

EU Crowdfunding Regulation and Directive - Preparing for November 2021 and 2022

December 22, 2020

The European market for crowdfunding has grown rapidly in recent years and is likely that it will grow further as investors look for yield-generating opportunities and people, organizations and businesses, notably start-ups can raise financing through websites (also known as portals or crowdfunding platforms) that acts as service providers or intermediaries between those wanting to invest and those wanting investment.

Improving the regulation of European crowdfunding service providers (**ECSPs**) and how investors as well as how small-to-medium sized enterprises (**SMEs**) can make use of crowdfunding as an alternative to bank intermediated funding has been a longstanding priority of the European Commission including as part of its FinTech Action Plan.¹ Rulemaking in this area was first proposed as part of the first launch of the EU's Capital Markets Union (**CMU**) in September 2015 and has now become legislative reality as part of the 2020 relaunch as CMU 2.0. The European Commission is of the view that crowdfunding, in addition to being an important source of non-bank financing, can help spur job creation, economic growth and competitiveness – areas which the European Crowdfunding Stakeholders Forum,² as an expert group of representatives of associations of concerned stakeholder groups as well as national competent authorities (**NCA**s).

The new EU regime on ECSPs will have some far reaching changes and this Client Alert should be read in conjunction with the first part of this dedicated series of coverage “The new ECSP-Proposal reaches the home straight on harmonized crowdfunding rules.”

The EU's Regulation (**ECSP Regulation**)³ and a Directive (**ECSP Directive**)⁴ on Crowdfunding Service Providers were published in the EU's Official Journal ⁵ on October 20, 2020, entering into force on November 9, 2020 with its scheduled date of application beginning November 10, 2021. Both the ECSP Regulation and ECSP Directive have direct effect across the EU-27 and while the ECSP Regulation has direct effect, Member States have six months' time to implement the ECSP Directive into national law.

However, the rules do not stop there. The ECSP Regulation states that in the interests of legal certainty and in view of replacing national rules, a transitional switchover period applies. This means that a person carrying out activity that is covered by the ECSP Regulation and ECSP Directive may continue to conduct such business until November 10, 2022 under the existing national regimes (where these exist). During the transitional period, Member States can put in place special procedures enabling legal persons, which have been authorized under national law to convert such authorizations into ECSP compliant authorizations provided that such firms meet the requirements set out in the regime. Where crowdfunding service providers have failed to obtain an authorization as an ECSP by November 10, 2022 they should not issue any new crowdfunding offers after that date but may continue, in accordance with applicable national law, to service existing contracts, including collecting and transferring of receivables, providing asset-safekeeping services or processing corporate actions.

What the new EU regime will mean for ECSPs,

investors but also those seeking funding

Crowdfunding can be an important contribution to help SMEs to overcome the lack of access to finance, as this is a problem even in such EU Member States, where general access to bank finance remains stable throughout financial (or pandemic) crises.

Currently, various EU Member States have already introduced different regulatory regimes for crowdfunding services, resulting in a significant divergence as regards the conditions of operation of crowdfunding platforms, the scope of permitted activities and the licensing requirements. This fragmentation of rules and supervisory expectations as well as an absence of passporting rights, made it very difficult for crowdfunding to operate cross-border.

The ECSP Regulation and Directive creates one of the world's largest harmonized regulated environments for crowdfunding. It also covers ESCPs' providing either:

1. Loan-based crowdfunding (also known as peer-to-peer or P2P lending) whereby persons acting as lenders use the platform of the ESCP to lend (on the expectation of a return through interest payments and the repayment of principal) to eligible persons requesting a loan and satisfying relevant criteria;
2. Investment-based crowdfunding whereby persons invest directly, or indirectly in new or established businesses by purchasing investments such as shares and debentures.

The new legislative framework aims to remove barriers for ECSPs when providing their services on a cross-border basis while harmonizing the regulatory requirements and investor protection rules that apply across the EU-27 when ECSPs operate in their home Member States and other EU Member States. However, given that the commercial activity of lending in certain jurisdictions (notably Germany) is subject to much more stringent regulation than in other EU Member States, jurisdiction-specific considerations may still be very relevant. The same also applies in respect of national supplementary rules on marketing communications, which have been recently been passed in certain Member States (notably Spain)⁶, may be further displaced by EU rules on marketing communications.

The ECSP Regulation and ECSP Directive provides ECSPs with a single set of rules applicable when providing crowdfunding services across the EU.

These rules include:

- a single set of requirements that will apply to all ECSPs for offers up to EUR 5 million, calculated over a period of 12 months for each crowdfunding project owner. Larger fund raisings will fall into the scope of MiFID II/MiFIR and the Prospectus Regulation. Reward and donation-based crowdfunding are explicitly excluded from the scope of the new rules;
- a harmonized investor disclosure regime whereby crowdfunding project owners provide investors with a key investment information sheet (KIIS) for each crowdfunding offer or at platform level, in addition to a comprehensive set of disclaimers and recommendations on ECSP websites and communications;
- a suitability and appropriateness testing requirement for investors prior to being able to invest assessing their understanding of financial products and their ability to bear financial losses;
- a uniform authorization and passporting process for ECSPs across the EU-27 whereby the European Securities and Markets Authority (**ESMA**) has a central role in facilitating coordination and cooperation amongst national competent authorities (**NCA**s) or otherwise has supervisory powers including developing further technical standards and a binding dispute resolution mechanism; and
- detailed conduct of business obligations for ECSPs including duty to avoid and prevent conflicts of interest, restrictions on inducements to clients and on a ECSP participating in crowdfunding offers hosted on their

crowdfunding platform.

Persons outside of the EU-27 will need to be authorized as ECSPs in order to undertake business in and across the EU-27. While the UK (which makes up more than 75% of the crowdfunding sector across Europe) and other jurisdictions around the globe have their own regimes, the ECSP Regulation and Directive, which shares similarities with existing UK regulation⁷ do not contain a legislative regime that would facilitate equivalence between the EU and non-EU regimes and thus allow for a non-EU crowdfunding provider for easier market access to the EU beyond reverse solicitation (where permitted).

Outlook

With the breadth of changes and opportunities that the ECSP Regulation and ECSP Directive introduce, existing but also new firms that will need to become authorized ECSPs will need to carefully consider how their existing platforms, target operating models and compliance programs, as well as investor- and company-facing documentation comply with the requirements set in the ECSP Regulation and ECSP Directive. Firms may need to consider remedial but equally preparatory measures and when action will be required.

The same applies for assessing how the known changes interoperate with further proposed changes. This includes those introduced in regulatory technical standards (a number of which are only to be submitted to the European Commission's approval in May 10, 2022) setting on individual portfolio management of loans, complaints handling, conflicts of interest, authorization as crowdfunding service provider, information to clients, default rate disclosure, the entry knowledge test and simulation of the ability to bear loss, the key investment information sheet and cooperation between competent authorities, regulatory reporting and other areas where powers have been delegated to the European Banking Authority (**EBA**) and ESMA.

ECSPs will also want to take note of how this new regime also interoperates with proposed EU Regulation, including the Digital Operational Resilience Act (DORA)⁸ and/or the Markets in Crypto Assets Regulation (MiCA).⁹

In short, the ECSP Regulation and ECSP Directive, while welcome, are part of a wide range of regulatory reform that firms that are active or looking to become active in this space and ultimately become authorized as ECSPs will want to begin preparing for. The same also applies to companies small and medium that may benefit from a more regulated framework that protects consumers and bolsters their confidence in investing in projects open to crowdfunding as well as, due to the passporting, means projects can be financed by a much broader base.

If you would like to discuss strategic options or any of the items mentioned above, in particular how to plan ahead for any operational impact from meeting compliance requirements and/or documentation or how these priorities may affect your business or your clients more generally, please speak to our key contacts.

1. See here.↩

2. See here.↩

3. Regulation (EU) 2020/1503 on European crowdfunding service providers for business and amending Regulation (EU)2017/1129 and Directive (EU) 2019/1937. ↩

4. Directive (EU) 2015/1503 amending the MiFID II Directive (2014/65/EU) relating to crowdfunding. ↩

5. The ECSP Regulation and ECSP Directive, as published in the Official Journal are available here. ↩

6. See coverage available here. The new Spanish rules enter into force in February 2021. ↩

7. Which is due partly to the core role the UK played in drafting core parts of the legislative proposals. ↩

8. See coverage available here and here. ↩

9. See coverage available here.↩

Your Key Contacts



Dr. Holger Schelling
Partner, Co-Head Financial
Institutions Regulatory
Europe, Frankfurt
D +49 69 45 00 12 345
holger.schelling@dentons.com



Robert Michels
Europe Sponsoring Partner –
People Inclusion,
Engagement & Diversity,
Frankfurt
D +49 69 45 00 12 398
robert.michels@dentons.com



Dr. Kai Goretzky
Partner, Head of Europe
Insurance Regulatory,
Frankfurt
D +49 69 45 00 12 460
kai.goretzky@dentons.com



Valeria Hoffmann
Counsel, Frankfurt
D +49 69 45 00 12 144
valeria.hoffmann@dentons.com