



# Capital Markets Union

## Crowdfunding

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Crowdfunding is a multi-faceted approach to financing that is evolving quickly, opening up major development prospects and posting exceptional growth rates in Europe, the United States and China. From its starting point as a way for people with projects to raise money from acquaintances and family members, crowdfunding could well become a fully-fledged financing alternative for SMEs.

### France: a crowdfunding pioneer

#### France has set up a secure regime that protects investors and lenders

Given the plethora of legislation that could potentially apply to crowdfunding platforms, at the end of 2013, following a consultation, the AMF teamed up with France's prudential supervision and resolution authority (ACPR) and the Ministry of Economy and Finance to propose a dedicated framework for crowdfunding. The new national rules, which came into force on 1 October 2014, introduced two distinct regimes for lending and securities investment platforms, respectively. Any platform wishing to engage in crowdfunding must opt for one or both of two statuses: crowdfunding adviser ('conseiller en financement participatif' or 'CIP'), to be able to offer shares or bonds; and/or crowdfunding intermediary ('intermédiaire en financement participatif' or 'IFP'), to offer loans. Platforms are subject to various obligations and must comply with rules of conduct, which cover such areas as conflicts of interest management and suitability testing. To get a European passport, platforms offering financial instruments may also opt for investment services provider (ISP) status, which is governed by the Markets in Financial Instruments Directive (MiFID).

An AMF-approved prospectus is not required for securities issues through crowdfunding advisers ('CAs') – or ISP – registered crowdfunding platform using a staggered access website, provided the total amount offered for a single issuer does not exceed €1 million over twelve months. In return, the issuer and platform must provide investors with simple, clear and balanced information on the specifics of the project and the nature of the offer, such as associated risks and fees, based on an information document prepared by the AMF.

#### Initial results following introduction of the French legal and regulatory framework

On 30 April 2015, seven months after the regime came into force, 13 platforms were registered as CAs, one as an ISP, and 32 as crowdfunding intermediaries ('CIs'). A total €152 million was raised in 2014, twice as much as in 2013<sup>1</sup>. Securities-based crowdfunding accounted for 16% of the total, or €25.4 million.

These figures suggest that the establishment of a domestic regime geared to the peculiarities of crowdfunding has spurred market development in France.

The regime has helped to raise the professional standard of platforms in terms of due diligence, IT systems, and so on, and build confidence among lenders and investors. National associations and a European Crowdfunding Network (ECN) have been set up and provide useful and important forums for exchanging best practices and advocating for crowdfunding platforms. And lenders and investors are expected to benefit from a learning effect over the course of their investments. At the same time, we note that the development of platforms has brought wider variety in the underlying assets proposed to investors, creating a danger that risk might be unevenly understood or underestimated by investors. A case in point is real estate crowdfunding, which is posting high rates of return (between 8% and 12%).

<sup>1</sup> Crowdfunding survey by Finance Participative France, a crowdfunding association.

## The need to build a European crowdfunding market

Although crowdfunding has major growth prospects<sup>2</sup>, its development will require the establishment of a European market governed by more harmonised rules.

### **Mobilising potential lenders and investors at European level**

With platforms currently rejecting a high proportion of applications, the main difficulty does not lie in the number or appeal of proposed projects. One of the real challenges facing crowdfunding participants is to make themselves known, achieve critical mass and mobilising potential investors and borrowers on the domestic and European market. To achieve profitability, which depends heavily on the number of projects funded, most European platforms are looking to operate outside their own borders. Aside from France, other European countries, such as Germany, Spain, Italy and the UK, have also established legal frameworks for crowdfunding, while others, including Austria, Finland and the Netherlands, are considering the same. Given the risks of legal fragmentation and arbitrage between different Member States, a more harmonised competitive market needs to be organised<sup>3</sup>.

### **The risk of competitive distortion increases the need for a common approach anchored in investor protection**

Competition on the French market is set to intensify with the arrival of foreign platforms, notably from other European Economic Area countries and operating with a European passport under the freedom to provide services or the freedom of establishment. This competition raises issues because of the many different national regimes, which do not provide a uniform level of investor protection.

Without interfering with the flexibility and simplicity provided by crowdfunding platforms, essential issuer and investor protection mechanisms need to be established in such areas as conflicts of interest management, cost transparency, and disclosure to investors of information on funded projects so that they can understand the risks and rewards

In this regard, it would be appropriate to establish a harmonised and streamlined disclosure regime in Europe for crowdfunding offers that are exempt from the need for a prospectus. This could be modelled on the standardised document provided for under French rules. Similarly, it would be useful to promote shared interpretations for certain European legal provisions, particularly in terms of the scope of the AIFM Directive and investment services such as receiving and transmitting orders and placing of instruments without a firm commitment basis. Steps could also be taken to extend application of MiFID to platforms offering securities that do not constitute financial instruments.

<sup>2</sup> *Forbes*, a business magazine, is predicting that US\$1 trillion will be raised worldwide in 2020

<sup>3</sup> The European Commission has set up an expert group, the European Crowdfunding Stakeholders Forum, to determine the potential and risks linked to crowdfunding and assess the case for possible European action. Similarly, on 18 December 2014, the European Securities and Markets Authority (ESMA) published an opinion and advice to clarify the applicable European rules and lay the foundations for a possible shared regulatory framework.

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