BETTER FINANCE FOR ALL
The European Federation of Financial Services Users
Fédération Européenne des Usagers des Services Financiers

The Opportunities and Risks of Crowdfunding

European Commission Workshop on Crowdfunding

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Summary of Guillaume Prache's speech

EuroFinUse welcomes the workshop organized by the European Commission on this very important emerging trend in financial services. EuroFinUse also thanks the Commission to invite a retail user representative to the speakers table.

Financial services users, savers and retail investors **are not opposed to innovation**, particularly with regard to the emergence of Crowdfunding, which could actually dramatically improve the delivery of retail financial services, **provided the EU regulators find an adequate user protection framework**.

1. Drivers for the emergence and development of crowdfunding

- First, the development and spreading of internet technologies, the evolution of behaviors vis-à-vis the internet and social media platforms, and the growth of internet-based financial services.

- More specifically, from the lender or investor side, the low return environment which in reality has turned into financial repression: most short term investment products such as bank savings accounts, but also long term investment and pension products[1] are providing negative real returns to EU citizens. Therefore, retail investors are chasing real returns and yields, looking to CFDs, Forex, bets and also crowd investing and lending.

- From the borrower / issuer side, governments and EU regulators have driven retail savings into Government debt and bank equity financing, crowding out borrowers and securities issuers such as individuals and SMEs. The existing financing venues: banks and capital markets have failed to adequately address those needs in terms of access and costs.

- EU financial regulations have not helped. The Commission itself courageously pointed out the possible inconsistencies of EU financial regulations with regard to long term financing in its recent green paper on this issue.

[1] See upcoming EuroFinUse research report on the real return of private pensions.

For example, the Prospectus Directive seems ill designed both for SME issuers and private investors. Only a few ever read the lengthy prospectuses and even the “summary prospectuses” that can be up to 15 pages long of often obscure legal verbiage, are not standardized, formatted or comparable. This applies

even more so when trying to compare other investment options. Sometimes even the most important information is missing such as the interest rate for a fixed rate bond.

2. Crowdfunding opportunities

- More access to credit and capital.

- More efficient intermediation because of internet-based processing and the minimization of intermediary-chain. The economic and social added value could become huge when looking at current financial intermediaries margins. In the credit business for example, banks often currently borrow at less than 1% and lend to individuals at up to 20 %, when accepting applications. Crowdfunding could become a cheaper and easier way of producing and delivering financial services and managing risk.

- More competitive pressure on established financial institutions which may pressure those institutions to greater efficiency and to reduce fees and commissions.

- Increased pressure on regulators to come up with more horizontal and simple financial regulations that do not longer follow a “silo” approach but are horizontally applied whatever the retail financial product offers and whoever is offering them.

For example, the EC “KID” (Key Information Document) Regulation approach would be generalized.

- The development of crowdfunding could also provide more diversity and proximity; although, there is a clear risk that larger US-based providers will expand at the expense of smaller and more local players if Europe does not quickly adopt an appropriate regulatory framework for crowdfunding. The CEO of Google once stated that in the internet business, there are global winners and local losers.

3. The risks of Crowdfunding for retail users

- Transparency on client asset protection: retail users may not understand that most crowdfunding offerings are not guaranteed: they usually do not benefit from the deposit guarantee schemes and/or from the Investment Guarantee Schemes. This should be made very clear prior to any commitment.

- The need for “fair, clear and not misleading information “ (MiFID requirement for “financial instruments” which unfortunately already exclude the majority of retail financial products) is also a must for crowdfunding, although fair, clear and not misleading information is already often hard to find in the existing rules for other established financial services such as life insurance and pension funds. Transparency on risks and on costs and fees is critical.

- There is a risk that the weaker clients and least financially literate may be misled by crowdfunding offerings and could suffer very damaging losses, in particular borrowers who have been rejected by banks for loan applications.

- The lack of a long enough track record regarding the sustainability of crowdfunding economic models, at a time when the sustainability of micro credit is being debated.

For example, we do not yet have enough evidence on the non-performing loans rate of crowd lending platforms.

4. Conclusion

- EuroFinUse first asks that regulators do not kill crowdfunding but instead provide a proper and EU wide regulatory framework for the competitive growth of this new approach in Europe.

- We would also like Public Authorities to conduct a sound economic analysis of crowdfunding economic models: by how much can we expect a reduction of margins and pricing for real economy users (individuals and SMEs in particular), and how sustainable are these models?

- Last but not least, we believe crowdfunding is a unique opportunity to design a lighter but more horizontal regulatory framework at EU level ensuring a consistent financial user protection level whoever the provider (regulated financial institution or crowdfunding platform) and whatever the financial product is (security, credit, “packaged” product).

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