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Crowdfunding in the EU--addressing the 'regulatory limbo'

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Financial Services analysis: The European Securities and Markets Authority (ESMA) has published a position paper on the regulation of crowdfunding at an EU level. Charles Leveque, partner at Harbottle & Lewis, considers the likely impact of ESMA's paper and warns that, EU recommendations aside, clients must be alert to the already tight regulation of crowdfunding platforms in the UK.

Original news

Guidance: Crowdfunding--Position paper, LNB News 06/05/2014 66

ESMA should coordinate its approach to crowdfunding with the European Banking Authority (EBA) and both should be proactive in giving advice to the European Commission regarding the specific regulation of crowdfunding, according to the Securities and Markets Stakeholder Group (MSG) opinion on the alternative financing tool. The MSG's opinion has been published by ESMA and sets out the approach it believes ESMA should take to crowdfunding at a time when the benefits and risks of using such a finance alternative are becoming increasingly prominent.

What is the background to ESMA's position paper?

There is currently no homogenised body of pan-European rules governing investment-based and loan-based models of crowdfunding. Following public consultations, the European Commission published a paper in March 2014, 'Unleashing the Potential of Crowdfunding in the European Union'. The Commission revealed in the paper that it did not intend, for the time being, to prepare legislation to govern crowdfunding activities. However it stated that it intended to keep the sector under close monitoring and would develop a common understanding at EU level of crowdfunding and prepare the ground for possible future actions. ESMA is part of the European System of Financial Supervision and one of its functions is to develop technical standards and guidelines relating to securities and financial markets. Its view on crowdfunding, as set out in the position paper, will therefore be taken into consideration by the Commission when considering whether further action is necessary and should be taken.

What is ESMA's stance on the issue of crowdfunding?

ESMA analyses the approach to crowdfunding taken by different legislators in the European Union. It notes that some legislators place emphasis on the need for transparency and disclosure (requiring crowdfunding projects to provide sufficient clear information relating to the investment or loan to enable an investor or lender to make an informed decision before pledging funds) and others seek to protect prospective investors and lenders by limiting the amount that they can invest or lend.

ESMA states that its priority should be to achieve 'the maximum homogenization and clarification about crowdfunding across European countries'. In the same way as the UK regulator has done, ESMA recognises the key role played by crowdfunding platforms in both investment-based and loan-based crowdfunding activities. Its position paper suggests that those platforms should be the target of any future European-wide

regulation. It states that ESMA should take the lead on setting out standards on transparency, and potentially also capital, requirements to be imposed on crowdfunding platforms on a European wide setting.

Finally, ESMA also makes reference to the possibility of a future European label 'to be granted to crowdfunding platforms meeting more exigent and harmonized requirements at European level'. This approach was also referred to in the European Commission's paper and would be designed to promote confidence in crowdfunding platforms having met prescribed criteria designed to mitigate the risk of investing or lending through them.

What are the potential next steps that could be taken at EU level?

The European Commission has said that it will set up the European Crowdfunding Stakeholder Forum as an expert group of high level representatives of associations of concerned stakeholder groups and national authorities. The Forum would help raise awareness, providing information and training modules for project owners, promoting transparency and exchange of best practice, and identifying issues that may need to be addressed. It has also said that it will look at standards adopted by industry associations to develop standards at national and European level. Finally, it has said that it will launch a study to examine the existing national self-regulatory bodies and their rules. In short, the Commission is, during 2014, gathering information to ensure that any future decision to initiate legislative action is fully informed.

It is therefore, at this stage, too early to state with any certainty whether a harmonised set of European rules will emerge. That said, if ESMA's view is shared by the Commission, then some form of homogenised standard for crowdfunding at a European level looks to be a possibility.

Is there anything in ESMA's stance that could lead to a new approach to the regulation of crowdfunding in the UK?

It seems unlikely that ESMA's position paper will influence regulation in the UK for the time being. The Financial Conduct Authority (FCA) has recently considered the position and opted, as subsequently recommended by ESMA in its position paper, to target the increased regulation of crowdfunding platforms, particularly in relation to loan-based crowdfunding. The UK regulator therefore now looks to have a settled approach to the regulation of crowdfunding and ESMA's position paper will not alter the rules introduced on 1 April 2014.

What, if anything, should lawyers be advising their clients at this stage?

We are advising clients to be mindful of the fact that the setting up and operation of a crowdfunding platform in the UK for investment and loan-based crowdfunding is almost certain to constitute a regulated activity for which the FCA's approval will be required. Clients who are seeking to make use of a crowdfunding platform for investment or loan-based crowdfunding in the UK should be aware that tighter regulation has restricted the number of people who are likely to be able to pledge funds and the 'crowd' is therefore a smaller 'crowd' than previously.

Charles Leveque is a partner at Harbottle & Lewis. He advises on corporate transactions relating to both publicly listed and private companies, including mergers and acquisitions, fundraisings (both on and off market), joint ventures, corporate re-organisations and public offerings of securities. Charles is recognised as a rising star in the 2013 Super Lawyers Listing.

Interviewed by Helen Redding.

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