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“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

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EBI Working Paper

“What to expect when you are expecting” an European crowdfunding Regulation: the current ‘Bermuda Triangle’ and future scenarios for marketplace lending and investing in Europe

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Abstract

Marketplace lending and investing have been recently attracting increasing regulatory attention. However, regulatory responses to such phenomenon have been extremely varied, even in Europe, characterized by maximum harmonization in the field of financial regulation, continuous efforts in creating a single market and in centralizing supervision. Such fragmented framework poses the risk of different levels of investor protection in Europe, regulatory arbitrage, competition distortions, obstacles to cross-border activity and to existing EU passports. The European Commission, after an initial “wait-and-see” approach, adopted in March 2018 a proposal for a Regulation on European Crowdfunding Service Providers (ECSPs) for businesses. Such proposal, nonetheless, has undergone a number of significant revisions during the trilateral negotiations among the European Commission, the European Parliament and the Council of the European Union, underlying the ambiguous nature of crowdfunding and the complexity in reaching a common view on the same. The three European Institutions seem in fact to have divergent views of crowdfunding and different ideas on how to regulate it, this delaying the approval of the proposed Regulation. Will crowdfunding eventually escape such Bermuda Triangle receiving adequate regulation or is it destined to die in the process? The present paper, after briefly describing crowdfunding main features and regulatory trends in Member States, will critically analyze

the ECSPs Regulation Proposal, with respect to all the three different versions, inferring from each text a different vision (and consequent envisioned regulation) of crowdfunding and of financial regulation in general, underlying their pros and cons and proposing adjustments to reach a functional, tiered and proportional regulation. Finally, after mentioning certain recent revisions in national crowdfunding laws (e.g. in Italy, Belgium, UK and Germany), the paper will conclude trying to forecast the future direction of the ongoing trilateral negotiations and the possible impact of the European Regulation on national crowdfunding laws and the sector.

Keywords: Banking regulation, peer-to-peer lending, crowdfunding, FinTech, MiFID II, Prospectus, regulatory arbitrage

JEL Classification: D18, E51, G21, G23, G24, G28, G29, G38, K12, K20, K22, K24, L14, L22, O16, O17

1. Introduction: main features of marketplace lending/investing. Objective of the paper.

‘Financial-return’ crowdfunding (hereinafter, FR-crowdfunding) consists in the provision of funds by internet users (the ‘crowd’) to other individuals or enterprises under the form of loans (lending-based crowdfunding – LBC – or marketplace lending) or equity investments (equity-based crowdfunding – EBC) and/or, more generally, other forms of investments (investment-based crowdfunding – IBC – or marketplace investing) through an online platform facilitating the operation.

In the LBC area, such platform’s facilitation generally involves the applicants’ screening based on certain pre-established criteria (e.g. certain credit scores or even an evaluation system based on the deploy of algorithms, big data and behavioural analysis), matching of crowd-borrowers’ requests of funding with crowd-lenders’ interests in lending, provision to the parties of boiler-plate contracts, handling of contractual relationships between the parties (including credit collection procedures) and, when not resorting to a separate payment service provider, the transfer of money between the parties. This basic model can present significant variations, entailing different degrees of platforms’ engagement. For instance, the matching service might simply allow crowd-lenders to directly choose the admitted crowd-borrowers or present to crowd-lenders - or even automatically assign their funds to – crowd-borrowers on the basis of the results of algorithms taking into account crowd-borrowers’ risk profile and crowd-lenders expressed preferences about risk-exposure, return and maturity. The price (interest rate) of loans might be the result of competitive bids, rating provided by the platform, a combination of the two or other systems. Furthermore, some models go even further, with the platform facilitating the sale to crowd-lenders of loans originated by a bank and

provided to crow-borrowers chosen by the crowd-lenders directly or through a securitization structure or even participating to the loans facilitated through the platforms or setting up a guarantee fund to protect lenders from borrowers' defaults. The variety of models implies different levels and types of risks but the literature seems to attest the differentiation of this form of intermediation in respect to the banking model (for the absence of maturity and liquidity transformation as well as of money creation).¹

Instead, IBC generally involves the following services performed by platforms: the selection of applicants, business support in business plans preparation, publication of projects on the website, provision of boilerplate contracts, handling of parties' relationships on their account after the deal is closed. Investments take the form of equity stakes in a firm (considered or not a financial instrument depending on national interpretations) or other financial instruments (e.g. bonds, notes, mini-bond) or in contracts assigning a right to a participation to firms' returns or instead an indirect investment through a platform's holding subscribing firms' capital.

The market size of financial-return crowdfunding (FRC) or marketplace lending/investing is constantly increasing, especially the lending compartment.² It can represent an important alternative form of finance for consumers and SMEs, expanding financial inclusion, as well as an interesting investment opportunity in terms of diversification (being an alternative and therefore more resilient market), financial and non-financial/ethical returns, while also improving competition, diversification

¹ See O. Havrylchyk, 'Regulatory framework for the loan-based crowdfunding platforms', (13 December 2018), OECD Economics Department Working Papers No. 1513, [http://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=ECO/WKP\(2018\)61&docLanguage=En](http://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=ECO/WKP(2018)61&docLanguage=En); O. Havrylchyk and M. Verdier, 'The financial intermediation role of the P2P lending platforms', (2018) 60(1) *Comparative Economic Studies* 115 (the authors recognize aspects close to the banking activity in the use of auto-bid mechanisms, credit scoring – because of the reliance on platforms' due diligence - and creation of liquidity for secondary markets but I believe that these aspects are not of such relevance to transform the crowdfunding activity in the banking one but simply raise additional risks to be dealt with in the applicable regulatory regime).

² The consumer-based LBC (P2C) reached in 2017 €1,392 million, representing the 41% of the European market. The business-lending segment (P2B) had instead a 14% market share and the EBC only the 6% (plus a 2 % for debt-securities, 0.9% mini-bond and 0.05% profit-sharing contracts): T. Ziegler et al., 'Shifting Paradigms - The 4th European Alternative Finance Benchmarking Report', (2019), at 31-33, https://www.jbs.cam.ac.uk/fileadmin/user_upload/research/centres/alternative-finance/downloads/2019-04-4th-european-alternative-finance-benchmarking-industry-report-shifting-paradigms.pdf.

and innovation in the financial market.³ Nonetheless, also significant risks are attached to the same,⁴ especially in respect to crowd-investors/lenders: capital loss (for either the recipient's or the platform's default), misleading or insufficient information, conflict of interest (see in case of remuneration schemes based on the volume/number of transactions), collective action problem (unless the platform assumes the role of lenders/investors' agent and has not defaulted itself) and illiquidity. Also recipients might face governance problem (EBC) or collective action issues in debt restructuring (LBC), discrimination in selection or abusive contractual terms and negative consequences from the publication of un-protected corporate information. Finally, the financial system might have to deal with the increased risk of frauds, cyber-crimes or money-laundering and financing terrorism, while systemic risk remains low at present, although such conclusions might change considering the sector's growth rate and increased interconnections with the mainstream sector. Some of these risks have started materializing with the first platforms' defaults in Europe, increasing regulators' attention and concerns.⁵

³ Among others, see Commission, 'Unleashing the potential of Crowdfunding in the European Union', (Communication), COM(2014) 172 final 2, at 5, http://ec.europa.eu/internal_market/finances/docs/crowdfunding/140327-communication_en.pdf. Recently about the marketplace lending potential for financial inclusion, see J. Jagtiani and C. Lemieux, 'Fintech Lending: Financial Inclusion, Risk Pricing, and Alternative Information', Federal Reserve of Philadelphia Working Paper No. 17/2017, <https://www.philadelphiafed.org/-/media/research-and-data/publications/working-papers/2017/wp17-17.pdf>; H. Hau, Y. Huang, H. Shan and Z. Sheng, 'Fintech credit, financial inclusion and entrepreneurial growth', (2018) Working Paper, abstract available at https://editorialexpress.com/cgi-bin/conference/download.cgi?db_name=EEAESEM2018&paper_id=598.

⁴ More extensively about the characteristics, business models, benefits and risks of FRC and references, see E. Macchiavello, 'Peer-to-peer lending and the "democratization" of credit markets: another financial innovation puzzling regulators', (2015) 21(3) *Columbia Journal of European Law* 521, 540-42; Id., 'Financial-Return Crowdfunding and Regulatory Approaches in the Shadow Banking, Fintech and Collaborative Finance Era', (2017) 14(4) *European Company and Financial Law Review* 662; G. Ferrarini and E. Macchiavello, 'Investment-based crowdfunding: Is MiFID II enough?', in D. Busch and G. Ferrarini (eds.), *Regulation of EU Financial Markets: MiFID II* (OUP, Oxford, 2017), 668; Id., 'FinTech and Alternative Finance in the CMU: The Regulation of Marketplace Investing', in D. Busch and G. Ferrarini (eds.), *Capital Markets Union in Europe*, (OUP, Oxford, 2018); A. Sciarone Alibrandi et al., 'Marketplace lending. Verso nuove forme di intermediazione finanziaria?', Consob Quaderno Fintech n. 5 (July 2019), http://www.consob.it/documents/46180/46181/FinTech_5.pdf/a92a97f0-7d0e-43de-9fcd-4acfd97199f2; J. Armour and L. Enriques, 'The Promise and Perils of Crowdfunding: Between Corporate Finance and Consumer Contracts', (2018) 81(1) *The Modern Law Review* 51; FCA, 'The FCA's regulatory approach to crowdfunding and similar activities', (2013) CP13/13; European Commission Financial Services User Group, Crowdfunding, 'Crowdfunding from an investor perspective', (EU 2015), 25; M. Carney, 'The Promise of FinTech – Something New Under the Sun?', speech at Deutsche Bundesbank G20 conference 'Digitalising finance, financial inclusion and financial literacy', Wiesbaden, 25 January 2017, www.bankofengland.co.uk/-/media/boef/files/speech/2017/the-promise-of-fintech-something-new-under-the-sun.pdf?la=en&hash=0C2E1BBF1AA5CE510BD5DF40EB5D1711E4DC560F; FSB, 'Financial Stability Implications from FinTech. Supervisory and Regulatory Issues that Merit Authorities' Attention', (27 June 2017), www.fsb.org/wp-content/uploads/R270617.pdf; CGFS and FSB, *FinTech Credit. Market structure, business models and financial stability implications*, (BIS, Basel, 2017); EBA, 'Opinion on Lending-based Crowdfunding', EBA/Op/2015/03'; ESMA, 'Opinion on Investment-based Crowdfunding', ESMA/2014/1378.

⁵ The Swedish platform TrustBuddy went into administration in October 2015 and undergone investigations for management "serious misconduct", while the British Lendy's entered into administration in May 2019: <http://www.p2pfinancenews.co.uk/2019/05/29/p2p-administrations-a-timeline/>.

The approaches shown by regulators around the world to such new phenomenon have not been univocal, not even within the European Union (*see* below § 2), characterized, especially after the financial crisis, by special efforts towards more harmonization and centralization in financial regulation and supervision (see the increased deploy of Regulations and maximum harmonization Directives in the sector, the Banking Union and the Capital Markets Union – CMU - projects, the revision of the system of European Supervisory Authorities, etc.).

The European Commission, after initially considering an EU regulatory action unsupported,⁶ presented in October 2017 an ‘Inception Impact Assessment’⁷ and on March 8th, 2018 a Proposal for a Regulation on European Crowdfunding Service Providers (ECSPs) for businesses,⁸ within its CMU program and FinTech Action Plan,⁹ also to react to such regulatory fragmentation. Brexit has likely created incentives for EU countries to facilitate the passporting of crowdfunding activities in the EU in order to attract businesses from the UK (the biggest market of alternative finance in Europe)¹⁰ but, at the same time, potentially relevant obstacles (again for being the UK the main game player but subject to the uncertain negotiations’ outcomes). The Proposal presents very interesting and innovative aspects, adopting a partially cross-sectoral approach (targeting both marketplace lending and investing), a MiFID-exempted *ad hoc* regime focused on disclosure, warnings and an entry test (instead of the appropriateness/suitability tests), under the supervision of the ESMA. Nonetheless, the European Parliament in its Resolution of March 2019¹¹, anticipated by the Committee on Economic and Monetary Affairs’ (ECON) report of November 2018,¹² seems to look at crowdfunding in a partially different way (a varied range of services subject to differentiated regimes) and foresee

⁶ Commission, ‘Crowdfunding in the EU Capital markets Union’, Commission Staff Working Document, SWD(2016) 154 final, at 31.

⁷ Commission, ‘Inception Impact Assessment. Legislative proposal for an EU framework on crowd and peer to peer finance’, (30 October 2017), https://ec.europa.eu/info/law/better-regulation/initiatives/ares-2017-5288649_en.

⁸ Commission, ‘Proposal for a Regulation of the European Parliament and of the Council on European Crowdfunding Service Providers (ECSP) for Business’, 8 March 2018, COM(2018)113. For a first comment, *see* E. Macchiavello, ‘Feedback on the European Commission “Proposal for a Regulation on European Crowdfunding Service Providers (ECSP) for business”’, (11 May 2018), https://ec.europa.eu/info/law/better-regulation/initiatives/ares-2017-5288649/feedback/F11570_en?p_id=181605

⁹ Commission, ‘FinTech Action plan: For a more competitive and innovative European financial sector’, (8 March 2018), COM/2018/0109 final.

¹⁰ The UK represents the 68% of the European market, followed by France (especially for IBC and P2B), Germany (P2C) and the Netherlands (IBC and P2B): Ziegler, ‘Shifting Paradigms’, 13, 16, 35.

¹¹ European Parliament, ‘Legislative resolution of 27 March 2019 on the proposal for a regulation of the European Parliament and of the Council on European Crowdfunding Service Providers (ECSP) for Business (COM(2018)0113 – C8-0103/2018 –2018/0048(COD)), [http://www.europarl.europa.eu/RegData/seance_pleniere/textes_adoptes/provisoire/2019/03-27/0301/P8_TA-PROV\(2019\)0301_EN.pdf](http://www.europarl.europa.eu/RegData/seance_pleniere/textes_adoptes/provisoire/2019/03-27/0301/P8_TA-PROV(2019)0301_EN.pdf)

¹² European Parliament, ‘Report on the proposal for a regulation of the European Parliament and of the Council on European Crowdfunding Service Providers (ECSP) for Business’, (9 November 2018), www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//NONSGML+REPORT+A8-2018-0364+0+DOC+PDF+V0//EN.

for the same a different role and future (closer to incumbents' regulation and with increased platform's liability - for the information in the KIIS and in evaluating the suitability of the products). Finally, the Council's version of the text¹³ shows a more 'schizophrenic' attitude, limiting crowdfunding to execution-only types of services but then designing a stricter and rigid regime with relevant prudential requirements, closer to other more complex services' regimes. The legislative process is therefore experiencing a stall but negotiations are expected to resume on October 22nd 2019.¹⁴

What can we expect therefore from the version of the Regulation on crowdfunding that will be eventually approved¹⁵ and consequently for the future of crowdfunding in Europe? The topic is extremely timely and sensitive because of, for instance, the first platforms' defaults (see below), difficult Brexit negotiations regarding financial services (in particular, considering that the UK is the main FinTech market), current tentative reforms in the financial regulation area (CMU, proportionality in EU banking and investment services law, reforms of ESAs, etc.) and discussions about the future of the EU amidst the recent political turn towards nationalism in many countries.

The present paper, after presenting all the three versions of the Proposal and assessing their pros and cons, tries to provide an answer to this question and suggest adjustments for the final version of the Proposal, confirming the need for an *ad hoc* regime for FR-crowdfunding, in order to reach a more balanced regulatory approach.

2. Brief overview of regulatory approaches to marketplace lending/investing in Europe

Member States' regulatory responses to marketplace lending/investing, as mentioned above, have been extremely varied.¹⁶

¹³ Council of the European Union, 'Proposal for a Regulation of the European Parliament and of the Council on European Crowdfunding Service Providers (ECSP) for Business and amending Regulation (EU) No 2017/1129 - Mandate for negotiations with the European Parliament - Compromise proposal', (24 June 2019), <https://data.consilium.europa.eu/doc/document/ST-10557-2019-INIT/en/pdf>.

¹⁴ Agence Europe, 'Launch of interinstitutional negotiations on crowdfunding on 22 October', (17 October 2019), <https://agenceurope.eu/en/bulletin/article/12351/24>; Id., 'Possible European Parliament/EU Council agreement on 11 December on Regulation on crowdfunding', (28 November 2019), <https://agenceurope.eu/en/bulletin/article/12378/13> (reporting anyway the lack of consensus to reach an agreement on the 25th October 2019).

¹⁵ The title of the present working paper - quoting the famous bible for "mums-to-be" by Heidi Murkoff and Sharon Mazel titled 'What to Expect When You're Expecting' (ed. Workman Publishing, first edition 1984)- refers to the great expectations surrounding such proposal and the considerable length of the legislative process (actually closer to an elephant's pregnancy than to a human's one!).

¹⁶ For the comparative analysis of the main European systems and related discussion please refer to my previous works indicated at footnote 4 and to: Commission, 'Crowdfunding in the EU Capital Markets Union', Commission Staff Working Document, SWD(2016) 154 final, https://ec.europa.eu/info/system/files/crowdfunding-report-03052016_en.pdf; Id., 'Final Report – Identifying market and regulatory obstacles to crossborder development of crowdfunding in the EU, (December 2017), https://ec.europa.eu/info/sites/info/files/171216-crowdfunding-report_en.pdf; CrowdfundingHub, 'Crowdfunding crossing borders', (2016),

Marketplace lending platforms, for instance, have received varied qualifications and consequent treatments, depending on the country: payment service providers (PSPs) or even payment agents of EU PSPs, professional lenders, credit intermediaries, financial intermediaries abusively conducting the banking activity (for collecting repayable funds from the public or facilitating the same, depending on the particular borders of the banking monopoly in each country), investment firms (brokers or investment funds depending on the business model) or a (generally) new financial intermediary subject to a special regulation (e.g. in France, UK, Netherlands; applying the same regime for IBC and LBC in Portugal, Spain, Belgium, Finland and Lithuania).

Such special crowdfunding regulations have in common the creation of a new operator, authorized by the financial authority after verification of fit and proper requirements of managers and directors, adequate business plan, business continuity arrangements and professional insurance (somewhere as an alternative to a certain minimum capital, such as in Spain, Portugal and Finland) and, in some countries, adequate organization (see Spain and Portugal). They are subject to lighter regulation than banks or investment firms, focused on informational duties (but the borrower remains the only responsible for the information provided about the project and him/her-self¹⁷) and conduct rules (including conflict of interest) towards both crowd-lenders and crowd-borrowers (in some countries assimilated at least in part to consumers under the consumer credit legislation: UK, Netherlands, Finland, Lithuania) and a general duty to avoid money-laundering, without prudential requirements, save for the UK, Lithuania and - when loans intermediated exceed € 2 million – Spain, which also entail certain own funds requirements. On the other hand, crowdfunding providers face everywhere significant limitations in permissible activities (with the prohibition to provide activities reserved to other intermediaries, in particular investment services or payment services, except when, in the latter case, specifically authorized) and, saved the UK and the Netherlands, size of the loan requests from the same borrower in 12 months (generally € 1 or 2 million) and maximum investible amount by each retail crowd-lenders per project and in total per year. The majority of jurisdictions do not require platforms to assess the appropriateness of the investment for the crow-lender (this is

<https://drive.google.com/file/d/0B7uykMX1rDrWU3BRZTBMNzFwLVE/view>; D.A. Zetzsche and C. Preiner, 'Cross-Border Crowdfunding – Towards a Single Crowdfunding Market for Europe', European Banking Institute Working Paper Series 2017 - No. 8, <https://ssrn.com/abstract=2991610>; E. Härkönen, 'Regulating Equity Crowdfunding Service Providers -An Innovation-Oriented Approach to Alternative Financing', (2018) 1 *NJCL* 201; T. Jørgensen, 'Peer-to-Peer Lending – A New Digital Intermediary, New Legal Challenges', (2018) 1 *NJCL* 231 (especially about Nordic and Eastern European countries).

¹⁷ The information, especially about the provider, investments, risks, costs and past performance, with warnings about the absence of traditional safeguards, have to be presented on the website and in an informative document which substitutes the prospectus (in exemption from Prospectus regulation where applicable to investment products other than transferable securities) and is not approved by the authority. In certain countries, the law or the authority provides a standard document (France and Portugal) but in any case the document should be concise and easy to understand.

not the case, however, in the Netherlands for investments above € 500, in Belgium, in Lithuania and, starting in 2019, in the UK) and have only to disclose the checks performed on applicants (in Spain and Netherlands there is instead an explicit duty of due diligence). Only few recognize to crow-lenders a withdrawal right (UK and Netherlands).

Marketplace investing, instead, has been considered, in some countries, as falling within the MiFID and Prospectus regimes, while, in others, exempted from the same and subject to either a national general regime for brokers (not holding clients' money or transferable securities *ex Art. 3 MiFID II: Germany*) or an *ad hoc* national crowdfunding regulation (generally, resorting to art. 3 MiFID exemption; see Italy, France, Spain, Belgium, Finland, Lithuania; as a different and new type of service, therefore not subject to the above mentioned EU texts: Portugal).

The procedure and requirements to obtain the authorization under these special regimes are simple (fit and proper managers and major shareholders, certain minimum initial capital or a professional insurance) and the regime, in exemption, at certain conditions, from Prospectus and MiFID regulations, is quite light and focused on disclosure (again with a concise and clear document about risks, costs and performance, with warnings, not subject to the authority's approval) and other business conduct rules (fair conduct and efficient orders management, due diligence in recipients' selection only in France and Spain), with the UK, Lithuania and Spain again entailing instead also own funds requirements. On the other hand, the activities (prohibition to offer other investment services and holding clients' money or securities) and products¹⁸ that can be offered and amount of the offers are limited. Most countries - except in France and Italy - have also introduced limits to the sums investible by retail or non-sophisticated investors (except when receiving regulated advice: Spain and UK) per project and per year. An investor test or appropriateness assessment is required only in Italy, UK (when retail in absence of regulated advice), the Netherlands, Lithuania and Belgium, while in France platforms, being investment advisors, need to perform a suitability assessment.

Additional investor protection measures for retail investors have been implemented in some countries, such as withdrawal rights (e.g. Italy, UK, Austria, Germany and Netherlands) or redress mechanisms/ADRs (Portugal, France, Netherlands and the UK) while only Italy has introduced tag-

¹⁸ For instance, in France, the *Conseillers en Investissements Participatifs* could only deal in ordinary shares, fixed-interest bonds and '*bons de caisse*' but the products have been recently extended to mini-bond (even transferable through blockchain) preference shares, convertible bonds and participation instruments; in Italy, originally, crowdfunding providers could only deal in shares of innovative start-ups but subsequent reforms progressively extended the scope also to shares of all SMEs (s.p.a. or s.r.l.) and, after the law No. 145 of 30 December 2018 ('*legge di bilancio 2019*'), also bonds of the same companies (see below § 7).

along rights in case of change of control and the mandatory participation to the investment of professional investors (for the 5% or 3%). Some countries expressly apply to platforms AML/CT regulations (UK, Austria, Portugal and Germany).

Most regimes also allow traditional financial institutions to conduct crowdfunding operations (except Spain) but generally subject the same, in addition to their regime, to specific crowdfunding requirements.

Such differences in regulating FRC trace back, on the one hand, to the above mentioned variety of business models and, on the other hand, to the persisting differences in legal traditions, implementation of EU Directives and un-harmonized areas (e.g. company law) despite recent efforts in creating a CMU. For instance, Member States present different definitions or identification criteria of certain investment services and of financial instruments or transferable securities, which represent the grounds for the application of EU financial law (e.g. MiFID, Prospectus Regulation, MAR, etc.),¹⁹ and varied thresholds for the Prospectus exemption.²⁰

FRC platforms interested in offering cross-border crowdfunding services consequently face relevant regulatory obstacles, being their activity - where partially conducted also in other Member States - potentially subject to a different authorization or to additional rules. This applies in principle even when certain parts of the platform's activity are covered by a European passport: for instance, in case of an authorization as payment service provider, services offered in addition to payment ones – such as credit scoring, debt collection, etc. – might fall outside the passport scope. Furthermore, the diversity in regimes applied to FRC platforms in the EU territory clashes with the current objectives of creating a real single market (in terms of regulatory arbitrage, European freedoms, equal investor protection, etc.). No surprise, therefore, in finding out that the level of cross-border activity in Europe, although rising, remains limited.²¹

3. The Commission Proposal

3.1. Preliminary aspects: Opt-in and MiFID-exempted regime for both LBC and IBC. Scope

¹⁹ For instance, in Poland, Italy and Sweden the shares of private limited liability companies are not considered transferable security, while this is not the case in Hungary. See Macchiavello, 'Financial-return'; Härkönen, 224. See more recently, about the qualification of crypto-assets in Member States and different interpretations of the concept of financial instrument/transferable security, ESMA, 'Initial Coin Offerings'.

²⁰ Ranging, under the previous EU Prospectus Directive No. 2003/71/CE, from € 100.000 (mandatory exemption) to € 5 million (optional exemption) in total consideration per offer in 12 months and, under the recent EU Regulation No. 2017/1129/EU from € 1 million to € 8 million.

²¹ For recent data about investments and requests of funds across European borders (increasing in recent years), see European Commission, 'Final Report. Identifying Market and Regulatory Obstacles'; Ziegler et al., 'Shifting Paradigms', 48-51.

The Commission, having discarded the other options available²² presented in its previous Inception Impact Assessment, has decided to react to such regulatory fragmentation proposing an opt-in and *ad hoc* regime.

The proposed Regulation, in fact, aims at introducing an optional European regime for crowdfunding platforms (recital 14), facilitating cross-border operations and also overcoming national regulatory obstacles to such activity for platforms willing to opt for the European crowdfunding passport being subject to the related regime. The EU regime would coexist with national crowdfunding regimes and existing EU regimes (e.g. as banks and investment firms), working as a sort of label. This, although representing an interesting compromise between the need for an European regime and the survival of national crowdfunding regimes (more politically acceptable than a mandatory regime and respectful of the subsidiary principle) and potentially creator of positive regulatory competition, runs the risk of generating investor confusion about protections and recourses.²³

The status as ECSPs would be alternative to MiFID-authorized investment firms and to crowdfunding platforms operating under a national regime. In particular, investment firms would not be able to access the regime without withdrawing their original authorization (but are allowed to provide crowdfunding services under their own regime: recital 9 and Art. 2(2)b), while banks can hold both licenses (recital 13).

The regime would apply to both LBC and IBC platforms – and with almost no difference in the regime between the two -, partially overcoming the lack of harmonization in the lending area. However, the scope, and therefore the cross-sectoral coverage, remains limited. In fact, the regime would only apply to business loans (with, therefore, the exclusion of consumer loans) and transferable

²² Option 1 was simply a ‘no-action’ choice (only entailing the study of existing national regimes and the collection of best practices); option 2 consisted in the indication by the Commission of minimum requirements set up based on best practices and existing national regimes, with platforms complying with the same only voluntary in order to signal their commitment to users; option 3 implied instead the application of existing EU law (in particular, PSD and MiFID with regard to trading venues) to crowdfunding, with adaptations and a proportionate approach or – alternatively but with very different implications - the creation of a special crowdfunding regulation, taking anyway inspiration from existing EU laws; finally, option 4 (the one eventually chosen by the Commission in the Proposal) consisting in the creation of an opt-in European regime for crowdfunding, inspired to existing EU law but more proportionate.

²³ See the concerns expressed by the European Economic and Social Committee (EESC) of the European Parliament: «Since the 29th regime and national systems will exist in parallel as a result of the choices made, interested parties may be confronted with different laws, different conditions and unequal protection at the same time and in the same market, which may give rise to confusion and uncertainty» (EESC, ‘Opinion on the “Proposal for a Directive of the European Parliament and of the Council amending Directive 2014/65/EU on markets in financial instruments and Proposal for a Regulation of the European Parliament and of the Council on European Crowdfunding Service Providers (ECSP) for Business”’, (3 August 2018), points 1.6 and 3.10, <http://data.consilium.europa.eu/doc/document/ST-11544-2018-INIT/en/pdf>). See also Macchiavello, ‘Feedback’.

securities (not to other investment products, perpetuating the above mentioned significant differences among Member States), to activities corresponding to placement without firm commitment, reception and transmission of orders (as identified under MiFID II) or facilitation of granting of loans but are allowed to exercise discretion (see below). Platforms interested in adopting more complex business models will need to opt for, depending on the cases, MiFID II authorization or national regimes.

3.2 Authorization

Crowdfunding providers would have the opportunity to apply for an alternative authorization from the ESMA, in exemption from MiFID – which has been considered by the Commission as disproportionate – and conditional to certain ordinary requirements (business plan, internal organization, ‘fit and proper’ management; plus business continuity arrangements), among which minimum capital or insurance requirements are surprisingly absent.

In the original Proposal, ESMA has been entrusted with relevant on-going and direct supervisory powers, including in terms of request of information, investigations and inspections, penalties, withdrawal of the authorization (Artt. 10-13), with the right of people and entities affected by its decisions to challenge the same in front of the Board of Appeals and the European Court of Justice.²⁴

3.3. The regime for ECSPs: the focus on conduct and disclosure obligations. Restrictions.

The regime designed for ECSPs mimics the MiFID one (in its original version/inspiration) but further simplified, primarily based on general and typical conduct rules (to act honestly, fairly and professionally in accordance with the best interests of their clients) and disclosure obligations - disregarding prudential requirements and product governance rules - but without differentiating some rules depending on the retail or professional nature of the client. No obligation to conduct due diligence checks on project owners is explicitly assigned to the ECSPs, despite recital 15,²⁵ unless implicitly included in the duty to act ‘professionally’ under Art. 4(2).

²⁴ The expansion of ESMA’s powers follows the re-interpretation of the *Meroni* doctrine by the ECJ in the *ESMA – short selling* case (C-270/12) and the attempt by the Commission to reinforce ESAs role and expand ESMA’s supervisory role beyond existing Credit Rating Agency and short-selling Regulations showed in the Proposal to review ESAs regulations presented on September 20th 2017 and revised in September 2018. Nonetheless, such extension in the ESAs’ powers has been significantly downsized in the text adopted by the European Parliament on 16th April 2019 (available at http://www.europarl.europa.eu/doceo/document/TA-8-2019-0374_EN.pdf) and in the version eventually approved by the Council of the European Union on 2nd December 2019 (see <https://www.consilium.europa.eu/en/press/press-releases/2019/12/02/financial-supervision-council-adopts-a-review-of-the-supervisory-framework-for-financial-institutions/>).

²⁵ ‘In order to maintain a high standard of investor protection, to reduce the risks associated with crowdfunding and to ensure fair treatment of all clients, crowdfunding service providers should have in place a policy designed to ensure that

ECSPs have to provide clients (and potential clients), before they enter into the contract, with information (also at a marketing stage) about themselves, the costs and charges related to crowdfunding services or investments, crowdfunding conditions - including crowdfunding project selection criteria - and the nature of risks, in a clear, comprehensible, complete and correct manner, anyway publishing such information on a clearly identified section of their website, in a non-discriminatory manner (Art. 14).

ECSPs cannot allow their clients to access the offers unless they have performed a 'entry knowledge test', verifying whether and which crowdfunding services are appropriate for them considering their past investments in transferable securities and loans and their knowledge and professional experience about crowdfunding in particular (Art. 15). In case of a negative test result, ECSPs must simply warn the investor. This test resembles therefore an appropriateness test but pertaining to crowdfunding in general and to single crowdfunding services instead of specific financial instruments (therefore performed at an earlier stage and at a more abstract level than the 'know-your-customer' ones). ECSPs also need to offer their clients the opportunity to simulate their ability to bear losses, calculated as 10% of their net worth (i.e., they are not instead obliged to require their clients to perform such simulation).

With reference to single offers, ECSPs have to provide clients with a Key Investor Information Sheet (KIIS), based on the KID-PRIIPs model (six pages maximum, a-technical language) and prepared by the issuer/project owner which remains the sole responsible, being the ECSP only required to verify the completeness and clarity of the same (but also to request a revision by the project owner in case it identifies material omissions, mistakes or inaccuracies and to cancel the offer in case the former does not comply). Besides certain information specified in the annex and pertaining to the offering, costs and fees, risks, the business owner, its activity and the products offered, the KIIS will contain several warnings (about the lack of control/approval by supervisory authorities, of deposit/investment guarantee schemes or of an appropriateness test; about the risk of loss, illiquidity and lack of return; about the opportunity not to invest more than 10% of their own net worth). The language of the KIIS (and marketing communications) might be alternatively, at ECSP's choice, the one of each Member State in which it is marketed or one customary in international finance, in order to limit translation costs. However, to limit the risk of investors' inability to understand the KIIS, the investor can always require a translation in his/her language but, in case of refusal by the ECSP, the

projects are selected in a professional, fair and transparent way and that crowdfunding services are provided in the same manner'.

consequence is simply the prohibition for the latter to sell the product to that investor (Art. 16 and annex).

Furthermore, in case ECSPs exercise discretion in the execution of client orders, they need to disclose the 'exact method and parameters of that discretion and take all necessary steps to obtain the best possible result for their clients' (Art. 4(4)).

ECSPs are also subject to organizational requirements (conflict of interest; effective and prudent management; business continuity; to manage the additional operational risk coming from outsourcing; complaint handling: Artt. 5-8).

The lighter regime, compared with MiFID-investment firms, is counter-balanced by certain relevant restrictions: the business model of ECSPs has to correspond to the original and basic model of crowdfunding, therefore limited to certain services (see above) with the prohibition to offer other reserved services (i.e. additional investment services or, unless holding a specific license under national or EU law, banking, payment and asset keeping services: recital 12 and Art. 9)²⁶ or marketing certain projects (Art. 19(2)). Moreover, offers should not exceed € 1 million in total consideration in 12 months (Art. 2(2)d).

They can create systems to allow the direct interaction and exchange of products among clients but under the condition of warning clients that such 'bulletin boards' are not OTF/MTF and that the buying/selling activity is under the exclusive responsibility of the same clients and, in case the platform indicates a price, of specifying that this is not mandatory and indicating the criteria to determine the same (Art. 17).

Furthermore, platform cannot have any financial participation in the offers (even when conceived to align the platform and clients' interest and in all loans) or accept as clients their managers, employees, controlling shareholders or persons even indirectly linked to the previous ones (recital 19 and Art. 7(1)-(2)).

4. Assessment of the EC Proposal: the revival of disclosure and the risk of an un-level playing field?

²⁶ In particular, for realizing payment transactions, platforms would need to obtain an authorization as payment service providers or anyway recur to a payment provider (which will perform the AML/CT checks) (Art. 9).

Such regime tries to find a difficult compromise between investor protection and financial inclusion/innovation as well as between EU and national regimes (but see above § 3.1. about its opt-in character) while also reflecting the incertitude on the exact borders and nature of crowdfunding.

In fact, it seems hesitating among the options of conceiving crowdfunding platforms as sort of information services companies under the new platform model (presented as marketplaces for P2P transactions)²⁷, financial intermediaries (e.g. underwriters but even brokers/dealers) or something in the middle or anyway new. For instance, the commented regime, despite being associated with the reception/transmission of orders and placement services (actually, quite different services, consequently subject to distinct requirements but here surprisingly assimilated), resembles the OTF regime for the possibility to exercise discretion on clients orders, the best execution duty and the duty to verify only the completeness and clarity of the KIIS (e.g. instead of being responsible for the information as the leader underwriter). However, it also echoes the more executive services regulation for the lack of capital requirements and of due diligence obligation in the projects selection process, a sort of appropriateness (instead of suitability) test and the conflict of interests regime. Moreover, as mentioned, it creates a new 'entry knowledge test' that recalls the appropriateness test but at a more abstract level and likely performed with AI systems. Furthermore, it subjects both LBC and IBC to such 'mixed' regime and without differentiations, while the above mentioned 'Inception Impact Assessment' seemed to be inclined, instead, to find in the payment services regime and in the trading venues regime the optimal regulations (with adaptations) for, respectively, LBC and IBC. Such two regimes are quite different one from another and the second would have potentially transformed IBC platforms in pure markets (although for initial issues instead that secondary markets) freely accessible by retail investors (despite trading venues were conceived and regulated as markets for professional operators).

Even the exact boundaries of bulletin boards are not specified nor clear: the only conditions set in the Proposal are in fact certain warnings and disclosure to clients and the non-mandatory nature of the price but, considering the wide definition of MiFID trading venues,²⁸ it is unclear whether the

²⁷ The main and more general issue with the new platform model is to distinguish cases in which the platform is providing mere information or other technical services and a system for P2P communications and contracts (exempted also under Art. 2(a) of the e-commerce Directive No. 2000/31 and in application of Art. 2(2)(d) of Services in the Internal Market Directive No. 2006/123/CE, Art. 56 TFEU; see also discussions about Internet Service Providers' liability) or it is directly conducting a certain activity, with relevant consequences in terms of applicable laws and related protections (see the Uber case C-434/15 *Asociación Profesional Élite Taxi v Uber Systems Spain SL* and *Uber France* C-320/16 as regards the offering by Uber of transportation service instead of only intermediary services in this field; effects can also derive in terms of application of, e.g., labour law protections to Uber drivers).

²⁸ 'Multilateral system' refers to «any system or facility in which multiple third-party buying and selling trading interests in financial instruments are able to interact in the system» (Art. 4(1) No. 19 MiFID II); 'regulated market' to «a multilateral system operated and/or managed by a market operator, which brings together or facilitates the bringing

Proposal aims at exempting – always and in any case – bulletin boards pertaining to financial instruments (including loans when to be considered financial instruments for being negotiable on such venues) from MiFID or at simply deferring the decision in this regard once again to national interpretations.

At a general level - and looking at the regulation of the financial sector as a whole having in mind a functional, tiered and proportional approach in regulation -,²⁹ the simple fact of reserving a lighter regime (exempted from MiFID and Prospectus Regulation) to alternative providers might be considered in violation of the level-playing field and “same-activity-same-rules” principles when such operators conduct the same or a similar activity to traditional ones. However, while the function of crowdfunding platforms is close to investment firms’ one (i.e. reducing information asymmetries), there might be significant differences and good reasons (e.g. type of issuers and need of lowering costs to increase SMEs access to finance, absence of traditional protections such as guarantee schemes and authority’s checks – risks to be fully disclosed to investors -, low level of customer reliance, new techniques for firms’ evaluation and instruments to reduce information asymmetries without traditional intermediaries – e.g. co-investing with Venture Capitalist or Business Angels, etc.) justifying a different regulatory treatment, especially as regards LBC (which represents a new form of credit and investment intermediation).³⁰ Based on this reasoning and on the risky and alternative nature of the sector, traditional providers might even be excluded from the alternative regime, under the motivation of protecting them and their clients’ trust from possible shocks and consequent

together of multiple third-party buying and selling interests in financial instruments – in the system and in accordance with its non-discretionary rules – in a way that results in a contract, in respect of the financial instruments admitted to trading under its rules and/or systems, and which is authorised and functions regularly and in accordance with Title III of this Directive»; ‘MTF’ to «a multilateral system, operated by an investment firm or a market operator, which brings together multiple third-party buying and selling interests in financial instruments – in the system and in accordance with non-discretionary rules – in a way that results in a contract [...]» (Art. 4(1) No. 22 MiFID II); OTF to « OTF’ means a multilateral system which is not a regulated market or an MTF and in which multiple third-party buying and selling interests in bonds, structured finance products, emission allowances or derivatives are able to interact in the system in a way that results in a contract [...]». The CESR (pre-MiFID) used to refer to (alternative) multilateral systems a wide definition similar to the MiFID MTF one, specifying that also automatic matching and price-taking systems («which take prices from other trading venues») were included, where all material terms were agreed in the system, only excluding therefore ‘passive bulletin boards’ or ‘advertising systems’ where «participants contract each other outside the system (i.e. not under the system’s rules and not by means of the system’s protocols or internal operating procedures)» or bilateral systems i.e. «those systems where a single entity enters into every trade entered through the system, on own account and not as a riskless counterparty interposed between the buyer and seller»: CESR, ‘Standards for alternative trading systems’, (July 2002), CESR/02-086b, at 4ff, https://www.esma.europa.eu/sites/default/files/library/2015/11/1-02_086b.pdf.

²⁹ About a functional approach in regulation: R.C. Merton , ‘A Functional Perspective of Financial Intermediation’ , (1995) 24 (2) *Financial Management* 23; S.L. Schwarcz, ‘Regulating Financial Change: A Functional Approach’ , (2016) 100 *Minnesota Law Review* 1441; J. Armour et al., *Principles of Financial Regulation* , (Oxford, OUP , 2017); see also Ferrarini and Macchiavello, ‘FinTech and Alternative Finance’; E. Macchiavello, ‘FinTech regulation from a cross-sectoral perspective’, forthcoming in V. Colaert, D. Busch and T. Incalza (eds.), *European Financial Regulation: Levelling the Cross-Sectoral Playing Field*, (Hart, London, 2019).

³⁰ See more extensively, Macchiavello, ‘Financial-return crowdfunding’; Id., ‘FinTech regulation’.

systemic crises as well as of counterbalancing the competitive advantage of incumbents (e.g. information from long-standing relationship, implicit government/central bank backstop, switching and entry costs, existence of deposit guarantee and compensation funds, etc.)³¹. The original Commission proposal – as mentioned above - excludes investment firms from accessing the ECSP regime (but are allowed to offer crowdfunding services under their own MiFID regime, potentially encountering, however, obstacles in other national regimes despite their passport for investment services: see above § 2) but, surprisingly, not banks, which can instead sum their license with the ECSP one (and it is unclear whether they need to abide, while performing crowdfunding services, to both sets of rules and standards).

Anyway, the regime proposed by the Commission clearly focuses on transparency and disclosure (with information duties especially on issuers) and this approach might come as a surprise considering the post-crisis disillusion about such regulatory instrument related to behavioural biases of investors (especially online) and the complexity of certain investment products.³² The Commission is obviously aware of this and consequently limits crowdfunding to simple products as well as requires a short and clear document with simple language and express warnings but seems anyway to trust crowd-investors ability to evaluate and manage risks (related to opaque start-up and SMEs, a market characterized by intense information asymmetry, generally overcome only by venture capitalists)³³ more than investors' on traditional markets (where, despite gatekeepers and systems of price formation, burdensome MiFID obligations on intermediaries, product governance and product intervention measures have been instead introduced to better protect investors), likely also relying on platforms' reputation incentives and existing market mechanisms to reduce asymmetric information.³⁴ This might be an attempt to strike a balance between investor protection and the

³¹ See Havrylchuk, 'Regulatory framework', 9 and 31ff.

³² M. Andenas and I. Chiu, *The Foundations and Future of Financial Regulation*, (London, Routledge, 2013), 242-243; E. Avgouleas, 'What Future for Disclosure as a Regulatory Technique? Lessons from the Global Financial Crisis and Beyond', (26th March 2009), available at <http://ssrn.com/abstract=1369004>; O. Ben-Shahar and C.E. Schneider, 'The Failure of Mandated Disclosure', (2011) 159 *University of Pennsylvania Law Review* 687; N. Moloney, 'Regulating the Retail Markets: Law, Policy, and the Financial Crisis', (2010) 63(1) *Current Legal Problems* 375; Id., *How to protect Investors: Lessons from the EC and the UK*, (Cambridge, CUP, 2010), chapter 2; OICV-IOSCO, 'The Application of Behavioural Insights to Retail Investor Protection- Final Report', (April 2019), <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD626.pdf>; S. Schwarcz, 'Disclosures Failure in the Subprime Mortgage Crisis', (2008) 3 *Utah Law Review* 1109, at 1115-1117; S.M. Solaiman, 'Revisiting Securities Regulation in the Aftermath of the Global Financial Crisis: Disclosure - Panacea or Pandora's Box?', (2013) 14(4) *Journal of World Investment & Trade* 646. See also FCA, 'Applying behavioural economics at the Financial Conduct Authority', Occasional Paper No. 1, (April 2013), <https://bit.ly/2xmvOXt>; M.S. Barr, S. Mullainathan and E. Shaf, 'Behaviorally Informed Financial Services Regulation', (October 2008), Asset Building Program Policy Paper, <https://repository.law.umich.edu/cgi/viewcontent.cgi?article=1028&context=other>; G. Spindler, 'Behavioural Finance and Investor Protection Regulations', (2011) 34 *J Consum Policy* 315.

³³ Disclosure-based regulation is justified when relevant actors are able to knowledgeably evaluate and protect themselves from risks: J. Armour et al., *Principles of financial regulation*, (Oxford, OUP, 2016), 10-11.

³⁴ See Macchiavello, 'Financial-return crowdfunding'; Armour and Enriques, 'The Promise'.

survival and promotion of the crowdfunding sector, considering investors willing to invest in a riskier alternative market after being warned as more self-responsible. However, additional measures, also drawing from national experiences in regulating FRC (see above § 2), such as investment limits and withdrawal rights for retail investors would have improved the overall framework. More generally, the regime does not differentiate requirements in case of professional or retail clients in the area of conduct and disclosure requirements (e.g. KIIS and appropriateness test; making loss absorbing capacity test mandatory for retail) but this appears in contrast with a functional and proportionate approach since, in case of professional investors, it raises costs without responding to significant risks.

Furthermore, more precise and express conduct obligations for platforms, in particular in terms of maintaining a minimum level of due diligence in selecting issuers and an adequate organization also as regards cyber security, would have been appropriate. Moreover, while focusing on potential conflicts of interests between platforms and clients (see rules about co-investing by platforms and its staff), the Proposal fails to address the problems potentially deriving from the ‘institutionalization’ of crowdfunding, i.e. the presence as crowd-investors/lenders of, for example, banks and investment funds and, therefore, from the risk of cherry-picking by these at the expenses of retail investors.³⁵

Considering the recent proposal about online intermediation services,³⁶ it is also striking the absence of specific information duties on the platform in favour of the recipients (e.g. in terms of relevant contractual terms, mechanisms of ranking/credit scoring – unless included in duty to disclose to all clients ‘the crowdfunding projects selection criteria’ -, right of withdrawal and warnings about the consequences in case of breach and false statements in the KIIS). In fact, despite being business individuals or entities (not consumers), they might be in a contractually weaker position compared to the platform (as the business counterparties of digital platforms), subject to unequal contractual terms unilaterally prepared by the platform and relevant costs – including the disclosure of relevant information at the advantage of competitors -, and potentially liable for the information provided through the KIIS.

Finally, still in terms of client protection and conduct obligations, some issues arise from the scope of the regime. The Regulation in fact excludes from the range of products covered consumer

³⁵ The ‘institutionalization’ of crowdfunding has been a phenomenon on the rise for years but on the contrary decreasing at least for 2017 (from 45% in 2016 to 12% in P2P consumer lending and from 29% to 24% in P2P business lending): see Ziegler at al., ‘Shifting paradigms’, 17 and 41.

³⁶ Regulation proposal “on promoting fairness and transparency for business users of online intermediation services” (of 26 April 2018, COM(2018) 238 final.

loans, under the assumption that such loans are more delicate and already covered by the Consumer Credit Directive (CCD, No. 2008/48). Nonetheless, such Directive and related protections end up not to apply in a P2P lending context in many countries (where the scope of the regime has not been extended through national implementation) because of the lack of professionalism in the lending activity of crowd-lenders (when other than banks or other authorized operators) and therefore the absence of any professional lender as defined by Art. 3(1)*b*) CCD (a precondition for the application of the CCD under Art. 2(1)).³⁷ As a consequence, the EU regime would have the perverse effect of leaving unregulated the most delicate LBC subsector. Furthermore, the regime only applies to transferable securities as identified by MiFID (Art. 4(44) MiFID II) but this does not allow to overcome the above mentioned uncertainty and wide differences among member States about the real scope of such concept (unless the Commission does not clarify it through Art. 4(2) MiFID II, especially within the crowdfunding and Initial Coin Offerings contexts).³⁸

Despite the relevance assigned after the financial crisis to prudential requirements (especially in terms of capital requirements) also for non-banks to avoid systemic crises, the Proposal disregard them.³⁹ This might respond anyway to a functional approach in financial regulation when the platform does not offer credit on its own risk nor does perform other systemic economic functions⁴⁰ and does not hold client money or financial instruments (see Art. 4(1)2) CRR). Nonetheless, not even requiring a professional insurance to obtain the authorization is conflicting with the existence of such

³⁷ The European Court of Justice has almost had the opportunity to issue a preliminary ruling on the issue whether Art. 3(b) CCD could be interpreted as qualifying as “creditor” a P2P online platform, which only facilitated loans between consumers without lending itself the money but setting anyway the terms and conditions of the contract. However, the Finnish court that had presented the request eventually withdrew it on 16 October 2015 in relation to the entrance in administration of the platform: case *TrustBuddy AB v Lauri Pihjalaniemi*, C-311/15, 23 June 2015 and ‘Order of the President of the Court of 23 October 2015, *TrustBuddy AB v Lauri Pihlajaniemi* - Request for a preliminary ruling from the Korkein oikeus - Removal from the register’, Case C-311/15, ECLI:EU:C:2015:759. See C. Busch et al., ‘The Rise of the Platform Economy: A New Challenge for EU Consumer Law’, (2016) 5(3) *Journal of European Consumer and Market Law* 6; Wendehorst, ‘Platform Intermediary Services and Duties under the E-Commerce Directive and the Consumer Rights Directive’, (2016) 5(1) *Journal of European Consumer and Market Law* 30, at 32.

³⁸ See, in this respect (also for references), Macchiavello, ‘FinTech regulation from a cross-sectoral perspective’.

³⁹ In favour of a regime for crowdfunding replicating MiFID (including prudential requirements) but on a more proportionate basis, see D. Ahern, ‘Regulatory Arbitrage in a FinTech World: Devising an Optimal EU Regulatory Response to Crowdlending’, (March 1, 2018), European Banking Institute Working Paper Series 2018 - No. 24, <https://ssrn.com/abstract=3163728>; Zetzsche and Preiner would apply MiFID requirements as regards authorization, internal organization and conduct but consider too burdensome its prudential and product governance requirements (therefore excluded, in the first case, through the qualification of crowdfunding as reception and transmission of orders and execution without holding of clients funds or instruments, consequently applying the exemption of Art. 4(1) n. 2(c) CRR; in the second case, considering only the project owner as manufacturer): Zetzsche and Preiner, ‘Cross-Border Crowdfunding’.

⁴⁰ See Armour et al., *Principles*, 294; Macchiavello, ‘FinTech regulation’.

requirement under PSD2 for Account Information Service Providers (AISPs), which basically only provide information services.⁴¹

5. The European Parliament's text: reflecting the more varied nature of the sector while reducing the un-level playing field and defending national powers?

The ECON Committee of the European Parliament, first, and the European Parliament, more recently, as mentioned, have presented amendments to the examined text under significant aspects.

First, having the Member States in several occasions showed aversion towards the central role assigned to ESMA in the Proposal,⁴² the Parliament's draft, despite maintaining the regime optional (but clarifying that Member States should not impose license requirements on issuers or investors preventing them from using crowdfunding services offered under the ECSP Regulation), moves the supervisory responsibility from the ESMA to national competent authorities (NCAs). ESMA is only left with the responsibility of ensuring the consistent granting of authorization⁴³, coordination and conflict solving (with directly binding decision), consistently with the step backward in the ESAs Review⁴⁴ and re-insurgence of nationalisms in several member States.

Second, maybe fearing the creation of an uneven playing field with incumbents,⁴⁵ it has further aligned ECSPs general information duties with investment firms ones, requiring that information are presented in fair, clear and not misleading way (*see* MiFID II; instead of in a "clear, comprehensible, correct and complete manner" of the EC version) and proposes to at least partially subject platforms to AML/CT obligations directly (in the terms to be evaluated by the Commission), instead of indirectly through the PSPs involved. Among the information to be provided to clients, the Parliament

⁴¹ The final draft requires ECSPs to provide «proof that the crowdfunding service provider is adequately covered or holds sufficient capital against the financial consequences of its professional liability in the event of a failure to comply with its professional obligations set out in this Regulation».

⁴² See the doubts advanced by the EESC in its opinion (EESC, 'Opinion', point 3.15) and the position assumed, more emphatically, by Ashley Fox, the Rapporteur of the ECON Committee: «The experience of NCAs on granting authorisation and supervising the crowdfunding platforms should be recognised and their role in the European framework should be enhanced. NCAs do not only have this experience but are also closer to the national markets and better positioned to assess the CSPs» (ECON, 'Draft report on the proposal for a regulation of the European Parliament and of the Council on European Crowdfunding Service Providers (ECSP) for Business', (10 August 2018), 79, <http://www.europarl.europa.eu/sides/getDoc.do?type=COMPARL&reference=PE-626.662&format=PDF&language=EN&secondRef=02>.

⁴³ When ESMA disagrees with a NCA's decision about a ECSP application for authorization, it (the ESMA?) has to explain why in a reasoned manner (new Art. 10(6a)).

⁴⁴ See the revised text of the ESAs Review Proposal (footnote 24). See in this respect, N. De Arriba-Sellier, 'The Brexit Reform of European Financial Supervision: Lost in Transition?', (2019) 30(4) *European Business Law Review* 695, at 716-18.

⁴⁵ See EESC, 'Opinion', points 1.5.1 and 3.4.

has proposed to also insert platform's insolvency risk (new version of Art. 14(1)) and the default rate of the last 24 months (new Art. 14a).

Third, under the revised regime, ECSP would be also responsible for the correctness of the KIIS. Also the language rules of the KIIS and of marketing communications have been partially revised to reflect the shift in supervision from the ESMA to NCAs (and closer to the language rules of the Prospectus document): the KIIS should be in one of the languages accepted by the home country or, alternatively "*in a language customary in English*" (*sic*) (but leaving unchanged the investor right to request a translation in his/her language and, in case of refusal, the prohibition to sell that product to him/her) (new Art. 16).

Furthermore, in case of bulletin boards, ECSPs would also need to provide information on the performance of products but will be allowed to indicate the reference price as binding as long as they disclose it and the basis for calculating the same.

Although some members of the ECON had advanced proposal in this sense, the Parliament has not introduced retail investment limits.⁴⁶

On the other hand, the Parliament's draft aims at expanding the regime scope: in fact, it has raised the maximum threshold for offers' consideration to € 8 million and allowed financial participation by platforms (also as success fees) when accompanied by systems designed to align platform and investors' interests and not above 2%,⁴⁷ as well allowed under certain conditions the marketing of single projects.⁴⁸ It also added investment advice on transferable securities among admissible services (subjected anyway to the same regime as the other more "executive" services) and specified that LBC platforms can - not only match demands and offers but also - offer pricing and packaging services being subjected, in such a case as in other services other than simple matching, to additional rules and held responsible for preparing the KIIS with information about the platform, its systems and control mechanisms for managing risks and financial modelling and historic performance. However, even the final draft of the report, although aiming at improving clarity and investor protection, might have in this regard increased confusion and risk of misunderstanding: it

⁴⁶ European Parliament – ECON, 'Amendments 137 – 334', (13 September 2018), 2018/0048(COD), <http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//NONSGML+COMPARL+PE-627.793+01+DOC+PDF+V0//EN&language=EN>.

⁴⁷ Furthermore, the EP, while maintaining the prohibition for ECSPs to accept as clients managers and relevant shareholders, allows employees to invest through the platform as long as they do not hold direct or indirect influence over projects in which they have financial participation (new Artt. 7(2) and 7(3)).

⁴⁸ The new version of Art. 19(2) requires that the marketing does not "*disproportionately*" target individual live or pending projects (quite difficult to verify in practice).

has introduced the distinction between direct crowdfunding services and intermediated ones but the definitions provided, referring to MiFID services for both IBC and LBC, complicate the picture rather than clarifying it.⁴⁹

The same confusion seems attained with the revision of the entry-knowledge test: despite being treated as a sort of appropriateness test as regards the consequences in case of negative test result (triggering only a warning to the client), the new draft of the proposal requires ECSPs (irrespective of the types of crowdfunding service, being advice or reception and transmission of orders) to collect information from investors also about their financial situation and investment objectives (as under the suitability test) and a negative result might also be based on the ‘unsuitability’ of the product. Furthermore, in case of a negative simulation test, the ECSP will be allowed – but not required – to block the transaction, remaining anyway the investor fully responsible for his/her investment choices.⁵⁰ The reasons behind this hybrid (and rather confused) result in designing the knowledge test might be found in the difficulty in reaching a compromise among different members’ views (abstract *versus* concrete test and appropriateness *versus* suitability) and, maybe, in the attempt of realizing a level of investor protection ideally comparable to a suitability test or – better – product governance context but through more AI and ‘tech’ systems and in a client self-responsibility context, balancing financial inclusion and innovation with investor protection. Anyway, the revised version of the knowledge test might now overlap in the results and aims with the simulation of loss system and it remains unclear why the European Parliament has kept the latter as optional instead of making it mandatory and maintained both of them for all types of clients (even professional investors).

In conclusion, many of the described amendments are appreciable: the idea of introducing more complex models subjected to more stringent regulation, the requirement of non-misleading

⁴⁹ Art. 1(a): «‘crowdfunding service’ means the provision of a crowdfunding platform which enables either of the following: (i) direct crowdfunding service, comprising the facilitation of matching a specific investor with a specific project owner and of matching a specific project owner with a specific investor, (ii) intermediated crowdfunding service, comprising the facilitation of matching an investor with a project owner and determining the pricing and packaging of offers in respect thereof, or the facilitation of matching a project owner with an investor and determining pricing of offers in respect thereof, or both»; Art. 4a: «For the purposes of this Regulation, intermediated crowdfunding services shall be considered to comprise the following: a) the placing without a firm commitment basis, as referred to in point (7) of Section A of Annex I to Directive 2014/65/EU, of transferable securities or of the facilitation of loans issued by project owners; b) the offer of investment advice, as referred to in point (5) of Section A to Annex I to Directive 2014/65/EU, with regards to transferable securities or the facilitation of loans issued by project owners; and c. the reception and transmission of client orders, as referred to in point (1) of Section A to Annex I to Directive 2014/65, in relation to transferable securities or the facilitation of loans issued by project owners».

⁵⁰ The draft report of the ECON also included in the scope ICOs (under more stringent conditions to be defined through delegation) but the final draft reverted the choice, also recognizing the lack of adequate reflections and impact assessment on the same.

information and, in general, a more proportionate approach in regulation and supervision and the explicit direct applicability of AML/CT rules are commendable revisions. Nonetheless, on the one hand, such idea has not been adequately realized since, for instance, investment advice and reception/transmission of orders services are treated in the same way and more complex models - such as portfolio management - would have needed stricter organizational and risk management requirements; on the other hand, the efforts to move ECSP rules and terminology closer to MiFID might generate a misplaced reliance also on the comparable nature of their services and safeguards with traditional ones (despite warnings), as well as the undesired effect of creating a hybrid and confused regime. Moreover, instead of introducing a platform's responsibility also for the correctness of the KIIS (also for parts outside its competence), it would have been preferable to explicitly impose a minimum level of diligence in the selection and double-checks (not limited to AML/CT and residence) as well as obligations in the area of cyber-security.

Furthermore, NCAs supervision might reduce regulatory/supervisory arbitrage but aggravate users' confusion about the applicable regime.⁵¹ Finally, the prospective differentiation between LBC and EBC⁵² (only as regards the entry test and loss-simulation system that would be specified through ESMA RTS) still appears insufficient.

6. The Council's compromise version of the Proposal: a strict (and potentially disproportionate) regulation of FRC, perpetuating the risk of fragmentation?

The Council, despite endorsing some of the European Parliament's suggested revisions, further modifies the original Proposal under significant aspects, showing, generally speaking, a stricter and more suspicious attitude towards crowdfunding (for instance rejecting the European Parliament's choice to enlarge the regime scope to more complex services and to allow some forms

⁵¹ The ECON draft report had introduced a regime for providers from equivalent-third-countries, therefore increasing the number of applicable regimes in competition, but the final draft of November 2018 and the Parliament's resolution preferred to exclude third countries from the scope of the proposed regulation (maybe because of the current uncertainty about Brexit negotiations' outcomes) and requires ECSPs to be established in a Member State.

⁵² The first one, in fact, is riskier because of the limited universe of 'investible' SMEs/start-up (compared to the higher number of attractive loan recipients), lack of liquidity (because of the difficult or not-existent exit options related to the lack of a liquid market of such no/low-remunerative shares, contrary to short-term loans or loans with a secondary market or buy-back option on the platform), complexity of the due-diligence process (in case of start-ups, generally reserved to venture capitalists and business angels because of the information asymmetry and high research costs) and fewer risk-mitigating instruments developed by the equity sub-sector (where only few forms of co-investing with professional investors and business angels are available instead of, in the lending sub-sector, the high number of guarantee funds, lending-groups with co-lending and feedback systems, etc.); furthermore, while investment services receive an harmonized regulation at EU level, lending and credit intermediation do not (lending platforms would be potentially subjected to a stricter regime than their traditional counterparties). Possible differentiations might consist in reinforced due diligence, knowledge test and simulation of losses, and investment limits for retail in case of EBC while instead in knowledge test only above certain thresholds, basic checks for simple LBC models. See Macchiavello, 'Financial-return' and 'FinTech regulation'.

of co-investing and success fee, eliminating platform's discretion in clients' orders, etc.), although frequently referring to the principle of proportionality and the need to take into consideration the nature, size and complexity of the activity and the operator.⁵³

First of all, in addition to confirming the preference for entrusting NCAs - instead of the ESMA - with the power to authorize and supervise ECSPs (but harmonizing such powers in an extremely detailed way), the compromise draft transforms the European regime from an optional one to a mandatory one: any legal person willing to offer crowdfunding services and products covered by the EU Regulation will be required, once the transitional period expires, to apply for such new authorization, even when operating only nationally. Member States would also be prohibited to subject crowd-borrowers and crowd-lenders to banking regulation (or to require a banking license or a dispensation from the same). At the same time, the compromise text extends the original scope of the Regulation. For instance, all sorts of incumbents, such as banks, investment firms or PSPs, will be allowed to apply for such authorization, moreover benefiting from simplifications (in terms of procedure and documentation) to avoid duplication of requirements (Recital 26a; Artt. 10(9a) - (9aa)). It is still not clear, though, whether they will be also subjected to the requirements – for instance, conduct obligations - included in their own regime, in addition to the ones specific for crowdfunding and set in the proposed Regulation. An affirmative answer might rise competitive issues, while a negative one might have systemic risk implications (see above § 4).

The regime will cover offers from the same proponent up to € 8 million in total consideration in 12 months (as proposed by the Parliament) but with the possibility recognized to Member States to set lower limits according their transposition of the Prospectus Regulation (and, in case, also to prohibit offers above € 5 million from raising any capital from their residents), being the ECSPs held responsible for checking and respecting different thresholds when operating cross-border (Artt. 1(2a)-(2a1) and 4(6)). The compromise text also extends the regime scope to 'admitted instruments', i.e. shares of limited liability companies not considered financial instruments under national law and extends the terms of permissible marketing communications.⁵⁴ As a consequence, existing national crowdfunding regimes might be eventually swept away or maintained only for crowdfunding

⁵³ Reference to the proportionality principle can be found in many parts of the new version, with reference to: the regime in general (recitals 22 and 24), prudential safeguards (Art. 5(2)) and, among the requirements for authorization, the description of continuity arrangements (Art. 10(2) g), NCA's assessment of prospective ECSP application (Art. 10(6)) and exercise of their supervisory powers (Art. 27b(2)) as well as Commission delegated acts as regards complaint handling (Art. 6(4)), conflicts of interests (Art. 7(7)), authorization requirements and arrangements (Art. 10(10)), entry knowledge test and simulation of losses (Art. 15(6)) and KIIS (Art. 16(9)).

⁵⁴ The new version of Art. 19 does not address anymore the marketing of specific live or pending projects but more generally requires marketing communications to be fair, clear and not misleading, as well as consistent with the KIIS.

services/products not covered by the ECSPs Regulation (e.g. consumer loans where not already covered by CCD) or by other EU regimes (e.g. investment advice or portfolio management).⁵⁵

Secondly, as mentioned, the Council has decided to maintain the EU regime limited to “direct” and execution-only crowdfunding services (although retaining the reference to the placement without guarantee service), adding the express exclusion of more complex business models, such as the auto-bid function (and therefore replacing the reference to platforms’ exercise of discretion and related disclosure with indications about the limits for proposing and executing investment orders based on certain parameters⁵⁶), management of loan portfolios or co-investing (not even with systems ensuring the correct alignment of investors’ and platforms’ interests or adding organizational and capital requirements, which instead would have made sense).⁵⁷ The Regulation should specify whether more complex business models can still exist under national law or instead require a license under MiFID II, CRD IV/CRR or investment fund regimes (even if with reference to loans and investment products other than transferable securities or admitted instruments).

The text now also specifies the duty of ECSPs to hold in custody clients’ financial instruments directly or through authorized third parties, recalling that offering custodian services requires an authorization under MiFID II or CRD IV. Even the relevance and role of bulletin boards, although clarified (*cf* above 4), have been significantly down-sized, with these becoming mere ‘showcases’ for buy and sell interests, without the possibility to realize - not only a matching system of multiple orders (even where referred to loans instead of financial instruments) but not even - a system of direct interaction among clients (as instead originally conceived by the Commission).

Thirdly, and most importantly, despite restricting crowdfunding to direct and ‘execution-only’ services, the compromise version imposes on ECSPs prudential requirements, mainly consisting in

⁵⁵ For instance, offers of transferable securities – but not of other investment products, therefore left to the choices of national regulators - above € 8 million of total consideration in 12 months are already covered by the EU Prospectus regulation; portfolio management or investment advice pertaining to financial instruments – but not to different investment products, again potentially regulated by national law only – falls within the MiFID II scope.

⁵⁶ The compromise text specifies that platforms will be allowed to propose investments corresponding to certain preferences/parameters expressed by the clients, who will have then to specifically approve each of them (new Art. 4(4)). This requirement aims differentiating crowdfunding from portfolio management but might either excessively slow down and burden the procedure or, on the contrary, simply result in a formal measure (i.e. multiple subsequent clicks without real checks).

⁵⁷ As regards, instead, the possibility of managers, shareholders and employees to act also as clients, the compromise version takes a distance from both the Commission and the EP’s versions: ECSPs cannot accept as project owners managers, employees or significant shareholders but the same categories can invest through the platform, provided that they disclose each investment and do not receive any preferential treatment or privileged access to information (new Art. 7(2)). This solution appears the most balanced one among the three versions.

own funds for operational risk (but still alternative to a professional insurance)⁵⁸ and organizational measures for the risk evaluation of facilitated loans (with detailed rules about the organization and methods for the fixation of prices), which would have better suited more complex and “portfolio-management” or “co-investment”-like crowdfunding services.

Fourthly, the new draft changes again the rules about the KIIS and marketing communications language, moving them closer to the rules set in Art. 27 of the Prospectus Regulation about the language of the Prospectus summary (instead of the Prospectus document) and requiring its *ex ante* notification to NCAs (not its approval), consequently rising again the costs for ECSPs.⁵⁹ Furthermore, the KIIS must now identify the persons responsible for the information provided in the same and Member States are required to ensure that the responsibility attaches to at least the project owner or its administrative, management or supervisory bodies and an adequate regime of civil liability for omitted, misleading or inaccurate information, including for translations (Art. 16(4)-(4b)).

Finally, the Council has the merit to fill some gaps in the previous versions of the Proposal mentioned above. In fact, it requires platforms to disclose, in addition, the default rates and the credit scoring and creditworthiness assessment methods. Furthermore, it introduces a distinction among types of investors – sophisticated and non-sophisticated⁶⁰ - and adds in favour of the latter (in addition to the knowledge test, reserved to them) the right to withdraw in 7 days and the possibility for member States to set investment limits (anyway not below € 1.000 per investment).

In conclusion, the Council seems willing to move crowdfunding regime closer to incumbents’ one (e.g. rules on cross-border operations and passport, language of the KIIS, custodian requirements,

⁵⁸ Prudential safeguards might consist in CET1 or professional insurance or a combination of the two and in the amount of the higher between € 25.000 and ¼ of overheads of the previous year, including expenses for servicing loans, unless the platform is not already subject to prudential requirements for operational risk as investment firms or payment or e-money providers.

⁵⁹ The draft now allows the KIIS (and marketing communications) to be written in one of the languages accepted by the authority of the home member State but when the offer is directed also to residents in other Member States, the KIIS has to be made also available in one of the official languages of these Member States or anyway in one language accepted by the authority of the same Member States.

⁶⁰ Sophisticated investors do not coincide with MiFID II professional investors but, in addition to these, also include people requesting to be treated as sophisticated investors, declaring to be aware of the consequences deriving for the categorization as such and meeting the following identification criteria: 1) legal entities meeting one of the following conditions: *a)* at least €100.000 own funds; *b)* a turnover of at least € 2 million; *c)* a 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 on the capital markets in significant size, at an average frequency of 10 per quarter, over the previous four quarters. Providers must take reasonable steps to ensure that investors requesting to be categorized as sophisticated and warned about the consequences effectively qualifies as such but can approve the request unless it has reasonable doubt that the information provided is correct (see annex II).

prudential safeguards, differentiated categories of investors, whistleblowing), with, however, likely undesired effects. For instance, the regime, again, has been created in exemption from MiFID but the Regulation refers to MiFID for the most important concepts (e.g. admitted services), with some relevant exceptions and differences (e.g. same regime for placement and reception/transmission of orders, the creation of the new category of sophisticated investors, entry-knowledge test similar but different from the appropriateness test, etc.), this creating the risk of investor confusion and reliance on the existence of traditional safeguards as well of effects on incumbents' and financial sector's stability. Furthermore, the regime therefore ends up appearing excessively strict and disproportionate, even compared with similar ones in the traditional sector for executive-only services without the holding of client money or financial instruments or with volumes under certain thresholds (especially after the recent or proposed reforms in the area of CRD V/CRR II, prudential regulation and supervision of investment firms,⁶¹ PSD2, etc.), in particular with reference to investments in loans or in investment products other than financial instruments (generally subject only, at most, to PRIIPs Regulation No. 1286/2014 or PEPP Regulation No. 2019/1238) or in case of offers restricted to professional investors (for whom the KIIS and the loss-simulation system appear useless but costly for providers). ECSPs compliance costs are raised through the new rules about the KIIS language and providers' obligation to verify and respect different national requirements about the maximum amount of consideration per offer (varying from € 1 to € 8 million) and investment limits.

Finally, the compromise draft, despite reducing the room for national crowdfunding regimes, also introduces certain concessions to member States' discretion (e.g. again optional investment limits and different maximum thresholds of the offers) which might jeopardize the goal of attaining an effective harmonization and single market, also giving up the idea of harmonizing the concept of transferable security/financial instrument and preferring instead to leave untouched the differences in national interpretations and extending the regime only to the shares of limited liability companies not considered transferable securities under national laws but included in one of the annexes.

7. Conclusions: responses by some Member States, market and political trends and the future of crowdfunding in Europe. Suggestions.

7.1. Summing-up: a brief comparison of the options on the table

⁶¹ Regulation (EU) 2019/876 of the European Parliament and of the Council of 20 May 2019 amending the Capital Requirements Regulation [...] (CRR II) and Directive (EU) 2019/878 of the European Parliament and of the Council of 20 May 2019 amending the Capital Requirements Directive IV [...] (CRD V); European Commission, 'Proposal for a Regulation of the European Parliament and of the Council on the Prudential Requirements of Investment Firms', COM(2017) 790 final.

The three European Institutions show divergent views of crowdfunding and different ideas on how to regulate and supervise it, with also the effect of delaying the approval of the proposed regulation (see table 1 for a quick comparison).

The European Commission had in fact originally designed a light regime for ECSP, focused on disclosure (of key and simple information) and simple conduct and organizational requirements, under the assumption of execution-only services (or almost market-like systems, as originally considered in the Inception Impact Assessment) and small offers (up to €1 million as total consideration in 12 months) as well as investor self-responsibility, with the objective of containing ESCPs' costs at the benefit of SMEs' access to finance. However, the above-mentioned ambiguous nature of crowdfunding, difficult categorization within existing legal categories and consequent compromise solutions are reflected in the definitions (referring to two very different investment services such as reception and transmission of orders and placement) and in certain requirements more typical of OTFs and trading venues. The Commission had also decided for an optional regime and to entrust the ESMA with ECSPs direct supervision in order to ensure maximum harmonization for cross-border crowdfunding, while leaving space for national regimes for local platforms.

The European Parliament, instead, looks at crowdfunding as a more varied range of services (including investment advice, portfolio management and co-investing) worth to be subject to differentiated requirements depending on the type of activity (although the differentiation appears insufficient) but, in general, characterized by a more significant role played by the platform and, consequently, by increased platform's liability (e.g. for the information in the KIIS and in evaluating the suitability of the services) and obligations closer to MiFID II ones. It also reflects Member States' concerns over progressively giving up supervisory powers in the financial sector, therefore entrusting NCAs with the task of supervising ECSPs.

Finally, the Council appears to be willing to limit crowdfunding to execution-only types of services (e.g. prohibiting more complex services, auto-bid and bulletin boards similar to markets) but then inconsistently designs a stricter and rigid regime, closer to other and more complex types of services and incumbents' regulations (prudential requirements and more detailed and strict organizational rules), despite the reference to the proportionality principle and anyway positively filling some gaps in the original proposal (e.g. introducing the distinction between sophisticated and non-sophisticated investors, linked to differentiated protective measures). It also confirms and better defines NCAs' supervisory powers and cooperation, following MiFID's lines, but, at the same time, opens up for increased national discretions and differentiations (e.g. about the maximum threshold

for offers and investment limits for retail investors), without caring about the consequent increase in ECSPs' costs (see also the new language rules for the KIIS). Nonetheless, in doing so, it has the effect of undermining the original idea of creating a crowdfunding single market also through lower costs, at the benefit of SMEs.

TABLE 1. THE ECSPS REGULATION: ALTERNATIVES ON THE TABLE AND CONFLICTING POSITIONS			
	European Commission	European Parliament	Council of the EU
Type of regime (O/M)	Optional	Optional	Mandatory BUT allowing national discretions and differentiations (see differentiated maximum thresholds, retail investment limits: consequent fragmentation!)
Supervisor	ESMA	NCA	NCA
Types of services permitted	Only simple/"direct" crowdfunding: <ul style="list-style-type: none"> • Facilitation of business loans • Reception/transmission of orders or placement w/o guarantee (transferable securities) + strict conflict of interest prohibitions BUT "discretion" allowed (disclosure + client's best interest)	Varied range of services (including complex ones – advice, packaging and pricing; financial participation under certain conditions) with (only partially) differentiated requirements + conditions for co-investing	Only simple and "direct" services (EC) BUT further restrictions (see bulletin boards, need of authorized custodian, automation allowed but specific client consent, no financial participation) VS extension to "admitted instruments"
Size of the offers	No > € 1M	No > € 8M	No > € 8M (but MSs can set < thresholds)
Features of the regime	Light and <i>ad hoc</i> regime (exemption from MiFID); simple and general conduct and organizational requirements and disclosure (>investor self-responsibility): <ul style="list-style-type: none"> • Key information (KIIS by project owner); • Knowledge test and possibility to simulate losses 	Similar to the EC's version but reflecting a more central role of the platform and consequent increased platform's liability (e.g. KIIS, suitability), wording closer to MiFID II	Stricter and > expensive regime (see prudential requirements, KIIS language), closer to more complex types of services (although proportionality principle) w/o local broker exemption
Improvements compared to previous regimes/versions	e.g. removal of obstacles to cross-border activity for both IBC and LBC; gradual and partial shift from national to European regime (optional); special regime able to adjust to crowdfunding peculiarities	e.g. added initial capital/insurance as authorization requirement, disclosure of insolvency risks and default rate; clarified that information should not be misleading; success fees and employees as clients allowed	e.g. proportionality principle; inclusion of "admitted instruments"; distinction between sophisticated/un-sophisticated investors, disclosure of default rates and of credit scoring methods; staff can invest as long as no conflict of interest
Main cons	Lack of a professional insurance among authorization requirements; lack of specific definitions (and reference to MiFID); unclear role and liability of ECSPs ('patchwork'); exclusion of investment firms but	Confused regime (see knowledge-test, liability, simulation system)	Only simple and limited services but strict requirements; still no explicit due diligence in selection, protection of recipients; allowing regulatory fragmentation (and cross-

	not banks; insufficient protection for project owners; exclusion of consumer loans; no differentiation between LBC and EBC		border obstacles); bulletin boards only “showcases”
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7.2. Factors potentially affecting the ECSPs Regulation: Brexit and nationalisms.

The fate of the ECSPs Proposal, not approved before the end of the legislative period of the last European Parliament despite the sector’s requests and the Commission’s efforts,⁶² is difficult to forecast. Among the factors affecting the approval process, a relevant role has been played by the uncertain future of Brexit negotiations. Considering the central role of the UK in the EU financial sector and in the adoption of European financial regulation, Brexit has raised the doubts even about the future of the CMU itself.⁶³ With Brexit, the Commission has seen the opportunity to advance the CMU and integration process in a faster and substantial way (see the attempted amendments in the Supervision of Investment firms and ESAs reforms⁶⁴) and France and Germany to take over UK role, with the ESAs fearing a ‘race to the bottom’.⁶⁵ However, the deeper European integration still needs to fight against Member States concerns over losing too much control over their financial sectors and the recent resurgence of nationalisms and anti-EU parties.

All this considered, Member States might be willing to accept the strict EU regime proposed by the Council but on an opt-in basis as originally foreseen by the Commission, leaving national crowdfunding regimes alive and appealing for small local platforms. In this way, the ECSP might be chosen by the biggest and cross-border crowdfunding platforms but the strictness, costs and limits to

⁶² See European Crowdfunding Network, ‘Open Letter to Member States on the European Crowdfunding Services Providers Regulation (ECSPR)’, (17 December 2018), https://eurocrowd.org/wp-content/blogs.dir/sites/85/2018/12/ECN-open-letter-on-legal-framework-ECSP_17Dec2018.pdf. See above § 1 about the reprise of the negotiations in October 2019.

⁶³ D. Busch, ‘A Capital Markets Union for a Divided Europe’ (2017) 3 *Journal of Financial Regulation* 262; D. Howarth and L. Quaglia, ‘Brexit and the Single European Financial Market’ (2017) 55 (1) *Journal of Common Market Studies* 149, 153; W-G. Ringe, ‘The Politics of Capital Markets Union’, ECGI Law Working Paper No. 469/2019, 7, <https://ssrn.com/abstract=3433322>.

⁶⁴ See De Arriba-Sellier, ‘The Brexit Reform’, 716-18 (as regards supervision of delegation, outsourcing and risk transfer arrangements); N. Moloney, ‘Bending to Uniformity: EU Financial Regulation with and without the UK’, (2017) 40 *Fordham International Law Journal* 1335; Id., ‘Brexit and financial services: (yet) another re-ordering of institutional governance for the EU financial system?’, (2018) 55 *Common Market Law Review* 175.

⁶⁵ See EBA, ‘Opinion on Issues Related to the Departure of the United Kingdom from the European Union’, (12 October 2017), 34, <https://www.eba.europa.eu/documents/10180/1756362/EBA+Opinion+on+Brexit+Issues+%28EBA-Op-2017-12%29.pdf>; ESMA, ‘General Principles to Support Supervisory Convergence in the Context of the United Kingdom Withdrawing from the European Union’, (31 May 2017), points 4 and 6, https://www.esma.europa.eu/sites/default/files/library/esma42-110-433_general_principles_to_support_supervisory_convergence_in_the_context_of_the_uk_withdrawing_from_the_eu.pdf.

the permissible activities might make the MiFID authorization more appealing for such platforms, with consequent practical irrelevance of the ECSP reform and regime.

The ECSPs proposal is therefore expected to have a relevant impact on national crowdfunding markets and laws. Certain Member States seem to have already reacted with different regulatory responses. Some countries, at the time of the Proposal presentation, were in the process of adopting a national crowdfunding regime but considering the costs for concluding the same, they appear to have suspended it while awaiting for the results of the difficult EU negotiations (see Sweden and Ireland).⁶⁶ Other Member States, instead, have been trying to adjust their national regimes, likely aiming at making them more appealing in the view of a direct competition with an EU regime. For instance, Italy - originally characterized by a quite strict and equity-based crowdfunding only regime, restricted to innovative start-up shares -, has progressively expanded the same and now covers the shares of most company-SMEs (s.p.a. and s.r.l.) as well as debt-based instruments⁶⁷ (the ones of s.r.l. being restricted to professional-only investors, while s.p.a.'s ones now open to certain "sophisticated" investors).⁶⁸ In Belgium, the Prospectus law of 11 July 2018 introduced a new Prospectus exception: there is no obligation to present a Prospectus in case of securities offers up to € 500,000, provided that the investor cannot subscribe for more than € 5,000, while only an information note (concise, comprehensible, clear) is required for offers between € 500,000 and € 5 million.⁶⁹

⁶⁶ See, respectively, <https://iclg.com/practice-areas/fintech-laws-and-regulations/sweden> and <http://www.arthurcox.com/publications/crowdfunding-domestic-regulatory-regime-now-likely/>. The Cabinet of Ministers of Latvia submitted on 2 April 2019 a legislative draft on crowdfunding to the Latvian Parliament but there has not been trace of the adoption of such law since then: Baltic New Network, 'Latvian government approves crowdfunding legislation', (2 April 2019), <https://bnn-news.com/latvian-government-approves-crowdfunding-legislation-199067>.

⁶⁷ See footnote **Fehler! Textmarke nicht definiert.** about the latest Italian law No. 148/2018. The 'Growth' Decree No. 34 of 30 April 2019 also granted crowdfunding access to the SME guarantee fund and laid the grounds for a more general Fintech sandbox in Italy.

⁶⁸ The Italian civil code restricts the offer of s.r.l.'s debt securities to professional investors (provision left unchanged by crowdfunding laws which however have opened up close limited liability companies to external funding), forcing Consob to identify the categories of non-professional investors able to invest in SMEs debt securities through crowdfunding platforms only with reference to s.p.a. (public companies) and under other conditions identified by the civil code (e.g. offers up to the double of the company's net worth). The new text of the crowdfunding regulation proposes to identify as 'sophisticated' investors, in addition to professional investors: 1) the categories of investors already identified by Art. 24(2) Italian crowdfunding regulation as required to co-invest with retail clients and not benefiting from withdrawal right and appropriateness test (e.g. banking foundation, incubators of innovative start-ups, investors supporting SMEs) ; 2) investors with an investment portfolio (including deposits) of at least € 250.000 (see UK discipline for reserved alternative FIA); 3) investors willing to invest at least € 100.000 and declare to be aware of the risks (see EuVECA e EuSEF discipline for alternative investment funds below the threshold); 4) other investors investing within a service of investment advice or portfolio management provided by a regulated firm and with a positive suitability test (see ELTIF discipline, saved for the missing 10% limit): Consob, 'Regolamento n. 18592 del 26 giugno 2013 sulla raccolta di capitali tramite portali on-line', (as modified by Resolution No. 21110 of 11 October 2019), http://www.consob.it/documents/46180/46181/reg_consob_2013_18592.pdf/54eae6e4-ca37-4c59-984c-cb5df90a8393.

⁶⁹ Therefore, the new maximum threshold exemption is now € 5 million. The Crowdfunding Law of 18 December 2016 had already introduced a crowdfunding exemption from the Prospectus regime for crowdfunding platforms authorized under the new regime, if the total value of the offer is less than € 300,000 and the maximum investment for the offer is € 5,000 per investor. See L. Peeters, 'Crowdfunding in Belgium: New law simplifies fundraising under Euros 5 million',

Nonetheless, not all changes in national crowdfunding laws have aimed at facilitating crowdfunding. For instance, in the UK, despite Brexit, the FCA has recently moved LBC regulation closer to the IBC one (and consequently, to MiFID II one) by extending to LBC platforms risk management and governance requirements (similar to portfolio management's ones) in case of loan pricing or promise of a certain level of investment return, as well as maximum investment limits, and appropriateness test.⁷⁰ This might have influenced, as evidenced, the Commission's decision to treat LBC and IBC as they were the same and the latest ECSPs Proposal revisions (especially the Council's). Nonetheless, the UK remains the biggest and most developed market and the regulatory choices adopted there might not fit other Member States.

7.3. Final remarks and some suggestions

In conclusion, the future of crowdfunding in Europe appears particularly uncertain at the moment and also depends on which version of the Proposal will prevail and on the outcome of Brexit negotiations (in particular, about third country access and equivalence) but would need a more coherent approach with existing and prospective EU financial regulation. Looking at the options on the table, such Proposal might appear a lost chance for creating a new approach to FinTech, with new MiFID and Prospectus Regulation definitions (useful also in the area of ICOs), segments of alternative finance with different rules justified by different functions and systemic relevance, experimenting new rules (see forms of compliance by design, e.g. product governance thought AI entry test; investment limits, etc.). Furthermore, such sectors evolve very fast and the Proposal looks already old: it disregards not only rules addressing the risks coming from the sector institutionalization (see above), but also relevant and booming sub-sectors, such as invoice trading

(28 September 2018), <https://www.alliottgroup.net/practice-management-resources-for-owner-managed-firms/belgian-law-makes-access-to-crowdfunding-easier/>. Many countries have simply adapted to the new Prospectus Regulation thresholds: both Germany and the UK, after the new Prospectus Regulation adoption, raised in 2018 the maximum threshold exemption from Prospectus obligation to € 8 million (respectively, from € 2.5 million and € 5 million) per issuer per year, followed by France: see J.D. Alois, 'UK Government Ups Crowdfunding without Prospectus to €8 Million – Matching Germany', (2 July 2018), <https://www.crowdfundinsider.com/2018/07/135781-uk-government-ups-crowdfunding-without-prospectus-to-e8-million-matching-germany/>. The 'Loi PACTE' No. 2019-486 of 22 May 2019 raised the general Prospectus exemption from € 5 million to € 8 million and extended certain tax benefits to crowdfunding securities. The AMF is consequently consulting about raising from € 2.5 million to € 8 million the maximum threshold for the offers of shares, bonds and mini-bonds facilitated by *Conseillers en Investissement Participatif*. See AMF, 'Consultation publique sur les modifications apportées à la doctrine de l'AMF à l'occasion de l'entrée en application du règlement Prospectus', (31 July 2019).

⁷⁰ FCA, 'Loan-based ('peer-to-peer') and investment-based crowdfunding platforms: Feedback on our post-implementation review and proposed changes to the regulatory framework', (July 2018), CP 18/20, <https://www.fca.org.uk/publication/consultation/cp18-20.pdf> and Id, 'Loan-based ('peer-to-peer') and investment-based crowdfunding platforms: Feedback to CP18/20 and final rules', (June 2019), PS19/14, <https://www.fca.org.uk/publication/policy/ps19-14.pdf>.

(recently overtaking both P2P business lending and equity crowdfunding)⁷¹ and crowdfunding through ICOs, not considering, in addition, the menace coming for both incumbents and Fintech from Tech-Fin (Big-tech companies entering the financial sector).⁷²

In any case, considering the ongoing negotiations, few additional suggestions for improving such Proposal might be useful.

I agree with the choice of EU institutions of creating a special regulation for FR-crowdfunding, for the reasons explained above and in other works.⁷³ However, I believe that we should have the courage to create for the same a clearly separate sub-sector within the financial regulation landscape (considering its benefits but also risks) although inspired to MiFID, with *ad hoc* definitions (e.g. of the subjects involved, services and products covered), without continuously resorting to MiFID ones (often disputed and un-harmonized, anyway not always easily applicable, especially in a LBC context). The regime might be mandatory (specifying what is still left to national regimes) but without significant national variations and with exceptions allowed for only-local platforms performing simple services and with low volumes and size of transaction (compare with exemptions in a MiFID and PSD context).

Furthermore, the future Regulation should be clearer about what the crowdfunding activity is and which services can or cannot be provided. In particular, I believe that it would be more realistic to admit a more varied set of services, subjected to a differentiated treatment, reflecting different risks and functions (under a functional, tiered and proportional approach and in coherence with approaches

⁷¹ In 2017 invoice trading represented, with € 535.84 million, the 15.9% of all the whole alternative finance market and the second biggest sub-sector right after P2P consumer lending (41% with € 1,392.38 million) and before P2P business lending (14% and € 466.60 million) and equity-based crowdfunding (6% and € 210.93 million): see footnote 2 and Ziegler et al., 'Shifting paradigm', 31. About the challenge in regulating invoice trading in Italy, see E. Macchiavello, 'La regolazione del FinTech tra innovazione, esigenze di tutela e level-playing field: l'inesplorato caso dell'invoice trading', forthcoming in *Banca, impresa e società* 2019, 3, 497-534 (in Italian only, with English abstract).

⁷² FSB, 'FinTech and market structure in financial services: Market developments and potential financial stability implications', (14 February 2019), www.fsb.org/wp-content/uploads/P140219.pdf; A. Tanda and C. Schena, *FinTech, BigTech and Banks. Digitalisation and Its Impact on Banking Business Models*, (Springer, Cham, 2019); D.A. Zetzsche, R.P. Buckley, D.W. Arner and J.N. Barberis, 'From FinTech to TechFin: The Regulatory Challenges of Data-Driven Finance', (April 28, 2017), EBI Working Paper Series 2017/6, forthcoming *NYU Journal of Law and Business*, <https://ssrn.com/abstract=2959925>.

⁷³ IBC resembles to typical investment services but justification in creating a special regulation might be found in the need to create an alternative (clearly separated from the traditional one and therefore not involving investor trust or systemic implications), innovative (in terms of firms' evaluation, signalling and investors' decisions, co-investing with Venture Capitalist or Business Angels, etc.), riskier but simple market, conducive of more financial inclusion (e.g. more financing for SMEs) and diversification (avoiding model convergence), therefore responding to partially different functions. LBC, instead, under the basic business model, significantly differs from banking, not involving maturity or liquidity transformation and represents a new form of credit intermediation (connecting private people and offering related information services) with investment aspects, contributing to information asymmetry reduction. Therefore, a regulation following the traditional regulatory model for investment activities but simplified (in consideration of the different type of assets and business models) and taking into account the need to also protect SME and consumer crowd-borrowers appears reasonable. See § 4 and my previous works indicated in footnotes 4 and 29.

and exemptions in financial regulation), with prudential requirements and detailed organization rules only for the most complex ones (and in the most complex ones, the extension of MiFID or AIFM regimes) and with some differentiations between LBC and EBC.⁷⁴ It could also be the opportunity to experiment with new regulatory instruments (e.g. impose investment limits for retail investors; allow certain forms of AI for KYC procedures and product governance; differentiate among professional, sophisticated and retail clients). A duty of ECSPs to perform a minimum due diligence (beyond AML/CT checks) on project owners and verify the correctness of the general rating/credit scoring model should be explicitly introduced, with the corresponding liability for relevant and macro inconsistencies in the information provided by the project owner (gross negligence).

The centrality of conduct, flexible and organizational measures, with special regard to a-technical, simple and comprehensible information (KIIS)⁷⁵ should be maintained, with differences among professional, sophisticated and retail investors. The less “protective” environment (and the assumption of a more “self-responsible” investor) would be justified – as well as clearly disclosed to investors also through warnings – by the “alternative” character of the same (with traditional operators allowed to offer crowdfunding directly only under “traditional rules” to reduce systemic risk) and by the objective of improving financial inclusion.

Finally, specific information (about the selection criteria and their impact on the investment decision, costs, terms, reimbursement before maturity; warnings about consequences from false statement, excessive indebtedness, default) and protective measures (e.g. withdrawal right) towards project owners (especially when borrowers) should be introduced. The regime should also cover consumer loans, with the extension of most CCD protections.

⁷⁴ See above footnote 52.

⁷⁵ I would favour for the KIIS the language rules proposed by the Commission but I would improve the information required with the additional aspects added by the European Parliament and the Council (see default rate and credit scoring/selection methods).



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