BETTER FINANCE's Feedback to the European Commission Proposal on a Regulation on European Crowdfunding Service Providers for Business

BETTER FINANCE, the European Federation of Investors and Financial Services Users, is the dedicated representative of financial services users at European level. It counts about fifty national and international members and sub-member organizations in turn comprising about 4.5 million individual members. Our organization acts as an independent financial expertise centre to the direct benefit of the European financial services users (shareholders, other investors, savers, pension fund participants, life insurance policy holders, borrowers, etc.) and other stakeholders of the European financial services who are independent from the financial industry. As such its activities are supported by the European Union since 2012.

BETTER FINANCE is the most involved European end user and civil society organisation in the EU Authorities' financial advisory groups, with experts participating in the Securities & Markets, the Banking, the Occupational Pensions and Insurance and Reinsurance Stakeholder Groups of the European Supervisory Authorities; as well as in the European Commission's Financial Services User Group (FSUG), and in the European Financial Reporting advisory Group (EFRAG). Its national members also participate in national financial regulators and supervisors bodies when possible.

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BETTER FINANCE welcomes this initiative to consult stakeholders on this legislative proposal for a regulation on a European Crowdfunding Service Providers (ECSP) for business[1].

BETTER FINANCE already raised the issue that only a limited number of the larger SMEs are likely to benefit from Capital Market Union. As such, introducing an EU framework enabling crowdfunding platforms to provide their service across the Internal Market should be beneficial for both investors and SMEs.

However, BETTER FINANCE remains skeptical regarding the choice of the framework as it seems not enough investor-oriented. Indeed, the proposal only introduces a stand-alone crowdfunding regime (named European Crowdfunding Service Provider). The Commission is proposing an optional (voluntary) EU regime that could be chosen by crowdfunding platforms when they wish to conduct

[1] EC Proposal file:///C:/Users/User/Downloads/PART-2018-141058V1%20(4).pdf

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cross-border business. Crowdfunding service providers will apply to ESMA for authorization as a crowdfunding service provider and ESMA will establish a register of all crowdfunding services which will be published in its website.

The framework would therefore leave the national crowdfunding frameworks unchanged. The Regulation will set a "one-stop-shop" access to the EU market which is supposed to overcome the market fragmentation. Therefore, there is a risk that investors from Member States with a stricter national framework will be put at disadvantage if the platform operating in their country opts for the ECSP framework.

We believe that this regulation should be the opportunity to pave the way for a harmonized EU legislative framework to enhance the access for finance for SMEs and to provide for a consistent and equal investor protection within the Internal Market whether they are investing through a crowdfunding platform using the ECSP or the national framework [2]. The current proposal however sets a framework that will not fully address the fragmentation of the market. The Commission's proposal represents a (too) small improvement compared to the current situation.

Nonetheless, within the framework of the ECSP, BETTER FINANCE welcomes the Commission efforts in terms of investor protection. Investing in a crowdfunded project can be risky[3] for small investors: fraud, failure of the project (due to incompetence or mis-calibration from the project owner), the lack of an efficient secondary market where equity-based investors can re-sell their shares, unclear regulations and divergence in fiscal treatment.

1. **Clear, complete and correct investor information**

Crowdfunding represents an alternative way for project owners to finance these projects without seeking support from banks or venture capitalists which gives them more opportunities and leverage to obtain financing at a lower cost.

Crowdfunding allows project owners to have more control over their project but this flexibility must not be to the detriment of individual investors. The crowdfunding platform, as intermediary between the fundraiser and the funder must play the role of guard-rail. Therefore, BETTER FINANCE welcomes the provisions introduced in article 4(2) which provide that "*service providers shall act* ***honestly, fairly and professionally*** *in accordance with the interest of their clients and prospective clients*".

The proposal provides in article 14 that the crowdfunding platform must inform the client about the costs and charges related to crowdfunding services and investments and about the nature and the risk

[2] See BETTER FINANCE's feedback on a legislative proposal for an EU framework on crowd and peer to peer finance: http://betterfinance.eu/fileadmin/user_upload/documents/Position_Papers/Consumer_Affairs/en/BETTER_FINANCE_s_answer_to_IA_on_crowdfunding_and_peet_to_peer_lending_FINAL_27.11.2017.pdf

[3] JRC Science and Policy Report- Understanding Crowdfunding and its regulation, Gary A. Gabison

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associated with their crowdfunding conditions. This information **shall be clear, comprehensible, complete and correct**[4]**.**

BETTER FINANCE welcomes the intent of this provision: crowdfunding investment usually comes from individual investors with little or no financial education. The information disclosed must therefore be relevant, comprehensible and should not communicate too complicated or irrelevant information for the decision making.

However, we question why this wording is different from the same provision in MIFID I and II: where information shall be "***clear, fair and not misleading".*** BETTER FINANCE fails to see any benefits and a lot of detriment of inconsistent substance and wording in similar EU investor information rules. Moreover, not forbidding misleading information to crowdfunding investors is not acceptable in terms of investor protection. In particular, BETTER FINANCE research already found too numerous cases of misselling of MIFID – regulated financial products due to misleading information, and therefore of poor enforcement of this existing provision.

BETTER FINANCE ASKS TO HARMONIZE THE SUBSTANCE AND WORDING OF ARTICLE 14 WITH THAT OF ARTICLE 24(3) OF MIFID II AND REFER TO IT.

a. Initial assessment of appropriateness of a potential client

BETTER FINANCE welcomes the proposal to introduce an "*entry knowledge test*"[5]. This test aims at assessing the investor's level of financial knowledge and to simulate its ability to bear losses.

The article provides that the test must assess the investor's "*basic knowledge and understanding of risk in investing in general*".

The definition of "basic knowledge" should be detailed since the level of knowledge may vary between the different profile of investors (new or experimented investors, educational financial background…).

b. Key Investment Information Sheet (KIIS)[6]

BETTER FINANCE welcomes this Key Investment Information Sheet (KIIS) which should provide the funder with all the relevant information regarding the project. The KIIS should be an easy tool for the prospective investor where he/she could find all the information regarding the project owner and the project, the characteristics of the crowdfunding process and the conditions for raising funds or lending money, the information related to the securities, investor rights and legal redress.

As stated in article 16(6) of the proposal, the KIIS "***shall be clear, comprehensible, complete and correct***" (should be "clear, fair and not misleading", see above). The proposal provides that the

[4] Article 14 (1) of the EC proposal
[5] Article 15 of the EC proposal
[6] Article 16 of the EC proposal

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Commission may adopt delegated acts to determine the requirements and the content of the model for presenting the information, the types of risks that are material to the crowdfunding and the fees and costs (direct and indirect) to be borne by the investor.

However, the adoption of Delegated act should not result in the drafting of overly complicated documents.

BETTER FINANCE would also like to raise the attention on the percentage of fees charged by the platform provider. In fact, as raised by M.M. Gierczak and al.[7] in their 2015 study, crowdfunding results in a rather high cost of raising capital: on average, crowdfunding platform providers request 10% of the raised capital to be paid by the issuer/fundraiser, and charge additional fees for due diligence of projects or insurance to reduce the uncertainty and risks for the backers.

The fees charged to issuers, even used partly to insure the investment for the backers, should not lead the crowdfunding platforms to apply too high management fees since the cost would be borne by end-investors and fundraisers. BETTER FINANCE asks for the disclosure on fees to be complete and comparable from one platform to the other.

2. **Complaints handling**

Crowdfunding platforms grant a relative anonymity for the fundraisers. Because of the small amount invested, investors might be deterred from seeking compensation in case of fraud, even more when it comes to cross-border investment[8].

The proposal provides in article 6(1) that "*services providers shall establish and maintain effective and transparent procedures for the prompt, fair and consistent handling of complaints received from clients*".

BETTER FINANCE believes that the delegated act to be adopted (article 6(4)) should clearly specify and set up easily accessible redress mechanisms (through one-stop-shop mechanism for instance) for investors, especially in the case of cross-border investments. As mentioned in the EC proposal, crowdfunding investors are mainly individual investors who wish to invest small amount of money in a small company/project. Therefore, to ensure the trust and confidence of investors in these platforms, the regulation should ensure an easy access to complaint and redress mechanism.

[7] See the study "Crowdfunding- The new Era of Fundraising" file:///C:/Users/User/Downloads/GierczackEtAl_2015_Crowdfunding.pdf

[8] Please see BETTER FINANCE's position on the Commission's proposal for a " New deal for consumer" : http://betterfinance.eu/fileadmin/user_upload/documents/Press_Releases/en/Financial_services_users/PR_-_New_Deal_for_Consumers_-_170418.pdf

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To conclude, BETTER FINANCE would like to raise two concerns. Firstly, the absence of provision regarding the sale of their shares by investors for equity-based crowdfunding. The lack of an efficient secondary market for equity-based crowdfunding where investors could re-sell their shares does represent a barrier to crowdfunding.

Secondly and more importantly, the current uncertainty regarding tax treatment represents today one of the main barrier to crowdfunding in Europe. In 2015, the European Commission asked the EU VAT Committee[9] to discuss the VAT treatment of crowdfunding activities. The Committee concluded that when the investors receives in exchange of a financial contribution a financial reward (in the form of securities, shares or bonds), this transaction should be exempted from VAT. These conclusions are however not binding and Member States have exclusive competence in taxation. The proposal seeks to establish uniform rules on crowdfunding at EU level by introducing an optional EU regime which enables crowdfunding platforms to easily provides their services across the EU single market. To ensure the success of this initiative, this set of rules should include dispositions regarding the tax treatment.

[9] http://eurocrowd.org/2015/11/23/vat-and-crowdfunding-the-eu-rules/

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