> • German Trade, Commerce and Industry Regulation Act (<i>Gewerbeordnung</i>) • German Act on Money Laundering (<i>Geldwäschegesetz</i>) • German Securities Trading Act (<i>Wertpapierhandelsgesetz</i>) 	<ul style="list-style-type: none"> • Money Laundering Regulations 2007 	<ul style="list-style-type: none"> • Italian Money Laundering law • Italian Data Privacy law • Italian Law 231/2001 	<ul style="list-style-type: none"> • Draft Bill that supports entrepreneurs

BUILDING A PAN-EUROPEAN CROWDFUNDING ECOSYSTEM

by raising professional standards,
fostering transparency, creating
networking opportunities,
and undertaking industry and
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