# Fintech Regulation and the Licensing Principle

Edited by

Dário Moura Vicente
Diogo Pereira Duarte
Catarina Granadeiro

EBI European Banking Institute

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# Foreword

## by the President of the Academic Board of the European Banking Institute (EBI)

It is with pleasure that I write a foreword to this very interesting and well-structured collective work, which is the by-product of an international academic conference held in Lisbon in mid-2022. This work deals with the legal challenges related to the application of FinTech technology in the provision of financial services, as well as the interplay with the licensing principle as applicable to traditional financial service providers.

The EBI promotes and supports, since its establishment, research activity aimed at providing high-quality studies on legal, economic, and accounting issues related to banking (and, in general, financial) prudential regulation, prudential supervision and crisis management in Europe. Inter alia, the research promoted by the EBI is geared towards producing top-level publications, part of which are included in its EBI E-book Series, which seeks to address cutting edge banking regulation topics.

In this respect, the EBI has fully supported the initiative of the Faculty of Law of the Lisbon University Research Centre for Private Law to hold an international conference aimed at discussing the above-mentioned issues. Academics linked to the EBI actively contributed to several Panels of that conference, the output of which is now made available to a wider public through its publication as an EBI e-book.

I wish to extend a special word of thanks to all the contributors to this publication, whose work and research have made it possible.

Frankfurt, 16 December 2022

Professor Christos V. Gortsos

President of the Academic Board
of the European Banking Institute

# Foreword

by the Editors

Banks, investment undertakings and insurance companies are licensed entities and thus subject to prudential obligations that include a plethora of requirements, from minimum capital and liquidity to constraints on large exposures, specific rules on governance arrangements and compensation schemes. Moreover, these entities are also subject to regulations concerning consumer protection, anti-money laundering, rules on combating terrorism financing and the conduct of business which apply to the different services they offer, including deposit-taking, credit underwriting, payment services and wealth management.

Prudential regulation aims to address the impact of the failure of financial institutions on the stability of the system. To the extent that the risks of such an impact stem from the vulnerability of those institutions' balance sheets, prudential regulation follows an entity-based approach. This involves specific requirements for entities – such as banks – which perform a combination of activities that entail risk transformation: taking government-protected liabilities redeemable at short notice and at par value (deposits), and investing those funds in risky, longer-term, and less liquid assets (e.g., credit).

These traditional market players were challenged in recent times by FinTechs, defined by the Financial Stability Board as "technologically enabled financial innovation that could result in new business models, applications, processes or products with an associated material effect on financial markets and institutions and the provision of financial services".

These developments have generated profound changes in the market structure, as non-licensed FinTech players became very active in offering services that in the past were predominantly offered by heavily regulated entities, causing the so-called unbundling of banks effect, and fostering competition in the financial services market.

The entry of new players in the business of supplying finance-like products and the increasing reliance on electronic channels for their distribution, typically without the same systemic risk underlying the traditional licensing principle, has, according to some, challenged the belief that strict controls over entry into finance business are necessary.

The matter of licensing crypto-assets services providers is currently one of the most important issues surrounding the market in crypto-assets.

After the total market capitalisation of crypto-assets exceeded historical highs in the end of 2021, the Terra-Luna turmoil in the beginning of 2022 and the so-called crypto-winter made the case for regulators and regulation. Furthermore, the recent disclosure, through a tweet of Binance's CEO, of a letter of intent for the FTX bail-out, and the dramatic depression in the market caused by it, makes very clear case for the evidence that has been asserted since the Terra-Luna case. This evidence is that the market in crypto-assets has weaknesses, which have traditionally affected other verticals of the financial sector, and that industry players are unable to prevent or mitigate them. The case revealed the problems of conflicts of interest and market abuse that are traditionally addressed by regulation in other areas of the financial industry.

At this moment, it seems that only regulation can save the crypto-assets industry. The protection of the market and investors demand for requirements and prudential supervision in terms of own funds and assessment qualifying holdings, in the same manner these are current applicable for banks, investment companies and insurance companies. Transparency and investor protection is critical. Strict requirements are needed to exclude bad actors and opportunists.

With this background, the European Union is finalising the "market of crypto-assets regulation", the so-called MiCA Regulation, (having being reach an accord between the Council and the European Parliament for the final text last October), which among other aspects will regulate the offerings and marketing to the public of crypto-assets and the obligation to draw up a crypto-asset white paper in relation to it; the procedure for authorisation of stablecoins, providing for several aspects of the activity of those issuers; authorisation and operating conditions of crypto-asset service providers, including in relation to cross-border activity and several prudential requirements which will be applicable all crypto-asset service providers; and, finally, prevention of market abuse. It seems a step in the right direction, and we can only expect that MiCA can bring discipline to the market and appropriate protection to the investors, specially retail consumers.

The fundamentals behind the licensing principle, as well as its relevance in the context of FinTech driven innovation in the financial sector, were discussed at the Conference on 'Fintech Regulation and the Licensing Principle', held at the Faculty of Law of the University of Lisbon on June 30th, 2022.

This Conference was sponsored by CIDP (Research Centre for Private Law of the Faculty of Law of the University of Lisbon), as a component of its research line on 'Private Law in the Digital Era'.

The purpose of this research line is to assess, from a legal perspective, how the emergence of the so-called Digital Era challenges existing Private Law structures and calls for a reassessment of established principles in this area of the law.

The Conference was held in partnership with the European Banking Institute (EBI), a leading international centre for banking studies. EBI collects contributions from preeminent European

academic institutions, with the purpose of providing high-quality legal, economic, and accounting studies on issues of banking regulation, supervision, and resolution.

In this volume, the reader will find a thorough discussion of the licensing principle in banking law, now a frequently challenged principle both by the practice of financial intermediation activities by non-authorised entities and on theoretical grounds; a discussion on Fintechs and the desirable level playing field; and an analysis of the applicability of the licensing principle to the activities of investment-based crowdfunding, which includes as debate on whether investment-based crowdfunding platforms conduct activities subject to the licensing principle, as well of the applicability of the licensing principle in the area of payment services.

This publication also contains a discussion of the legal status of crypto-assets in enforcement and insolvency proceedings, which seeks to address the peculiarities of crypto custodians and the problems raised by the recognition of foreign judgments and the establishment of international jurisdiction over them. Linking both crypto-assets and the overarching theme of the licensing principle, a discussion is included in this volume on the licensing rules in the proposal for a Regulation on Markets in Crypto-Assets (MiCA).

The present publication also touches upon the challenges related to imposing requirements on offerors of crypto-assets that do not qualify as financial instruments.

A paper on the cutting-edge topic of smart contracts from a legal perspective is also included in this work, which discusses the way in which these contracts challenge traditional legal thinking and whether existing rules of Contract Law are fit to regulate the use of smart contracts.

Lastly, the book contains a case study on whether blockchain is the key to empower local energy communities, which provides an empirical perspective of the use of blockchain technologies in this market, as well as the legal complexities surrounding it.

This publication purports to shed light on the many legal challenges that have emerged with the developments brought about by FinTech and its connection with the licensing principle. The editors hope that this goal has to some extent been attained with the papers that are now made available to the public.

Lisbon, December 2022

Professor Dário Moura Vicente
Professor Diogo Pereira Duarte
Catarina Granadeiro, LLM

# The Licensing Principle and Investment-Based Crowdfunding

by Eugenia Macchiavello[1]


## Abstract

Crowdfunding has been recently regarded as an important instrument of alternative finance, contributing to meeting SMEs' financing needs. In particular, investment-based crowdfunding, although smaller in market size compared to lending-based crowdfunding, can potentially help seed and start-up companies move from the 'family, friends and fool' stage to venture capital and private equity investments. The activities of crowdfunding platforms present features similar to investment firms' services and an economic function of 'weak intermediation' similar to these, but also special characteristics. This paper sets out to discuss, in line with the main topic of this CIDP conference and EBI working paper series, whether investment-based crowdfunding platforms conduct activities traditionally subject to the licensing principle (the same or similar activities) and should be subject to the same or similar licensing requirements and legal framework. It also offers a critical analysis of the approach adopted by EU Regulation No. 1503/2020 on European Crowdfunding Service Providers for Businesses in this regard, drawing a number of conclusions on the gatekeeper's role assigned to platforms by the Regulation.


Keywords: Crowdfunding, Crowd investors, Investment-Based Crowdfunding, Licensing principle

## 1. Introduction: Investment-based crowdfunding as disintermediation or regulated activity?

Investment-based crowdfunding (or marketplace investing) is generally defined as an open call from entrepreneurs to raise funds in the form of investment in specific business projects, usually through specialised online platforms, aimed at a multitude of internet users (the 'crowd'). This investment can take the form of: a) equity: shares or equivalent forms of participation in ownership of a firm (equity-

1 Professor at the Genoa Centre for Law and Finance.

based crowdfunding,[2] the prevailing form); b) debt-securities, such as bonds, mini-bonds; c) other forms of investments, such as profit-sharing investment contracts, entitling the holder to a share in future sales revenue (e.g. royalties), although not recognising any ownership or governance rights over the venture.[3] Crowd-investors generally commit small sums to each project, diversifying their investments, with an expectation of financial return.[4] They might invest in firms directly, becoming shareholders in the company, or, indirectly, buying a security issued by a collective investment fund or SPV (generally one per venture), which then invests in companies (e.g. Seedrs, in the UK; Symbid, in the Netherlands). Crowd-investors generally make a free choice of investee companies but some platforms provide pricing/ratings or allow crowd-investors to invest along with business angels (e.g. Spreds, in Belgium).[5]

Crowdfunding has emerged as a financial innovation directly connecting investors with entrepreneurs and eliminating the long chain of intermediation, typical instead of traditional financial intermediation, involving for instance underwriters, distributors such as banks and investment firms, analysts, rating agencies, etc.. In this sense, crowdfunding has been seen as a way to reduce financing costs and democratise finance. However, from an opposing perspective, crowdfunding platforms might have simply taken the place of traditional intermediaries ('re-intermediation') and must therefore assume a similar role as gatekeeper, subject to equivalent regulation. Gatekeepers, in traditional financial regulation theory, are the intermediaries or professionals operating in the chain of financial investment (including lawyers, credit rating agencies, underwriters, etc.) and standing between issuers and investors, able in principle to reduce information asymmetry and other market failures.[6] Nonetheless, the importance of each particular gatekeeper and its potential liability towards investors generally depends on the effective or official role played (e.g. drafting only a part of the prospectus or diligent double-checking thereof), as also recognised in law (statute or case law ). Crowdfunding platforms are new intermediaries, whose role has yet to be clarified.

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2 Some platforms (e.g. Crowdcube) also allow offerings of dual-class shares but this model has not proved particularly successful: Douglas Cumming and Sophia Johan, *Crowdfunding. Fundamental Cases, Facts, and Insights* (Academic Press 2019) 151, 264ff.

3 Some classification systems regard real estate crowdfunding (investment in shares and debt securities of real estate ventures) as a separate category in the IBC area: see Tania Ziegler et al, 'The Global Alternative Finance Market Benchmarking Report' (2020) 31 <https://www.jbs.cam.ac.uk/fileadmin/user_upload/research/centres/alternative-finance/downloads/2020-04-22-ccaf-global-alternative-finance-market-benchmarking-report.pdf>: see also European Commission (2018b) 11; Rotem Shneor, 'The Context: Crowdfunding Market and its Recent Developments', forthcoming in Eugenia Macchiavello (ed)., Regulation on European Crowdfunding Service Providers for Business: A Commentary (Edward Elgar 2022), ch. 2.

4 For an unofficial EU description of crowdfunding: European Commission, 'Impact Assessment Accompanying the Document Proposal for a Regulation […] on European Crowdfunding Service Providers (ECSP) for Business-Staff Working Document' (8 March 2018) SWD(2018) 56 final, 7; European Commission, 'Unleashing the Potential of Crowdfunding in the European Union' (Communication) COM(2014) 172 final 2, 3. For widely used definitions inspiring the Commission, see Armin Schwienbacher and Benjamin Larralde, 'Crowdfunding of Small Entrepreneurial Ventures' in Douglas Cumming (ed), *The Oxford Handbook of Entrepreneurial Finance* (OUP 2012) 369, 370–371.

5 Concerning IBC models and characteristics: Eleanor Kirby and Shane Worner, 'Crowd-funding: An Infant Industry Growing Fast' (2014) IOSCO Research Department Staff Working Paper 3/2014 <www.iosco.org/research/pdf/swp/Crowd-funding-An-Infant-Industry-Growing-Fast.pdf>; ESMA, 'Opinion on Investment-based Crowdfunding' ESMA/2014/1378, 7; Macchiavello (2017) 668; Ferrarini and Macchiavello (2017) 660; Cumming and Johan (2019) 150.

6 See Jennifer Payne, 'The Role of Gatekeepers', in Niamh Moloney, Eilis Ferran, and Jennifer Payne (eds), *Oxford Handbook of Financial Regulation* (OUP 2015) 254; John C. Coffee Jr., *Gatekeepers. The professions and corporate governance* (OUP, 2006).

The issues that this paper seeks to address, in line with the main topic of this conference and EBI working paper series, are, first of all, whether investment-based crowdfunding platforms conduct activities traditionally subject to the licensing principle (the same or similar activities) and therefore should be subject to the same licensing requirements and framework; and secondly, which approach EU Regulation No. 1503/2020 on European Crowdfunding Service Providers for Businesses has adopted in this regard, discussing this through an analysis of its provisions.

## 2. A Closer Look: Investment-based crowdfunding platforms in comparison with financial intermediaries traditionally subject to the licensing principle

### 2.1 Investment-based crowdfunding versus traditional intermediation: economic function, activities and other main features

Most crowdfunding platforms present themselves simply as marketplaces where investors and entrepreneurs meet. However, platforms perform key services relating to the underlying transaction between investors and entrepreneurs: they generally screen applicants, performing certain due diligence activities such as background, credit and cross-checks to exclude fraudsters or even, in some cases, select the 'best-in-class'.[7] Sometimes, they also support entrepreneurs in preparing their business plans and making projects visible on the website or even providing additional promotion/marketing support. In addition, they channel information about entrepreneurs to crowd-investors, provide standard contracts, create and maintain communication channels between users, and also handle the parties' post-contractual relationships.[8] In cases where a regulated financial activity can be identified among these crowdfunding activities, the principles currently governing financial regulation require application of the corresponding regulatory framework. Among these 'governing' principles, we can recognise the licensing principle, geared to safeguarding the most important objectives of financial regulation (investor protection, stability, etc.), the technology neutrality principle, the level-playing field principle ('same risk, same rules'), as well as proportionality and the flexibility of EU financial regulation (able to accommodate innovations through interpretation).[9]

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7 Jonas Löher, 'The Interaction of Equity Crowdfunding Platforms and Ventures: An Analysis of the Preselection Process' (2017) 19 Venture Capital 51; Armin Schwienbacher. 'Equity Crowdfunding: Anything to Celebrate?' (2019) 21 Venture Capital 65.

8 See Yannis Pierrakis and Liam Collins, 'Crowdfunding: A New Innovative Model of Providing Funding to Projects and Businesses' (2013) <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2395226>; Douglas Cumming, Sofia A. Johan and Yelin Zhang, 'The Role of Due Diligence in Crowdfunding Platforms' (2019) 108 Journal of Banking and Finance 1.

9 See for instance, European Parliament, 'FinTech: the influence of technology on the future of the financial sector', (Resolution, 17 May 2017); European Commission, 'FinTech Action Plan: For a More Competitive and Innovative European Financial Sector' (8 March 2018) COM/ 2018/ 0109 final; EBA, 'Regulatory Perimeter, Regulatory Status and Authorisation Approaches in Relation to Fintech Activities – Report', (18 July 2019), 22, https://eba.europa.eu/documents/10180/2551996/Report+regulatory+perimeter+and+authorisation+approaches.pdf. See also, in this publication, the contributions by Mendes Correia and , Barroso. The reader is also referred to: Eugenia Macchiavello, 'FinTech Regulation from a Cross-sectoral Perspective' in Veerle Colaert, Danny Busch and Thomas Incalza (eds.), *European Financial Regulation: Levelling the Cross-Sectoral Playing Field*, (Hart 2019) 63-85, 73ff.

If we compare the platforms' activities and economic function with those of traditional intermediaries,[10] it is easy to dismiss any similarities with banking or insurance business. Instead, crowdfunding platforms present similarities with investment firms' economic function of 'weak intermediation', helping to channel economic resources to finance productive activities by reducing information asymmetry and adverse selection problems, but entailing agency problems (conflicts of interests).[11]

However, when comparing investment-crowdfunding with MiFID II services, identifying the investment service offered by platforms is less straightforward. In this context, investment-crowdfunding appears to combine features of different services: for instance, mixing elements of placement without a firm commitment, reception and transmission of orders, execution and markets, which has led to varying legal classifications in Member States (see below § 2.2.).

What is more, investment-crowdfunding also presents particular features that distinguish it from the traditional investment process. First of all, it generally focuses only on seed and early-stage companies, which are riskier and generally excluded from public markets because of the lack of public information and secondary markets, and therefore entail high transaction costs: as a consequence, these issuers are generally financed primarily by 'family, friends & fools' (FFF) and, in part, banks, venture capitalists and business angels. Technology (platforms and the internet, AI and big data for rating, etc.), in combination with the absence of traditional intermediaries, makes it possible to contain costs and reach a broad group of investors.

Considering the absence of underwriters and other pricing mechanisms, other market-based systems are used to contain risks for investors, such as diversification, the 'all-or-nothing' rule (i.e. the company gets the financing only if the campaign is successful in reaching the declared target amount and therefore in convincing enough investors), co-investing with experienced and professional investors, etc..[12]

Although the literature points to mixed results in this regard, investors seem motivated not only by the expectation of a financial return, but also by personal satisfaction, the possibility of influencing a campaign's outcome, freely pick specific projects, and even by a sense of involvement, a lower level of separation between ownership and control and the objective of supporting sustainable develop-

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10 Also discussed throughout this volume.

11 About economic functions of financial intermediaries and weak and strong financial intermediation: Alessio Pacces, 'Financial Intermediation in the Securities Markets: Law and Economics of Conduct of Business Regulation', (2000) 20 International Review of Law and Economics 479, 481-82; Monika Marcinkowska, 'Functioning of the Financial Industry', in Veerle Colaert, Danny Busch and Thomas Incalza (eds.), *European Financial Regulation. Levelling the Cross-sectoral field* (Hart, 2019), 13-38. See also Eugenia Macchiavello, **'**Financial-Return Crowdfunding and Regulatory Approaches in the Shadow Banking, Fintech and Collaborative Finance Era', (2017) 14 European Company and Financial Law Review 662, 688.

12 More extensively on the differences between crowdfunding and traditional intermediaries: Eugenia Macchiavello, 'The Crowdfunding Regulation in the Context of the Capital Markets Union', in Pietro Ortolani and Marije Louisse (eds), *The EU Crowdfunding Regulation*, (OUP 2021) 25-46; Eugenia Macchiavello, 'Disintermediation in Fund-raising: Marketplace Investing Platforms and EU Financial Regulation', in I-H. Chiu and G. Deipenbrock (eds.), *Routledge Handbook of Financial Technology and Law* (Routledge, 2021) 291, 299; see also Anna Lukkarinen, 'Equity Crowdfunding: Principles and Investor Behaviour', in Rotem Shneor, Liang Zhao and Bjørn-Tore Flåten (eds) *Advances in Crowdfunding* (Palgrave Macmillan, 2020) 93-118; Arash Gholamzadeh Nasrabadi, 'Equity Crowdfunding: Beyond Financial Innovation', in Dennis Brüntje and Oliver Gadja (ed.), *Crowdfunding in Europe* (Springer 2016), 201ff; Pierrakis and Collins (2013) 3–4.

ment.[13] Moreover, investors appear to ground their decisions not particularly on financial statements but rather on soft information, 'signals' and non-financial factors such as the availability of videos and updates, the perceived informativeness of the campaign material and clarity about plans and the use of funds, the originality of the business idea, certain characteristics of the entrepreneur (e.g. patents, level of education and business experience), the retention share, the involvement of a credible lead investor and venture capitalists or business angels.[14] The methods used to make disclosures to and inform potential investors are also different: instead of a long and complex prospectus and financial documentations, we find simple documents, video, pitches, forums and feed-backs.[15]

The risks for investors are considerable (fraud, illiquidity, lack of traditional safety nets, etc.)[16] and might justify subjection, if not to the licensing and other rules for investment firms, then - because of the differences mentioned - to a similar set of rules, with the main objective of protecting investors. However, investment-crowdfunding has often been subject to no or, more often, soft regulation in consideration of, firstly, the low level of systemic risk, not involving trust and reliance on traditional and systemically important financial institutions and still small compared to the mainstream market.[17] Secondly, in consideration of the potential benefits offered by regulation,

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13 Lukkarinen (2020) 96ff; Silvio Vismara, 'Sustainability in equity crowdfunding', (2019) 141 Technological Forecasting & Social Change 98, 104; Christoph Siemroth and Lars Hornuf, 'Do Retail Investors Value Environmental Impact? A Lab-in-The-Field Experiment with Crowdfunders' (2021). CESifo Working Paper No. 9197, 4-5, available at https://ssrn.com/abstract=3892621; Stefan Katzenmeier et al., 'The supply side: profiling crowdfunders', in Hans Landström, Annaleena Parhankangas and Colin Mason, Handbook of Research on Crowdfunding (Elgar 2019), 122-164, 137ff. Some recent studies distinguish between investors' motivations based on the type of crowd-investors ("venture trustful," "crowdfunding technicians," "financial investors, talent scouters," and "social dreamers"): Rosangela Feola et al., 'Segmenting "digital investors": evidence from the Italian equity crowdfunding market' (2021) 56 Small Business Economics 1235.

14 Lukkarinen, (2020) 99; Katzenmeier et al. (2019) 142ff; Gerrit K.C. Ahlers, Douglas Cumming, Christina Günther and Denis Schweizer, 'Signaling in Equity Crowdfunding', (2015) 39 Entrepreneurship Theory and Practice 955; Moritz (2015); Andrea Ordanini, Lucia Miceli, Marta Pizzetti and A. Parsu Parasuraman, 'Crowd-funding: Transforming Customers into Investors Through Innovative Service Platforms' (2011) 22 Journal of Service Management 443; Xuechun Li, Yuehuan Tang, Ningrui Yang, Ruiyao Ren, Haichao Zheng and Haibo Zhou, 'The Value of Information Disclosure and Lead Investor in Equity-based Crowdfunding: An Exploratory Empirical Study' (2016) 7 Nankai Business Review International 301; Evila Piva and Cristina Rossi-Lamastra, 'Human Capital Signals and Entrepreneurs' Success in Equity Crowdfunding' (2018) 51 Small Business Economics 667; Lars Hornuf, and Armin Schwienbacher, 'Market Mechanisms and Funding Dynamics in Equity Crowdfunding' (2018) 50 Journal of Corporate Finance, 556.

15 Alexander Moritz, Joern H. Block and Eva Lutz, 'Investor Communication in Equity-based Crowdfunding: A Qualitative-empirical Study' (2015) 7 Qualitative Research in Financial Markets 309; Anna Lukkarinen, 'Equity Crowdfunding: Principles and Investor Behaviour', in Rotem Shneor, Liang Zhao and Bjørn-Tore Flåten (eds), *Advances in Crowdfunding* (Palgrave Macmillan 2020).

16 About the risks and benefits of investment-crowdfunding: Ajay Agrawal, Christian Catalini and Avi Goldfarb, 'Some Simple Economics of Crowdfunding' (2013) NBER Working Paper 19133/2013, 10ff <https://www.nber.org/papers/w19133>; Kirby and Worner (2014) 12; European Commission (2014) 5; ESMA, 'Opinion on Investment-based Crowdfunding', ESMA/2014/1378, 10ff; John Armour and Luca Enriques, 'The Promise and Perils of Crowdfunding: Between Corporate Finance and Consumer Contracts' (2018) 81 Modern Law Review 51. See also Macchiavello (2017) 668ff.

17 In 2020, investment-based crowdfunding (equity, debt securities and profit sharing taken together) accounted for only $466 million (4.7% of all alternative finance in Europe, including the UK), making it tiny compared to the total traditional investment market. Nonetheless, data from the UK attest to the important role of crowdfunding and its more systemic relevance when focusing on data on the financing of SMEs: the equity crowdfunding platforms' share of all seed and venture-stage venture funding in the UK was 14.73% in 2019 and 15.08% in 2020 (see Tania Ziegler et al., 'The 2nd Global Alternative Finance Market Benchmarking. The Report', June 2021, 81, https://www.jbs.cam.ac.uk/faculty-research/centres/alternative-finance/publications/the-2nd-global-alternative-finance-market-benchmarking-report/).

especially if not over-burdened with the full weight of financial regulation. In practice, investment-crowdfunding seems to fill a significant gap in financing for start-ups (especially innovative and fast-growing ventures) and for micro or small enterprises, serving as a fast and convenient bridge from the typical first stage of financing (FFF) to business angels, venture capital, or even, in case of some small established firms, towards private equity and public capital markets.[18] At the same time, crowdfunding gives entrepreneurs the opportunity to leverage other funding resources and test the market response for their products before the official launch.[19] Investors can also benefit from lower costs, competition between different financial intermediaries and markets, investment diversification and the resilience of the alternative market.

### 2.2 Member States' approach to investment-based crowdfunding in relation to the licensing principle: regulatory fragmentation

Member States have responded differently to the question of whether investment-based crowdfunding needs to be subject to the licensing principle and, in particular, on what terms. The result is a varying balance between the objectives of investor protection, competition, single market, SMEs access to funding and a larger investor base. In fact, national regulatory approaches have ranged from a) no regulation; to b) the creation of a bespoke regime with exemption from MiFID II, the Prospectus Directive/Regulation and other laws; c) the mere introduction of special thresholds for exemption of crowdfunding, for instance, from the prospectus obligation; d) application to crowdfunding of special national regimes exempting it from MiFID II (based on Art. 3 of that directive); e) full application of traditional rules, in particular the MiFID II rules on investment firms.[20]

Despite the resemblance between crowdfunding services and certain MiFID II services, few countries have actually applied the entire bulk of EU-derived financial regulation to this segment of the market. One reason is that crowdfunding services, as already mentioned above, combine

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18 European Commission, 'Impact Assessment Accompanying the Document Proposal for a Regulation on European Crowdfunding Service Providers (ECSP) for Business' (8 March 2018) 6, 13ff. See also Yannis Pierrakis and Liam Collins, 'Crowdfunding: A New Innovative Model of Providing Funding to Projects and Businesses' (2013) 5–6 https://papers.ssrn.com/sol3/papers.cfm?abstractid=2395226.

19 Schwienbacker and Larralde (2012) 373; Roland Strausz, 'A theory of crowdfunding: A mechanism design approach with demand uncertainty and moral hazard' (2017) 107 American Economic Review 1430; Ethan Mollick, 'The dynamics of crowdfunding: an exploratory study' (2014) 29 Journal of Business Venturing 1.

20 For a more detailed discussion and comparative law analysis, see: Macchiavello (2017); Macchiavello (2021a); Guido Ferrarini and Eugenia Macchiavello, 'Investment-based Crowdfunding: Is MiFID II Enough?' in Danny Busch and Guido Ferrarini (eds.), Regulation of EU Financial Markets: MiFID II (Oxford University Press 2017), 668; European Commission, 'Crowdfunding in the EU Capital Markets Union', SWD(2016) 154 final, <https://ec.europa.eu/info/system/files/crowdfundingreport-03052016_en.pdf>; Matthias Klaes et al., 'Identifying Market and Regulatory Obstacles to Crossborder Development of Crowdfunding in the EU – Final Report', (December 2017), <https://ec.europa.eu/info/sites/info/files/171216-crowdfunding-report_en.pdf>; CrowdfundingHub, 'Crowdfunding Crossing Borders' (2016), <https://drive.google.com/file/d/0B7uykMX1rDrWU3BRZTBMNzFwLVE/view>; Dirk Zetzsche and Christina Preiner, 'Cross-Border Crowdfunding – Towards a Single Crowdfunding Market for Europe' (2018) 19 European Business Organization Law Review 217. See also Chapters 41 (by De Pascalis about the UK), 42 (J-M. Moulin about France), 43 (by Wenzlaff and Odorović about Germany), 44 (by Piattelli and Caruso about Italy), 45 (by Hakvoort about the Netherlands), 46 (by Pereira Duarte and da Costa Lopes about Portugal), 47 (by Cuena Casas and Alvarez Royo-Villanova about Spain), 48 (by Härkönen, Neumann and Højvang Christensen about Nordic countries), 49 (by Divissenko about the Baltics), 50 (by Härkönen about the US), 51 (by Macchiavello), all forthcoming in Macchiavello (ed)., *Regulation*.

aspects of different investment services (e.g. mixing fragments of placing, reception/transmission and markets), without any of the latter able to perfectly accommodate the former, also because of the particular infrastructure used (the platform model, reliance on technology and automatic systems). Another reason is the variety in national interpretations and legal traditions as regards the definition of certain investment services and financial instruments. The reason for exclusion from application of MiFID II and the Prospectus regulation could therefore be that the products offered through crowdfunding platforms, in particular shares of private limited liability companies, are not classified as transferable securities. In certain cases, particular obstacles to transferability, such as the lack of concrete evidence of transferability (as opposed to merely potential transferability), the need for notarial certification or shareholders' consent and restrictions on public offerings, were used as arguments to exclude such classification in some countries, but not in others.[21] Lastly, platforms might be exempted from MiFID II under Art. 3(1), as providers of services of the reception and transmission of orders or investment advice, without the holding of clients' money or instruments, and so subject to lighter national law. Similarly, the possibility of not issuing a prospectus and, more generally, of exemption from the Prospectus Directive/Regulation, depended on the threshold - in terms of total consideration in twelve months - set by each Member States between €100,000 and €5 million (with the Prospectus Regulation in 2019, between €1 million and €8 million).

In countries where a special framework has been adopted for crowdfunding, certain features may be identified: the procedure and requirements for obtaining authorisation are simple and correspond to the normal types (e.g. fit and proper requirements for managers and major shareholders, lower limits for initial capital or professional insurance) and the overall regimes are generally quite light and focused on general requirements of conduct (e.g. fair conduct and efficient orders management) and disclosure. The main information document must be concise, written in a plain and clear language and including information about risks, costs, selection criteria and performance, with warnings about specific risks and absence of approval by the financial authority. In contrast, it is rarer to find requirements concerning due diligence in the selection of recipients (e.g. in France and Spain), adequate organisation and prudential 'own funds' (e.g. in the UK and Lithuania). Some countries expressly apply anti-money laundering (AML/CT) regulations (or, in any case, rules) to platforms (UK, Austria, Portugal and Germany) and include some conflict-of-interest provisions. This softer-touch regulation is counterbalanced by limitations on permissible activities or products[22] - including a prohibition on offering other regulated services, or holding clients' money/

21 For instance, shares in private limited liability companies are not considered transferable securities in Poland, Italy, Sweden, Croatia and Romania, in contrast to the prevailing interpretations in Hungary, Finland, Denmark and the Netherlands. Similarly, silent partnerships are financial instruments in Italy and Germany, but not in Austria. See Macchiavello (2017) 689, 698-99, 715; Eugenia Macchiavello, 'The Scope of the ECSPR: the Difficult Compromise Between Harmonization, Client Protection and Level-Playing Field- Articles 1 & 2 (& 46, 48-49, 51)', ch. 3, and 'Conclusions about the ECSPR and its harmonisation force: a brief summary of the objectives achieved and the remaining 'grey' areas from a comparative law perspective', ch. 51, both in E. Macchiavello (ed.), *Regulation*; Zetzsche and Preiner, (2018); Panagiotis K. Staikouras, 'The European Union Proposal for a Regulation on Cross-Border Crowdfunding Services: A Solemn or Pie-Crust Promise?' (2020) 31 European Business Law Review 1047, 1069.

22 For example, a maximum offering size ranging from €1 million (e.g. Portugal) to €2/2.5 million (Spain, Netherlands, Germany) or €5 million (France, and later €8 million). Offering only of simple financial instruments (see France) or only shares in innovative start-ups (see in Italy, originally) or only subordinated loans and profit-participation loans (originally, in Germany).

securities – and investment limits for retail or non-sophisticated clients. In many cases, an investor test or appropriateness assessment is required.[23] For retail investors, some countries also include withdrawal rights (e.g. Italy, UK, Austria, Germany and Netherlands) and/or redress mechanisms (Portugal, France, Netherlands and the UK).[24]

## 3. The Regulation on European Crowdfunding Service Providers: the application of a 'light' licensing principle to investment crowdfunding

### 3.1 General aspects and scope

In view of this wide variation between Member States in regulating investment-based crowdfunding, the European Commission advanced in March 2018 a Proposal for a Regulation on European Crowdfunding Service Providers, subsequently adopted in October 2020 as Regulation 1503/2020 (ECSPR).[25]

The Regulation has introduced a special mandatory regime for lending-based crowdfunding for businesses and investment-based crowdfunding, by way of exemption, in particular, from MiFID II[26] and the Prospectus Regulation, but under certain conditions. The ECSPR requires providers of the specified crowdfunding services to apply for authorisation to start their activities from their national competent authority[27], qualifying them for an EU passport (see below), and therefore to offer their services, once authorised in their country and communicated the intention to operate across borders, in other EU Member States.[28]

While Art. 5(2) MiFID II only applies the licensing principle to the provision of investment services only when carried on 'as a regular occupation or business on a professional basis', the ECSPR does not assign relevance to these aspects, potentially requiring an authorisation even when

23 For example, in Italy, the UK (when retail, in the absence of regulated advice), the Netherlands, Lithuania and Belgium. A suitability assessment is instead mandatory in France (where crowdfunding platforms are investment advisors) and Belgium (only when platforms offer investment advice).

24 Instead, only Italy presents a tag-along rights in case of change of control and the mandatory pre-investment by professional investors.

25 Regulation (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 [2020] OJ
L347/1. For a detailed analysis of this legal text, please see: Macchiavello (ed.) *(2022)*; Eugenia Macchiavello, 'The European Crowdfunding Service Providers Regulation: The Future of Marketplace Lending and Investing in Europe and the 'Crowdfunding Nature' Dilemma' (2021) 32 European Business Law Review 557; Pietro Ortolani and Marije Louisse (eds), *The EU Crowdfunding Regulation* (OUP 2021).

26 See new Article 2, para.(p) MiFID II.

27 See Article 3, para. 1 ECSPR: "Crowdfunding services shall only be provided by legal persons that are established in the Union and that have been authorised as crowdfunding service providers in accordance with Article 12".

28 Crowdfunding service providers already operating in Member States under national law as of 10 November 2021 will be allowed, for a transitional period (originally ending 10 November 2022 but extended of an additional year in July 2022), to continue offering their services according to their national regimes until they obtain the new EU authorisation (Art 48(1) ECSPR).

crowdfunding service are only occasionally provided. In any case, under the ECSPR, crowdfunding service providers (or CSPs) are subject to the licensing principle throughout EU territory, and a new category of financial intermediaries and new EU license are created. As we shall see, the structure and principles of the rules introduced by the ECSPR are largely inspired by other EU regimes, in particular MiFID II. However, the Commission considered this to be disproportionately burdensome and proposed a lighter and simpler set of rules for crowdfunding platforms: the trilateral negotiations led to a more stringent regime[29] but this remains, overall, lighter (at least as regards investment-based crowdfunding) and subject to the proportionality principle.

The services identified as 'crowdfunding services' and in general defined as 'the matching of business funding interests of investors and project owners through the use of a crowdfunding platform' are the 'facilitation of granting of loans' to entrepreneurs (lending-based crowdfunding for businesses), and a combination of the MiFID II services of 'placement without a firm commitment basis' and 'reception and transmission of client orders'[30] relating to transferable securities[31] and the new category of 'admitted instruments for crowdfunding purposes' (Art 2(1)(a); recital 10). These instruments can be issued by a project owner or an SPV created for the purpose of a securitisation (Art 2(1)(q) ECSPR), but in this particular case, restrictions apply (see below, §3.2).[32] Therefore, the ECSPR has officially recognised the similarity between crowdfunding and traditional investment services, but opted to identify the former in jointly providing for two of such investment services, so as better to reflect the characteristics of crowdfunding services.[33]

'Admitted instruments for crowdfunding purposes' are defined by Article 2(1)(n) ECSPR as 'shares of a private limited liability company' not already considered transferable securities under national law but 'not subject to restrictions that would effectively prevent them from being transferred, including restrictions to the way in which those shares are offered or advertised to the public'. This category has been introduced to overcome differences at national level in the criteria for identifying transferable securities, especially with regard to shares of private limited liability companies. However, the national competent authority that grants authorisation retains the power to identify the types of shares of private limited companies to be considered admitted instruments for crowdfunding purposes based on the conditions mentioned above (Article 2(2) ECSPR): looking

29 For a comparison of the different texts, see Macchiavello (2021c).

30 As referred to in Annex I, Section A, items 7 and 1 MIFID II.

31 As identified in Article 4, para. 1(44) MiFID II. See also Macchiavello (2022a).

32 See Sebastiaan N. Hooghiemstra, 'Organizational and Operational Requirements for Crowdfunding Service Providers', ch. 4, and 'Crowdfunding, Alternative Investment Funds and the Relationship Between the ECSPR and the AIFMD', ch. 35, both in E.Macchiavello (ed.), *Regulation*.

33 'The joint provision of those services is the key feature of crowdfunding services compared to certain investment services provided under [MiFID II] even though individually those services match those covered by that Directive' (Recital 10, last period, ECSPR).

at the list published by ESMA of competent authorities' choices in this regard,[34] it is evident that divergences in the criteria will persist among Member States.[35]

Another condition for the application of the ECSPR is the upper limit on crowdfunding offers, which must not exceed €5 million in total consideration in 12 months per project owner (Art 1(2)(c) ECSPR). A corresponding exemption from the duty to publish a prospectus has been added in the Prospectus Regulation (PR) as Article 1(4) k). The maximum value for the threshold set in the ECSPR differs from the general 'small offer' exemption allowed under the PR for all non-crowdfunding offers: this can in fact be set by each Member State between €1 million (mandatory exemption, Art. 1(3) PR) and €8 million (Art. 3(2) PR) and, after the entry into force of the PR, most opted to set the threshold at the top of this range.[36] In any case, the ECSPR allows Member States with 'small offer' thresholds lower than €5 million to retain this in respect of crowdfunding only for a transitional period of 24 months, starting from 10 November 2021 (Art. 49 ECSPR).[37]

The ECSPR specifies that the total consideration should include offers not only of transferable securities, but also of 'admitted instruments for crowdfunding purposes' and loans conducted through crowdfunding platforms by the same project owner (Art. 1(2)I(i))[38]. as well as any other offer of transferable securities to the public by the same project owner through other means, when exempted under the mandatory or 'small offer' exemption of Articles 1(3) or 3(2) PR (Art 1(2)(c)(ii)). Consequently, the ECSPR rules appear more restrictive than those of the PR, where only transferable securities of the same class are counted, the upper limit is potentially higher and more than one exemption can apply (Art. 1(6) PR).

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34 See ESMA, 'European Crowdfunding Service Providers for Business Regulation (2020/1503) - Miscellaneous reporting to ESMA' (10 November 2021) ESMA35-42-1305, 2-3, www.esma.europa.eu/file/121782/download?token=rKWN71uD.

35 See Macchiavello (2022a).

36 For the list of 'small offer' exemption of each Member State, see ESMA, 'National Thresholds Below Which the Obligation to Publish a Prospectus Does Not Apply' (23 October 2020), https://www.esma.europa.eu/sites/default/files/library/esma31-62-1193_prospectus_thresholds.pdf (as of 23 October 2020, 11 countries have opted for the €8 million threshold, 9 for €5 million and 8 for a lower threshold, between €1 million and €3 million). See also Eugenia Macchiavello, 'What to Expect When You Are Expecting a European Crowdfunding Regulation: The Current "Bermuda Triangle" and Future Scenarios for Marketplace Lending and Investing in Europe' (2019) EBI Working Paper 55 < https://ssrn.com/abstract=3493688 >; Macchiavello (n 12) 569; Staikouras (2020) 1074; Konstantinos Serdaris, 'Behavioural Economic Influences on Primary Market Disclosure – The Case of the EU Regulation on European Crowdfunding Service Providers' (2021) 18 European Company and Financial Law Review 428, 455.

37 There are signs of a trend towards more restrictive 'small offer' exemptions for Fintech-based alternative finance tools: under the Markets in Crypto-Assets Regulation (MiCAR), the maximum value of the threshold for the small offer exemption in the case of crypto-assets other than asset-referenced tokens or e-money tokens has been set at €1 million, and at €5 million in case of asset-referenced tokens. For an early commentary on the MiCAR Proposal: Dirk Zetzsche, et al., 'The Markets in Crypto-Assets regulation (MiCA) and the EU digital finance strategy' (2021) 16 Capital Markets Law Journal 203. On DLT-based crowdfunding, see Filippo Annunziata and Thomaz de Arruda, 'Crowdfunding and DLTs: the Imperative Need for More Clarity', in Macchiavello (ed.), *Regulation*, Ch. 36.

38 The ECSPR does not specify whether the provision refers only to offers by a project owner on a single platform or to all offers available on the market and, therefore, on any platforms, presented by the same project owner. However, the broad, all-inclusive calculation method as well as the rationale (see recital 16) will suggest the second of these alternatives. See Macchiavello (2022a); Staikouras (2020) 1077.

Project owners are not subject here to the licensing principle: while some countries have regarded project owners, especially in case of lending-based crowdfunding, as potentially violating the banking monopoly by receiving repayable funds from the public, Article 1(3) ECSPR prohibits Member States from imposing a banking license or applying banking law to project owners.[39] As discussed below, project owners are required to prepare an information document, but the resemblance to a prospectus (which Moredo Santos identified in his speech as a particular application of the licensing principle) is limited, not least because no approval by the financial authority is required (see below §3.3.).

### 3.2 Authorisation requirements and procedure. Oversight.

The authorisation of crowdfunding services providers (CSPs) replicates in principle the general model deployed for other regulated activities in the financial sector, in particular that in MiFID II (and PSD2), but it is once again lighter in several respects.[40] The application for authorisation must be submitted to the competent authority in the country where the CSP is established and approval is subject to requirements such as 'fit and proper management' and the suitability of main shareholders, submission of a programme of operations, evidence of governance and internal control systems consistent with their obligations under the ECSPR and business continuity (see Art. 12(2) ECSPR).[41] But in comparison with Delegated Regulation (EU) 2017/1943 and the (available) ECSPR RTS, the requirements are lighter and less detailed.[42] For instance, there is no minimum initial capital requirement (in contrast to Art. 15 MiFID II) and professional insurance is sufficient (as exempted national operators under Art. 3(2) MiFID II or Account Service Information Providers under PSD2). In addition, no organisational requirements are established in relation to product governance. The procedure is also expected to be faster, since the national competent authority must decide on the application within three months (Art. 12(8) ECSPR, as compared to the six month period set in Art. 7(3) MiFID II).[43] In addition, because the ECSPR is a regulation (and not a directive) and considering

39 See Macchiavello (2022a); Macchiavello (2021c) 563; Ella van Kranenburg, 'Outsourcing Under the ECSPR', in Macchiavello (ed.) *Regulation*; Hooghiemstra 2022; Jonneke Van Poelgeest and Marije Louisse, 'The Regulatory Position and Obligations of Project Owner', in Ortolani and Louisse (eds.) *The EU Crowdfunding*, 193.

40 On this topic, see also Macchiavello (2021c) 577ff; Marije Louisse and Adam Pasaribu, 'Authorization and Supervision of Crowdfunding Service Providers', in Ortolani and Louisse, 'The EU Crowdfunding', 139-161, 143ff; Tanja Aschebeck and Lina Engler, 'Authorization Procedure, Scope of Authorisation and Register- Articles 12, 13 & 14', Ch. 13, as well as Francesca Chiarelli, Leonardo Droghini and Raffaele D'Ambrosio, 'Supervision and Reporting Obligations of Crowdfunding Service Providers- Articles 15 & 16', Ch. 14, both in Macchiavello (ed.), *Regulation*.

41 Interestingly, while MiFID II allows investment firms to be natural persons, the ECSPR requires the applicant to be a legal entity (Articles. 2(1)(e) and 3(1) ECSPR). Moreover, the information to be included in the business plan under PSD2/MiFID II and ECSPR differs: Art. 5(1)(b) PSD2 requires information about the first three financial years to demonstrate appropriate and proportionate systems, resources and procedures to operate soundly; Art. 7(2) MiFID II requires applicants to indicate the types of business envisaged and the organisational structure, and they must show that all the necessary arrangements are in place to meet MiFID II obligations; in contrast, the ECSPR, focuses on the types of services, the crowdfunding providers and platform and the marketing strategy (ESMA, 'Draft technical standards under the European crowdfunding service providers for business Regulation', (10 November 2021) ESMA35-42-1183, 85ff): see Aschenbeck and Engler (2022a).

42 Concerning information about the management board: see Louisse and Pasaribu (2021) 144.

43 Louisse and Pasaribu (2021) are sceptical about the ability of national competent authorities to assess crowdfunding applications in such a shorter time, considering that the application documents are similar to those under MiFID II.

the powers assigned to the ESAs and the Commission, the level of harmonisation in CSP procedures and documentation is expected to be higher.[44]

Nonetheless, the list of requirements in Art. 12(2) is quite long since it is specified that the application must also contain a description of the prospective CSP's systems, resources and procedures for the control and safeguarding of the data processing systems, operational risks, outsourcing arrangements, complaint handling procedures, internal rules to prevent the related persons referred to in Article 8(2) from operating on the platform as project owners, procedures to verify the information document prepared by the project owner (see below) and to comply with the investment limits for non-sophisticated investors (see below and Art. 21(7) ECSPR) and evidence of prudential safeguards (see below and Art 11 ECSPR).

The CSP must indicate in the application the crowdfunding services that it will provide and where it will market its services (Art. 12(2)(d) and 13(1) ECSPR).[45] The CSP cannot conduct activities reserved for other regulated providers, unless, where possible, it also obtains the relevant authorisation (for instance, payment services; asset-keeping services; other investment services; Articles 1(2)(b) and 10 ECSPR). Indeed, other regulated providers (such as investment firms and bank) can also obtain the ECSPR license, through a simplified procedure to avoid duplication of documentation (recitals 35 and 55; Art. 12(14) ECSPR).

In any case, the ECSPR sets out to eliminate ambiguity about the prohibition on CSPs providing investment services when these CSPs do not hold any other license , in order to maintain a level-playing field. For instance, recital 21 specifies that the use by CSPs of filtering tools that help investors take investment decisions based on objective factors (e.g. economic sector, type of instruments, risk category, interest rate) does not count as investment advice, provided no recommendation is given and the presentation is neutral in tone. Moreover, in order also to exclude the provision of individual investment portfolio management, the CSP must not exercise any discretion and the investor in transferable securities and admitted instruments must always 'review and expressly take an investment decision in relation to each individual crowdfunding offer' (Art 3(4)). More generally, indirect forms of investment are considered to lie outside the nature and scope of crowdfunding: as mentioned, the use of SPVs is therefore restricted (only in case of an illiquid and indivisible asset) and the deployment of collective investment vehicles is in principle excluded (recitals 19 and 22; Art. 3(6) ECSPR).[46]

Instead, offering investors the opportunity to take their investment decisions based on, among other things, the pricing of offers relating to transferable securities or admitted instruments is allowed, probably as ancillary service, but subject to additional duties of disclosure (e.g. description of methods used) and organisation (e.g. to ensure a fair pricing) (see Articles 4(4), 19(6); recitals 11, 41).[47]

44 See also Aschenbeck and Engler (2022a).

45 It can always extend its activity to other crowdfunding services, through a similar procedure (Art. 13(2)).

46 See Macchiavello (2021c) 570ff; in favour of the use of collective investment arrangements to provide crowdfunding services: Hooghiemstra, (2022); Louisse and Pasaribu (2021) 158-9.

47 See also Federico Ferretti and Francesca Mattassoglio, 'Legal Issues in the Obligations for an Effective and Prudent Management of Crowdfunding Service Providers', in Macchiavello (ed.), Regulation, Ch. 5.

Finally, the ECSPR differentiates between other crowdfunding platforms' services and regulated trading venues: CSPs may 'allow clients who have made investments through its crowdfunding platform to advertise on a bulletin board on its crowdfunding platform their interest in buying or selling loans, transferable securities or admitted instruments for crowdfunding purposes which were originally offered on that crowdfunding platform'. However, the ECSPR specifies that this system should not present the characteristics of a regulated market or MTF, unless the CSP holds also the relative authorisation to manage it, and, therefore, should not consist of an 'internal matching system that executes client orders on a multilateral basis' (Art. 25(2) ECSPR): clients will have therefore to conclude the transaction outside the platform, which reduced the effectiveness of this instrument in increasing market liquidity as hoped, especially for equity shares (highly illiquid). In addition, the Regulation imposes certain duties, in particular of disclosure, to protect investors (e.g. clarity about the nature of the bulletin board, pricing; availability of the original KIIS and warnings to non-sophisticated investors).[48]

In any case, CSPs 'may also engage in activities other than those covered by the authorisation [...] in accordance with the relevant applicable Union or national law' (Art. 12(13) ECSPR) to which the ECSPR does not apply (Art. 1(2)(b)), without the restrictions or conditions generally set in case of traditional financial intermediaries (e.g. banks or investment firms), in relation to non-financial ancillary activities (see, for example, Art. 34(1) MiFID II).

Once authorised, CSPs are included in a public register managed by ESMA and can benefit from a EU passport similar in requirements and procedures to the MiFID II passport: however, in recognising the digital nature of crowdfunding platforms, the ECSPR's procedural rules do not differentiate between operation through branches and without physical presence (freedom of services), thereby envisaging a light and smooth procedure in both cases and prohibiting Member States from requiring the CSP to be physically present in another country (Art. 12(12) ECSPR).[49] The passport should cover the crowdfunding services listed in the authorisation and in the passporting communication, preventing Member States from imposing additional requirements, but probably not the additional services provided by the same CSPs under other EU and national laws (which also have to be followed in relation to cross-border provision of services).[50] The cases where authorisation is withdrawn under the ECSPR (Art. 17 ECSPR) are similar to those under MiFID II (Art. 8(a) MiFID II).[51]

48 It is not clear from the ECSPR whether this service should be considered an ancillary service or an additional (unregulated) service that CSPs may provide. For a more detailed discussion: Macchiavello (2022a); Matteo Gargantini, 'Secondary Markets for Crowdfunding: Bulletin Boards', in Macchiavello (ed.), *Regulation*, Ch. 21; Anne Hakvoort, 'Secondary Trading of Crowdfunding Investments', in Pietro Ortolani and Marije Louisse (eds.), *The EU Crowdfunding,* 267, 274ff.

49 See Vittorio Tortorici, 'The EU Passporting System for Crowdfunding Service Providers: Towards a New Type of Passport?- Article 18' and Diego Valiante, 'Foreword', both in Macchiavello (ed.), *Regulation*.

50 See also Louisse and Pasaribu (2021) 147-8.

51 See Tanja Aschebeck and Lina Engler, 'Causes and Procedure of Authorisation Withdrawal- Article 17', in Macchiavello (ed.) *Regulation*, Ch. 15.

The ECSPR harmonises the minimum level of supervisory and investigatory powers as well as the power to impose administrative sanctions that national competent authorities (NCAs) must have (Art. 30 and 39 ECSPR)[52]: the list is again more or less comparable to that in MiFID II (Art. 69-70 MiFID II). Interestingly, the ECSPR does not mention the power to require recordings of conversations or electronic communications, etc. held by the CSP or the power to summon and question a person to obtain information.[53] In any case, the upper limit for administrative fines that can be imposed under the ECSPR are, understandably, lower than under MiFID II.[54]

### 3.3 Organisational and good conduct requirements. In particular, disclosure duties.

The general organisational requirements imposed on CSPs (Art. 4(1), 3(3) and 9 ECSPR) are inspired by the corresponding requirements in MiFID II (Art. 9(3), 16(5) and 27(2) MiFID II), requiring effective and prudent management, including the segregation of duties in the investment firm, prevention of conflicts of interest, containment of operational risk in outsourcing and prohibition of inducements. However, special requirements apply to CSPs in the event of provision of pricing services (Art. 4(4) ECSPR), relating to debt instruments (or loans, to which additional and more detailed provisions apply).[55] In particular, CSPs must establish, implement and maintain clear and effective policies and procedures to enable a reasonable assessment of the credit risk of offers and project owners based on sufficient information (as specified by the EBA's RTS), as well as price fairness (although this might refer only to loans) and an adequate risk management framework, keeping records of evidence of compliance with these requirements.[56] In relation to clients, they must also disclose the procedures adopted and the methods used to calculate prices (Articles 4(4) and 19(6) ECSPR).

The issue of conflicts of interests is particularly important in crowdfunding, where the platform, whilst providing fundamental information to investors, does not bear the risks and might be remunerated on the basis of volumes rather than performance. This high level of agency risk might be counterbalanced by the reputational risk and the need to maintain an active community of investors, so as to increase investment and the network effects, but, as multi-sided platforms, crowdfunding providers also have the difficult role of acting in the best interest of different types of clients (investors and project

52 See Chapters 14 (by Chiarelli, Droghini and D'Ambrosio), 23 (by A.M. Agresti on Competent Authorities), 24 (by N. de Arriba-Sellier on the relationships between competent authorities), 25 (by G. Pala, M. Lamandini and R. D'Ambrosio on the relationship between ESMA and NCAs), 26 (by N. Badenhoop on professional secrecy), 29 (by K. Serdaris on administrative sanctions and measures), all in Macchiavello (ed), *Regulation*.

53 Louisse and Pasaribu 'The Authorisation', 149-150.

54 For example, generally, €500,000 under the ECSPR, but €5 million under MiFID II. On this topic, see Konstantinos Serdaris, 'Ex Post Enforcement of the EU Crowdfunding Regime: Administrative Sanctions and Measures- Articles 39, 40, 41, 42 & 43', in Macchiavello (ed.), *Regulation*.

55 See Eugenia Macchiavello and A. Sciarrone Alibrandi, 'Marketplace Lending as a New Form of Capital Raising in the Internal Market: True Disintermediation or Re-intermediation?', in Emilios Avgouleas and Heikki Marjosola (eds), *Digital Finance in Europe: Law, Regulation, Governance* (De Gruyter 2021) 37-85; Ferretti and Mattassoglio (2022).

56 CSPs must also have an insurance policy covering damage caused to clients by gross negligence in asset evaluation or credit pricing/scoring.

owners).[57] The general provision on conflicts of interest reflects the corresponding MiFID II rule but particular emphasis is assigned to the proportionality principle. However, in view of the nature of CSPs as 'neutral intermediaries' (recital 22), the ECSPR prohibits CSPs from having any financial participation in the offers (even if this might help align the platform's and investors' interests) or from accepting managers, employees or significant shareholders as project owners on their platform (Art. 8(1)-(2) ECSPR).[58]

The ECSPR also envisages prudential requirements for CSPs based on the model already in use for investment firms (Art. 11). The safeguards relate exclusively to operational risk[59] and consist of CET1 or a professional insurance policy, or a combination of the two, with a value of €25,000 or ¼ of the previous year's overheads, whichever is highest, unless the platform is not already subject to prudential requirements for operational risk. These prudential safeguards are reminiscent of the capital requirement for class 3 firms under the Investment Firms Regulation (IFR 2019/2033) and Directive (IFD 2019/2034) but are set potentially lower, since the latter are based (as an alternative to 25% of fixed overheads) on the minimum capital requirement established for the service provided, where the lowest level is €75,000.[60]

Moving on to good conduct duties, Article 3(2) ECSPR has imposed a general duty of care on CSPs, requiring them to act honestly, fairly and professionally in accordance with the best interests of their clients, which replicates the corresponding Art. 24(1) MiFID II and Art. 12(1)(b) and (f) AIFMD. However, CSPs, as peer-to-peer platforms, have different types of clients (investors and project owners), whose interests are often in conflict, making compliance with this duty more complex for CSPs. On project owners, the ECSPR imposes a general duty of due diligence limited to only criminal records for certain economic crimes and AML violations, whilst they themselves are not directly subject to AML/CT obligations[61] (for example, only if they are also banks or payment institutions): in this respect, therefore, these duties appear lighter than those for other financial intermediaries, classified as obliged entities.[62]

The ECSPR provisions on information to be provided by CSPs to clients (Art. 19 and 27(2) ECSPR)[63] are reminiscent of Art. 24(3) MiFID II on marketing communications but, in contrast to

57 See Macchiavello and Sciarrone Alibrandi (2021) 49, 75-79. For a detailed analysis of Art. 8 ECSPR, see Diogo Pereira Duarte, 'Intermediation Risk and Conflicts of Interest- Article 8', Ch. 9, in Macchiavello (ed.), *Regulation*.

58 In contrast, these categories of people may invest through the platform, provided that they disclose this circumstance and each investment and do not receive any preferential treatment or privileged access to information: see Macchiavello (2021c) 583ff; Pereira Duarte (2022).

59 For instance, the risk of misleading information, breach of legal and regulatory obligations, duty of skill and care towards clients, absence of/defective conflicts of interests procedures, losses from business disruption and system failures, gross negligence in pricing, etc. (see Art. 11(7) as regards the requirements for insurance coverage).

60 Macchiavello (2021a) 298; Macchiavello (2021c) 586; Marije Louisse, 'Due Diligence of Project Owners', in E. Macchiavello, *Regulation*, ch. 6.

61 Art. 45 assigns to the Commission the task of assessing the need and proportionality of subjecting CSPs to the duties established under the AML Directive, adding CSPs to the list of obliged entities: see Eugenia Macchiavello, 'The Commission's Interim Report and Prospective Adaptations of the ECSPR- Article 45', in Macchiavello (ed.), *Regulation*, Ch. 31.

62 See also Louisse(2022). Only recital 18 refers in general to the need for CSPs to exercise an adequate level of due diligence in the selection of projects, so as to protect investors.

63 For example, information about the CSP, financial risks and other risks and costs of the crowdfunding service (*cf*. Art. 24(4)-(5) MiFID II); before entering into a transaction; in a clear, fair and not misleading way (*cf*. Art. 23(4) MiFID II).

these, are complemented by the detailed provisions of a delegated regulation.[64] In addition, the ECSPR features a requirement to warn clients about risks and the lack of traditional protections (for examples, the absence of deposit insurance or investor compensation schemes, appropriateness test, etc.). Also interesting is the specific importance assigned to the disclosure of the selection criteria for project owners, identified by the ECSPR as of primary importance for investors, and designed to limit investors' complete reliance on the platforms' screening.

As already mentioned, the main informative document is prepared by the project owner (without the collaboration of an 'offeror', 'guarantor' or any other entity responsible for their respective parts) and this is not comparable with a prospectus. Its simple style, short length and non-technical language puts it closer to a prospectus summary or a PRIIPs KID.[65] In addition, no authority has a mandate to check it and the ECSPR prohibits national competent authorities from imposing such requirement (Art. 23(14) ECSPR).[66] Interestingly, however, the CSP must have adequate procedures for verifying the completeness, clarity and correctness of the information contained in the Key Investment Information Sheet, or KIIS (Art. 23(11) ECSPR). Although it will depend on the EU[67] or national interpretation of the provision, in particular of the notion of 'correctness' and the relevant national liability regimes, the platform might take on the role of private gatekeeper and supervisor, as a lower cost substitute for the public authority.[68]

Lastly, the ECSPR has recognised special investor protection measures for the new category of 'non-sophisticated' investors. This category is residual, corresponding to investors other than professional investors or other types of 'sophisticated investors'. The first of these is borrowed from MiFID II, whilst the second corresponds to any natural or legal person requesting to be treated as such and

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64 Catalina Goanta, Marije Louisse and Pietro Ortolani, 'Marketing Communications and the Digital Single Market', in Ortolani and Louisse (eds.), *The EU Crowdfunding*, 293; Tommaso Martini Varvesi and Vittorio Tortorici, 'The New European Rules on Advertising Crowdfunding Campaigns Between Proportionality and Customer Protection- Articles 27 & 28', in Macchiavello (ed.), *Regulation*, Ch. 22.

65 The KIIS can in fact substitute the PRIIPs KID (Art. 23(15) ECSPR) where the latter is required. Authors gave stressed that this is only the case when the crowdfunding operation entails securitisation (see Martin Ebers and Benedikt M. Quarch, 'EU Consumer law and the boundaries of the crowdfunding regulation, in Ortolani and Louisse (eds.), *The EU Crowdfunding*, 83-112, 108) or an alternative investment fund (Van Poelgeest and Louisse (2021) 199).

66 On Art. 23 see Van Poelgeest and Louisse (2021), 200-201; Karsten Wenzlaff, et al., 'On the Merits of Disclosure Requirements in the ECSP Regulation- Article 23 & 24 (& Annex I)', in Macchiavello (ed.), *Regulation*, Ch. 20.

67 From the discussions during the trilateral negotiations, 'correctness' seemed initially to refer to the absence of evident mistakes in filling in the form (e.g. not inserting the information in the correct box), but see ESMA's Q&A on the ECSPR: 'The CSP maintains the responsibility to have adequate procedures in place to identify cases where inaccurate or misleading information may be provided by the project owner and to take appropriate action' (ESMA, 'Questions and Answers on the European Crowdfunding Services Providers for Business Regulation', 20 May 2022, ESMA35-42-1088). This might be interpreted as an obligation simply to adopt adequate measures, in abstract terms, or else, to ensure that the information is correct. On this topic see Macchiavello (2021c) 588; Wenzlaff et al. (2022); Eugenia Macchiavello, 'The Challenges Awaiting the European Crowdfunding Services Providers Regulation: Ready for Launch?' (2022), forthcoming, in Nordic Journal of Commercial Law.

68 For discussion of crowdfunding platforms as gatekeepers: Macchiavello and Sciarrone Alibrandi (2021); Macchiavello (2021c) 593; Macchiavello (2021a) 303; Joseph Lee, 'Investor Protection on Crowdfunding Platforms' in Ortolani and Louisse (eds.), *The EU Crowdfunding*, 263-264.

presenting certain characteristics.[69] The criteria for classification as a professional investor upon request under MiFID II[70] and as a sophisticated investor under the ECSPR, as well as the respective procedures, differ in several respects.[71] As regards the procedure, for instance, investment firms enjoy greater discretion in assessing whether the investor possesses the required characteristics, while the CSP must approve the investor's request unless there are reasonable doubts as to the correctness of the data. Under the CMU Action plan and in the course of the MiFID II review, the Commission is considering whether to introduce a similar new category of investor, relevant also for disclosure obligations under PRIIPS.[72]

The protective measures applicable only to non-sophisticated investors include the 'entry-knowledge test' (Art. 21(1)-(4) ECSPR), to be taken before allowing non-sophisticated investors to access offers, resembles the appropriateness test (assessment of knowledge, skills and experience; if failed, the client is issued with a warning which must be acknowledged) but is not service/product-specific and is performed at an earlier stage.[73] Curiously, the ECSPR also requires CSPs to collect information about their clients' financial situation and investment objectives, as for the suitability test (which under MiFID II is limited to portfolio management and investment advice services), but, in contrast, does not expressly include these aspects in the entry-knowledge test assessment and, if that test is failed, simply requires the CSP to issue a warning, not to prevent the investment. ESMA's RTSs simply specify that CSPs must request information about the investor's holding period, risk profile and sustainability preferences and purposes only 'where relevant in relation to the type of crowdfunding services offered', therefore probably with reference to more complex services such as individual portfolio management of loans. Other differences relate to the personal scope of the test and timing.[74] More generally, all information must be collected 'to the extent appropriate to the nature, scale and complexity of the crowdfunding service to be provided and the type of investment envis-

69 Individuals or entities requesting to be treated as sophisticated investors must declare they are aware of the consequences of their being classified as such and meet the following requirements: 1) legal entities meeting one of the following conditions: *a)* at least €100,000 own funds; *b)* turnover of at least €2 million; *c)* balance sheet of at least €1 million; 2) natural persons meeting at least two of the following conditions: *a)* personal gross income of at least €60,000 or a financial instrument portfolio (including cash deposits and financial assets) exceeding €100,000; *b)* professional experience in the financial sector in a position requiring knowledge of the transactions or of the services envisaged or an executive position in the legal entities listed under 1) for at least 12 months; *c)* operations of significant size on the capital markets, at an average frequency of 10 per quarter, over the previous four quarters. ECSPs must take reasonable steps to ensure that investors effectively meet these requirements but may approve the request unless they have reasonable doubts as to whether the information provided is correct (see annex II).

70 For example, the same conditions for natural and legal persons; investment portfolio threshold of €500,000 (higher).

71 Specifically and extensively on this topic: Joeri De Smet and Veerle Colaert, 'Between Investor Protection and Access to Crowdfunding: the Entry Knowledge Test and the Simulation of the Ability to Bear Loss- Article 21 (& Annex II)' in Macchiavello (ed.), *Regulation*; see also Lee 'Investor Protection', ch. 18,251-252.

72 See Macchiavello, 'The Scope'.

73 On this topic, see Macchiavello (2021a) 303 and (2021c) 591-92; De Smet and Colaert (2022).

74 For instance, investment firms are in principle also required to perform the appropriateness test in respect of professional investors, but they can actually assume that such investors have the necessary knowledge and experience (Art. 56(1) MiFID II). Furthermore, the entry-knowledge test must be repeated every two years and the loss simulation every year, while MiFID II does not specify any set timing for the appropriateness/suitability test (some events may trigger it). See again the detailed comparison in De Smet and Colaert, 'Between Investor Protection'.

aged', suggesting flexible and lighter requirements compared to MiFID II services, which are subject to primary and secondary provisions which are detailed and varied (based on the type of service), as well as to guidelines.[75]

The information relating to the investor's financial situation might be in any case useful for another investor protection measure, the (online) simulation of losses, designed to assess whether the investor would be able to withstand a loss corresponding to 10% of his/her net worth (Art. 21(5)-(6) ECSPR). This might partially resemble a suitability test, but it is more abstract, does not relate to investment objectives and a negative result does not preclude the investment, requiring only an acknowledgement from the client.[76]

In addition, a warning must be provided to non-sophisticated investors in the case of an investment above €1,000 or 5% of his/her net worth, and these investors must expressly agree. This protection appears to draw inspiration from Art. 30(3) of the ELTIF Regulation, which requires ELTIF managers to verify that retail investors do not invest more than 10% of their financial instrument portfolio, but can commit at least €10,000. However, an investment above the threshold requires only a warning and express consent from the investor under the ECSPR, whereas under the ELTIF Regulation the transaction is blocked.[77]

Lastly, non-sophisticated investors enjoy a reflection period of four day and must be informed by ECSPs about this right (Arts. 21(7) and 22 ECSPR).

An interesting final area where the ECSPR and MiFID II (or other provisions regulating traditional finance) diverge is in sustainability requirements. While the EU Action Plan on Sustainable Growth[78] has gradually assigned relevance to sustainability risks, factors and investor preferences in EU financial regulation (including MiFID II, AIFM, etc.), the ECSPR does not introduce any particular disclosure or organisational requirements in this regard (not even in the case of loans portfolio management).[79] However, Article 45(2)(s) assigns to the Commission the task of assessing whether to introduce specific measures to the ECSPs Regulation to promote sustainable and innovative crowdfunding projects, also through the use of Union funds. This expression seems to suggest the introduction of softer requirements for CSPs in the area of sustainable finance, although a future

75 See Article 25, paras. 2 and 3 MiFID II; Articles 54-58 MiFID II Delegated Regulation No. 2017/565; ESMA Guidelines on certain aspects of the MiFID II appropriateness and execution-only requirements, (2022) ESMA 35-43-2938.

76 For a partially different interpretation: Lee, 'Investor Protection', 256ff.

77 De Smet and Colaert, 'Between Investor Protection'.

78 European Commission, 'Action Plan: Financing Sustainable Growth', (Communication, 8 March 2018) COM/2018/097 final,.

79 On green crowdfunding and respective references, as well as a discussion of the compatibility of the ECSPR with the green crowdfunding market, please see: Macchiavello (2022b); Macchiavello (2022d); Eugenia Macchiavello, 'Sustainable Finance and Fintech. A Focus on Capital Raising', forthcoming in M. Siri, M. Gargantini and K. Alexander (eds.), *The Cambridge Handbook of EU Sustainable Finance. Regulation, Supervision and Governance* (Cambridge University Press 2023); Eugenia Macchiavello and Michele Siri, 'Sustainable Finance and Fintech: Can Technology Contribute To Achieving Environmental Goals? A Preliminary Assessment of "Green Fintech" and "Sustainable Digital Finance"' (2022) 19 European Company and Financial Law Review 128.

alignment of CSPs with the traditional duties of intermediaries in the area of sustainability cannot be excluded per se. Assigning relevance to sustainability in the ECSPR will require a difficult balance: while requirements similar to those for traditional providers would reduce greenwashing and promote a level-playing field, this might also entail excessive costs for all the parties involved, although other emerging technology-based solutions might help with that.

## 4. Concluding remarks

Investment-based crowdfunding service providers carry on a business akin to but not entirely the same as investment services and the regulated activities of investment intermediaries. Seeking also to overcome differences in treatment at national level, the ESCPR has chosen to extend the licensing principle to crowdfunding platforms, but by introducing a new and lighter form of license (compared to licensing under MiFID II, for instance), although inspired by existing regulatory rules, in particular, those in MiFID II (e.g. authorisation, general duties of good conduct, conflict-of-interest policy). These simplified requirements, justified also by the fact that these platforms and public confidence in them are systemically less important, are counterbalanced by restrictions on the activities permitted, products and the size of offerings. In addition, certain new and special provisions seek to address special features of crowdfunding (see investment thresholds; the professional insurance cover required; duty of diligence with regard to project owners' criminal and anti-money laundering profile; KIIS prepared by project owners but double-checked by platforms). The aim is to facilitate crowdfunding and therefore the financing of SMEs, without endangering investor protection or the level-playing field.

For instance, the ECSPR allows some protections to be lifted in the case of professional and sophisticated investors, thereby reducing costs. However, the difficult balance between all these interests has sometimes led to hybrid solutions, not necessarily justifiable. By way of example, the combination of the entry-knowledge test and simulation of losses (which entails collecting data, including about the investor's financial situation and investment objectives) seeks to increase protection for non-sophisticated investors, while containing costs. However, it has yet to be seen whether this outcome will be achieved: to apply the same good conduct requirements in this regard irrespective of the type of service (if this turns out to be the prevailing interpretation) is not only inconsistent with MiFID II (which distinguishes between executive services and advice/portfolio management) but might also not be effective in protecting investors or limiting costs: indeed, the consequence of a negative result is limited to warnings, while the amount of information to be collected is disproportionately large.

The organisational and prudential requirements are greater than in the Commission's original proposal, reflecting the increased attention post-crisis to the risks posed by shadow banking and intermediaries other than banks and investment firms (see also increased requirements for payment service providers under PSD2). Moreover, to offer clients the pricing of instruments is perceived as riskier, also from the perspective of agency risk, triggering increased requirements (especially in the case of loans), as happened in the past with the regulation of credit rating agencies.

Crowdfunding platforms are regarded by the ECSPR as gatekeepers, often substituting the public authority in order to lower supervisory costs (see the controls over the KIIS) but, at least as regards investment-based crowdfunding, a step below other regulated financial intermediaries, which, in any case, can benefit from the presence of traditional safeguards (e.g. investor compensation, access to credit bureaux), public support and, therefore higher investor trust. However, their exact position and role as gatekeepers will also depend on the future interpretation of the new Regulation as well as on certain national discretions, including in terms of civil liability.

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“It is with pleasure that I write a foreword to this very interesting and well-structured collective work, which is the by-product of an international academic conference held in Lisbon in mid-2022. This work deals with the legal challenges related to the application of FinTech technology in the provision of financial services, as well as the interplay with the licensing principle as applicable to traditional financial service providers.“

Professor **Christos V. Gortsos**

*President of the Academic Board*
*of the European Banking Institute*

# Fintech Regulation and the Licensing Principle

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