Respective scopes of EU and national laws concerning crowdfunding operations

How to change legal framework at both levels

France version

Contents

Introduction

For the last twenty years, regulation of the banking and financial system has drawn more and more of its content from legal texts issued at the EU level. Mainly defined via harmonisation directives, this law of EU origin provides a reference framework, aiming to reconcile national legislations which may vary greatly, for example in the definition of a "credit institution" and to create new regulatory regimes, for example the one applicable to payment institutions, that are transposed into the law of each member state.

The French "Code Monétaire et Financier" (CMF) has thus evolved repetitively since its creation in 1999, in order to transpose into French law new elements of the European legal framework and also to adapt to the constant evolution of financial practices, mainly due to the impact of technological innovation.

In considering past and future evolution of legislation impacting crowdfunding, a distinction should be made among rules set out at the supranational level, which govern most fundamental aspects of banking and financial activities; rules set on at the national level transposing EU legislation, which include may exceptions and other choices to the extent permitted by the relevant directives; and rules set on at the national level in areas not governed by EU legal texts.

Crowdfunding, which is subject to a variety of legislation developed initially for a more traditional financial activities, is impacted by EU directives as transposed in member states and permitted exceptions and other choices made by member-states legislation, as well as by other national legislation outside the scope of existing directives.

The goal of this document is to review these three categories of rules applicable today in the context of crowdfunding.

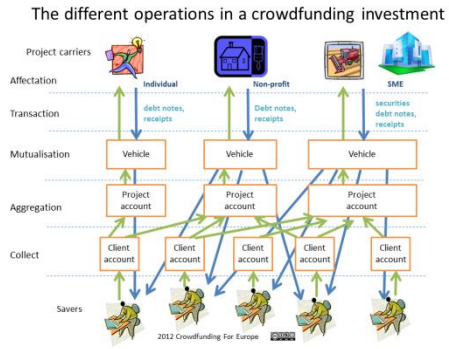

Figure 1: Structure of the different operation in crowdfunding

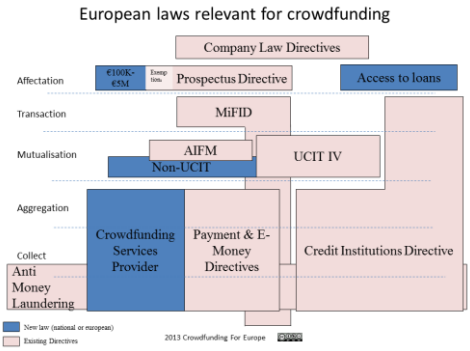

Figure 2: mapping of the different directives within the structure of operations

Collection

The first function of a crowdfunding platform is to facilitate the pooling of funds by funders to jointly finance a project, in the form of donations, loans (with or without interest) or investments in securities.

During this collection of intentions, decisions and/or money, performed directly by the issuer, or facilitated by the platform, several domains of the law may be applicable to communication of information to the funders, transmission of funders' decisions, movement of funds, and the representation of funders' interests over time. These different functions can be governed by elements defined in EU laws, can be adjacent to their scope, or be governed – or not – by elements of national laws.

EU laws

The Payment Services Directive

Concerning the transfer of funds, the first question that arises is to consider if Directive 2007/64/EC on Payment Services (PSD) is applicable. It should be noted that positions expressed on this matter by different national regulators are not necessarily consistent: The French regulator takes the position that donation crowdfunding should be regulated by the rules transposed from the PSD, whereas the British and Belgium regulators do not seem to agree. Beyond discrepancies that could come from options taken in the transposition process, it seems that we need a clear statement on this issue

from a pure EU law standpoint so that the different regulators can harmonise their respective interpretations.

The E-Money Directive

Concerning the potential conservation of funds, the question arises of applicability, or not, of obligations relating to Directive 2009/110/EC on E-Money (EMD2). The issue is complicated because the delimitation of the PSD and DME2 is blurry in many respects. There are on-going deliberations on the harmonisation of these two legal texts, with even suggestions that they should be merged.

On the subject of the conservation of funds, Directive 2006/48/EC relating to the taking up and pursuit of the business of credit institutions should also be mentioned. Even though the original text should not create any ambiguity on the non-applicability of the obligations of this directive to crowdfunding, discrepancies in the national transpositions could create adverse effects.

In the written position of May 2013, published jointly by the French financial-services and securities regulators, the "Autorité du Contrôle Prudentiel" (ACP) and the "Autorité des Marchés Financiers" (AMF), stated that the bank monopoly on fund collection does not apply on this part of the activity of crowdfunding platforms since they collect the funds for someone else (the project).

The MiF Directive

Relationship with funders, in particular when dealing with financial instruments, also raises the question on the applicability of Directive 2008/10/EC on markets in financial instruments (MiFID 2). Furthermore, a proposal of a new Directive by the Commission, dating from the 20th of October 2010 creates confusion that is detrimental to crowdfunding. The main subject of these various directives is very remote from the operating conditions faced by crowdfunding platforms and it would be beneficial that the applicability, or not, of obligations relating to these directives on financial market is clearly stated.

The Anti-Laundering Directive

Finally, transversal to all financial activities, Directive 2005/60/EC on anti-money laundering and anti-terrorist financing (AMLD) sets out real obligations that should be considered applicable to crowdfunding platforms. In this matter, the lack of clear guidelines is detrimental to new financial activities (payment services or crowdfunding), that basically involve money flows between institutions on the EU territory that already comply with these necessary obligations.

National laws

Article L. 312-2 of the CMF – money received from the public

We have already mentioned the French transposition of the Directive relating to the taking up and pursuit of the business of credit institutions, and the discrepancies between the original text and the national reference text. Nevertheless, the French regulator in this position dating of May 2013 a clearly expressed his position, and article L. 312-2 does not apply to the crowdfunding activity.

Anti-money laundering and anti-terrorist financing

The rules in the battle against money laundering and terrorist activity are also governed by national texts such as Decree n° 2013-183. Beyond the variations due to the combination of legal texts from different origins, a variety of doctrines and market practices can arise in different national contexts which create a very opaque situation. It would be beneficial to fix simple rules in order not to hamstring crowdfunding with because of uncertainty in this area..

Investment vehicles

The goal of crowdfunding is to establish a direct and transparent link between funders and projects. For various reasons (governance, management of funds, representation, etc.) funders can come to the point of deciding to group within a legal entity, capable at the same time to maintain the direct link and to facilitate operations during the life of the project. Several legal forms are regularly used today to meet those needs. These forms depend on the context, but have not reached a market consensus on the most adequate ones. In response to that, we propose the creation of a specific vehicle, so-called a FinPart Fund, that could offer an adequate answer, at low cost and with ease of setting up that could support the development of crowdfunding.

In face of this problem of mutualising as illustrated on the above figures, several EU Directives, or national dispositions are potentially relevant.

EU laws

UCITS IV Directive

Even though mutual vehicles for crowdfunding belong to a logic establishing a direct link between funders and projects, and that this mutualisation is more involved with a logic of management of operations, rather than a logic of mutualisation of financial risks – which is at the heart of collective investments schemes (CIS) – some of the legal forms that are used could be governed by Directive 2009/65/CE on undertakings of collective investment in transferable securities (UCITS IV).

It should be noted that we consider that the FinPart Fund should not be governed by the UCITS IV Directive.

AIFM Directive

For the management of vehicles, who are clearly not governed by the UCITS IV Directive, the question of the applicability of Directive 2011/61/EU on Alternative Investment Fund Managers (AIFMD) can be raised. Vehicles currently used for crowdfunding in France (e.g. SAS, cooperatives) are not a priori concerned by this directive, which - it should be recalled - had the primary objective of controlling hedge funds.

It should be noted that the FinPart Fund that we propose would belong to the family of non-UCITS funds as we indicated before, but we think that the management of these Funds should not be

governed by AIFMD, because of the explicit nature of the projects to be funded will be known before the fund is actually created.

National laws

National legal forms

As mentioned above, several legal entities (e.g. SAS, cooperatives, associations), governed only by national laws are currently used in an ad-hoc manner to offer a mutual vehicle for crowdfunding financing. These different forms have a very well-known body of legal precedents but, because of their wide scope, they do not always offer the necessary flexibility and low cost that would facilitate the development of crowdfunding on our national territory.

Specific Collective Investment Schemes

There also exist local Collective Investment Schemes (e.g. the French "fonds d'investissement de proximité" or FIP) who are only governed by national laws because they fall outside of the scope of UCITS IV and AIFMD.

We then recommend for France the creation of a local variety of the proposed FinPart Fund, which could be created at the level of national legislation, while being a forerunner of a form that would be eventually created at the EU level independently from UCITS and AIFM Directives.

Financial Instruments

Transaction to finance a project can take the form of a donation, a loan or investment in a security. Applicable laws, at the EU or national levels, are today in very distinct legal silos. The relationship between natural or legal persons looking for financing and those providing financing on a regular basis belong are also governed by very distinct legal texts, depending on the form of the transaction (donation, loan or security).

Depending on the nature of the instrument, different legal texts are then potentially applicable.

EU laws

Securities

The Prospectus Directive

Concerning securities (equities and obligations), issuing of these instruments is governed by Directive 2003/71/EC (amended by Directive 2011/73/EU), called the Prospectus Directive because of the obligations relating to the information of investors defined for any issuance superior to 5 million euros.

The Prospectus Directive also defines several cases where issuance is exempted from any formality (e.g. total amount raised below 100 000 euros, offer to a limited circle of investors). These

exemptions have been necessarily incorporated in national texts because of the nature of maximal harmonisation of the directive.

Finally, the Prospectus Directive has explicitly left to national laws the governance of issuance between 100 000 and 5 million euros, with a limit calculated over a period of 12 months.

The MiF Directive

We mentioned above the MiF Directive concerning the obligations relating to the presentation of information and the reception of funds. Firms performing on a regular basis activities related to transactions on financial securities (investment firms) are also governed by this directive. Legislation transposing the directive impose obligations relating to the amount of capital they need to have, depending on the nature of their activity (advisory services, order reception/transmission, placement, management), as well as on operational requirements about governance and management of conflicts of interest.

The Directive relating to the taking up and pursuit of the business of credit institutions

Concerning the issuance of credit, Directive 2006/48/EC relating to the taking up and pursuit of the business of credit institutions represents the endeavours to unify a multitude of national legal systems that existed independently in each country for many years. This directive has a broad scope in intent, but at the same time must accommodate numerous and very extensive defined areas of activity that show a large variety of pre-existing national banking laws.

It should be noted that EU law has not initiated any action to try to define a common framework governing the issuance of loans by individuals.

National laws

Securities

Current national laws are largely defined by EU legal texts. As we indicated, the Prospectus Directive does leave to the national level the definition of rules governing issuance between 100 000 and 5 million euros. On the hand, several pre-existing statuses (like the advisors in financial investments called CIF or the advisors in asset management called CGP) continue to be governed and can evolve at national levels, within boundaries defined for acknowledged exceptions in MiFD 2.

Bank monopoly on the issuance of credits in the CMF

All aspects of the credit activity, issuance and management of the relationship, is included in the definition of the bank monopoly, as stated in the CMF.

The issuance of loans outside of the banking system - where some alternative forms have remained legally defined outside of the CMF (e.g. loans from shareholders to companies) – is mainly circumscribed in the CMF within article L. 313-13 defining the “prêts participatifs” (or the loans to an enterprise that are considered as quasi-equity) and in article L. 511-6 on the actors benefiting from exemptions on the bank monopoly over credit issuance.

Our proposals

We have been formulating 3 sets of proposal that would offer a simpler and more favourable legal environment for the development of crowdfunding in Europe. These proposals concern:

- The creation of a Crowdfunding Services Provider Directive
- The creation of a vehicle to group funders of a project within an ad-hoc entity
- The extension of exemptions allowing peer to peer financing in the form of securities or loans

As we have explained in the preceding sections, these proposals are meant to be implemented within the framework in EU laws, as illustrated in figure 2, these proposals will mainly lie outside of current directives, and may need only minor amendments from the Payment Services Directive to clarify that transfer of funds for crowdfunding are not payments in the sense of this directive.

As we have demonstrated in the same sections, these evolutions can either be directly incorporated into EU law, or can be included as national implementations, spearheading the approval of the EU legal texts, and the subsequent transposition into national legal texts.

Creation of a Crowdfunding Services Provider status

The first proposal concerns the creation of a Crowdfunding Services Provider status. We have explained how the money collection in the crowdfunding context is completely different from a payment service, and how the directives on financial instrument or credit operations are inappropriate or detrimental to the growth of a European crowdfunding industry. We propose then to create a separate status for actors that offer third party services in crowdfunding operations. This proposal can be implemented as:

- A specific Crowdfunding Services Directive, inspired from the PSD on payments to offer a similar pan-European legal framework for crowdfunding services
- Or a national status spearheading the directive

Concerning the national implementation, FinPart has proposed the creation of a "établissement de financement participatif" that can be added to the "Code Monétaire et Financier" (CMF) and that would match the addition that would eventually be incorporated in the CMF when transposing the forthcoming Crowdfunding Services Directive.

Definition of exemptions for certain type of investments and loans

Currently, we have a very heterogeneous legal landscape throughout Europe concerning the exemptions from the obligations imposed to project via traditional financing schemes. Projects looking for financing via crowdfunding typically correspond to the contexts justifying these exemptions. We have countries where exemptions are relatively broad, like in the UK for loans, or some others where exemptions correspond to the strict requirements resulting from EU directives, like the Prospectus Directive for the emission of securities.

We thus propose to harmonise and extend the scope of exemptions that would allow a more direct and transparent financing of projects that are currently very constrained by the existing requirements.

Securities

The Prospectus Directive, with the definition at the EU level of exemptions from the obligations on issuance of securities to the public, has provided at the time a prescient move that let crowdfunding pioneers emerge in Europe. Unfortunately, this early advantage will soon disappear with the advent of the Crowdfund Act in the US. In order to push further this innovative legal action, we propose to extend and harmonise the scope of exemptions throughout Europe.

We thus propose to extend the exemptions in the Prospectus Directive by:

- Raising from €100 000 to €1 million the threshold on issuance in exemption e)
- Extending the notion of limited circle of investors from 150 to 1 000 natural or legal persons in exemption b)
- Creating a crowdfunding exemption for issuances where investors invest less than €2 000 per offer

Because issuances between €100 000 and €5 millions are out of the scope of the current Prospectus Directive, these proposals can once again be implemented either directly at the EU level, or in a spearheading manner by member states.

FinPart has been advocating for such modifications in the French legal texts for the past 18 months.

Loans

The Commission has produced the Directive relating to the taking up and pursuit of the business of credit institutions in order to start harmonising the issuance of credits by banks. But we have not yet any EU legal texts that define the conditions for the issuance of loans by natural individuals and we witness very different situations between the UK, where this activity is authorised, and most of the continental member states, where bank monopoly has been extended to prevent this form of financing.

We thus propose to:

- Create a directive to harmonise the loans from a natural individual to a natural or legal person

This of course can be either be implemented from the EU level to the member state level, or directly at the member state's discretion since no existing directive would prevent such a modification.

FinPart is advocating for the extension to natural persons of the possibility to issue "prêts participatifs" to enterprises.

Creation of a non-UCIT, non AIFM vehicle

We have mentioned the interest of having a simple vehicle that could serve to organise the collaboration overtime between the potentially numerous funders and the project. We have called this vehicle a FinPart Fund for lack of a better name. While several existing vehicles are currently used by crowdfunding platforms throughout Europe, in place of this FinPart Fund, we believe that these vehicles are usually too costly and are potentially subject to a re-characterisation risk.

We thus propose to:

- Incorporate an exemption in the UCIT Directive that would allow to create ad-hoc funds after a crowdfunding operation
- Create national forms of collective investment schemes that would allow the setup of such vehicles at the local level

While the exiting heterogeneity in the different legal environment in the different member states offers flexibility in implementing the FinPart Fund at a national level, we see the action of the Commission as particularly important in order to first clearly define the limits of the UCIT and AIFM Directive, and in order to harmonise the nature of the FinPart Fund throughout the various implementations that could cause confusion for cross border crowdfunding activities.

FinPart is advocating for the creation of a "fonds commun FinPart" for France

Who are we?

"Crowdfunding for Europe" is an open movement meant to let any organisation and individual interact and collaborate at the European level to develop crowdfunding within Europe.

Fellow minded crowdfunding supporters are invited to participate and cooperate:

- by following us on Facebook: http://www.facebook.com/CrowdfundingForEurope
- by joining us on: https://groups.google.com/group/crowdfunding-for-europe
- by contributing open texts at: http://crowdfundingforeurope.org