

Question 1 – Should crowdfunding in Ireland be regulated?

The lack of centralised regulation within Ireland in respect to crowdfunding (principally investment-based, loan or equity), has led to inefficiencies and uncertainty regarding the applicability of a myriad of EU Directives, EU Regulations, implementing Irish Statutory Regulations and guidance from the Central Bank of Ireland.

In our experience, there is interest domestically and from overseas in establishing crowdfunding platforms in Ireland for investment-based models. Unfortunately for Ireland, if an investor or entrepreneur is looking at Ireland or our nearest neighbour, the UK, as a location to start such a business – the lack of a clear regulatory framework is resulting in such businesses not being established.

A workable crowdfunding regulatory regime must take into consideration other legislative provisions that are most likely to be “triggered” – both from the issuer perspective and the platform perspective. For example, companies using crowdfunding platforms typically use a private limited company which is generally prohibited from offering securities to the public. Given the nature of crowdfunding (i.e. offers of shares on internet), it would be extremely useful for companies seeking funding to be able to avail of a specific exemption for this purpose. Consideration for abuses of this would naturally be required. Similarly, consideration should be afforded as to whether the current prospectus thresholds are appropriate for crowdfunding.

Question 2 (a): What risks associated with crowdfunding should be considered and addressed in any potential regulatory regime? How could they be mitigated?

Please see table at end of this document.

Question 2 (b): If regulation is to be introduced, should there be minimum standards of due diligence, disclosure and a process in the event of default, insolvency or bankruptcy? Should there be a standard suggested procedure or best practice outlined? If so, what should this include and what would best practice entail?

We believe that platforms should be required to carry out basic checks of companies seeking funding – which may include the following or a combination: (i) latest financial statements – relevant for ability to repay loans for example; (ii) companies office search; (iii) credit checks; and (iv) restriction of directors searches; and (v) litigation searches at the central office of the high court.

Prior to completing investments, these checks / searches should be updated.

Platform default is an area that should be addressed and platforms should have contingency plans in place for the orderly wind down (or maintenance) of investment positions taken. Insurance is a possible solution but will require providers in the market which we understand currently do not exist in Ireland. We understand that providers such as AIG are currently offering cover for issuer fraud through a product known as “crowdfunding fidelity”. If such providers can develop a product around platform failure/insolvency it would help address this issue.

Question 2 (c): Should businesses be required to provide specific information when seeking funding on crowdfunding platforms? If so, should there be different requirements for loan based and investment based crowdfunding? What specific information should be provided?

Yes – there should be a difference. There will be a degree of overlap but the nature of an equity investment dictates that matters such as the proposed share structure will be required to be disclosed and the rights attaching to shares is relevant. To a large extent, the unsecured lending model is more straightforward – but the basic commercial terms need to be clear in terms of applicable interest rate, the term of the loan and the purpose.

In terms of due-diligence type there should be no material differentiation between information that is mandated by regulation for equity based crowdfunding and loan based.

To this end, any potential regulations should mandate the following information be displayed on the 'investment screen' of the company:

- Companies Registration Office Report (showing company status, registered charges, directors etc);
- Companies Registration Office Letter of Good Standing / Letter of Status (this would be useful for overseas investors as it is a commonly used certification tool);
- Latest filed accounts; and
- Current management accounts.

It is acknowledged that the information listed above, is publically available (with the exception of management accounts) - however there are fees / subscriptions associated with its retrieval and without the specific experience in receiving same it could lead to difficulties for retail investors.

As noted above at 2(b) further diligence checks would also be appropriate prior to the time of completion of a transaction (equity or loan based) e.g.

Searches against the company including:

- Companies Registration Office search;
- in the Judgments Office of the High Court for unsatisfied judgments, orders etc.;
- in the Central Office of the High Court any proceedings issued including on the Index of Petitions and Winding Up Notices.

With the following additional searches to be carried out against individual directors:

- in the Judgments Office of the High Court for unsatisfied judgments, orders etc.;
- in the Central Office of the High Court any proceedings issued including on the Index of Petitions and Winding Up Notices; and
- Bankruptcy.

Consideration may be given to reducing (or as the case may be) the required mandated information in accordance with the level of investment that is being sought.

The intellectual property of an early stage company is, more often than not, their most valuable asset. However it usually is their least protected asset due to the expensive procedures and lack of awareness of how to protect it. Where a company is seeking funding and represents that it has particular IP protection (e.g. trademark or patent), it should be verified by placing an obligation on the company to disclose the relevant documentation.

Question 2 (d): Crowdfunding platforms in Ireland are not currently covered by prudential rules (including capital and liquidity requirements), by client asset rules or conduct of business rules. Should there be such standards for crowdfunding platforms in Ireland? If so, what should these standards include?

A similar approach could be taken as seen in other EU countries where the necessity for minimum capital requirements can be removed on the condition that adequate professional indemnity insurance is taken out.

As noted above, AIG insurance group have launched a specific product in this area which is available for issuer fraud in both the United Kingdom and Canada.

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By enforcing a large capital requirement on crowdfunding platforms it has the potential to stymie the market place. We believe appropriate indemnity insurance or minimum capital requirements that are linked to the financial exposure (as is the case in the UK) that a platform has are sensible protections.

Question 2(e): Should the SME Regulations be applied to crowdfunding platforms?

In general, no - however it may be useful to apply some of its principles, e.g. "suitability and appropriateness" assessments by a platform in respect of the retail investor in understanding the nature of the transaction; and what is appropriate in terms of advertising of loan products for example.

In general companies that may benefit from the SME Regulations will effectively set the terms and conditions of the financing they are seeking whether it be equity or debt based. It is then for investors to decide if the terms as set out by the businesses are acceptable to them.

Questions 2 (f): Should there be a limit on the maximum level of investment in a 12 month period that an individual may invest in one or more crowdfunding projects/businesses that a crowdfunding platform can accept from an individual? Should there be other restrictions on retail investors before they can invest in both loan based and equity based crowdfunding?

This is likely to be an extremely difficult rule to regulate and/or police. There is a strong argument to make that consenting adults, who are advised of the risks, should be able to invest what they like in companies seeking funding.

We note that several other European countries have restrictions in this area. In Germany retail investors are capped at €10,000 euro where they can prove they can bear the potential financial loss otherwise the limit is capped at €1,000. Where investors are deemed to be 'professional investors' no such limit applies to investments. We note that Spain have a similar threshold of €10,000 by way of an annual cap for non-accredited investors.

In the UK, retail investors who are not high net worth, who have not sought advice and are not sophisticated investors are subject to a limit of 10% of their net assets.

A further alternative approach is taken in Austria, where the cap is set at €5,000 per retail investor a year. Persons who fit the following categories are exempt (i) legal persons; (ii) professional investors. Where a retail investor has shown the relevant skills, they may invest more than the €5,000 limit provided that their investments do not (i) double their monthly income or (ii) 10% of their financial assets.

These types of limits raise the question of who is going to police this. Will it be up to the individual platforms to perform 'due diligence' on retail investors or will they be self-certifying and if so, what is the point?

We believe the important piece of regulation in this area is that platforms must display appropriate risk warnings and that the investor is obliged to take a positive action via the platform's investment steps that indicates he/she has been made aware of the risks and that he/she understand the risks and accepts such risks - before proceeding to making the investment.

Question 2(g): Are there any consideration that should be taken into account with respect to the cost of regulation or the cost of regulatory compliance?

The regulatory regime needs to be clear (to avoid large consultation fees) and balanced in terms of compliance costs. Generally the businesses seeking funding are small or early stage companies and often the investments being raised are modest in size. These factors should be taken into consideration.

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Question 2(h): Should regulation address situations where there could be a potential conflict of interest, for example, where a crowdfunding platform, its shareholders, managers or key employees can provide funds and potentially earn money from providing loans or having an equity share in enterprises through crowdfunding?

Any crowdfunding platform regardless of type of investment should understand that they are required to treat any potential investor in a fair, open and transparent matter. The ability of the platform and or employees of same who are privy to information that may lend them an advantage should be prevented from acting on it.

However this must be balanced as not to prevent a person from investing in an opportunity purely due to their employment. Consideration should be given to the level that they operate within the platform and what information and decisions they are privy to.

This issue has been raised in the Financial Conduct Authority's *"Interim feedback to the call for input to the post-implementation review of the FCA's crowdfunding rules"* published in December 2016 and gives examples of such perceived 'instances of abuses' as:

- Early, exclusive or effectively exclusive access to loans, provided either explicitly or by means such as the timing of auctions;
- Great access to information about borrowers provided by the originating platforms; and
- The option to opt out from lending to segments of the market, for example on a sector basis.

A secondary issue that may arise due to the nature of the revenue streams for crowdfunding platforms (i.e. receiving a fixed fee or a percentage of funds raised) is that there may be an incentive for platforms (or their associates) to invest in companies / projects in order to generate increased levels of interest in a particular company / project or to assist a company/ project reach its funding target.

The current regulatory regime in Spain, strikes a delicate balance between preventing conflicts of interest while still allowing the freedom of investment. In Spain platforms are required to publish a public policy on conflicts of interest. Platform directors, managers and larger shareholders are restricted to investing in a project to a cap of 10%. From a transparency perspective, such a policy is worth considering for Ireland.

Question 3: Should Ireland consider developing non-regulatory supports to encourage the development of crowdfunding?

We believe that appropriate education and public awareness will be key drivers. Industry players will push this once clear regulations are put in place.

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Risk	Should this risk be regulated Yes/No/Partially	Comment
Lack of understanding of risky nature of crowdfunding by consumers.	Yes	A transaction fact sheet should be mandated as a compulsory screen within crowdfunding platforms which would require a positive action from the user to progress past it. This together with appropriate risk warnings should be provided for.
Risk of identity theft, money laundering, terrorism financing, data protection and fraud.	Partially	All website platforms that require the user to enter sensitive information, especially surrounding payment information carry risks for that user. To this end it would not be prudent to place crowdfunding platforms under any additional scrutiny as it emphasizes an associated risk that is not heightened due to the nature of crowdfunding.
Misleading and insufficient disclosure of information by businesses on crowdfunding platforms.	Yes	Any possible regulation in this must not overload platforms with a requirement to carry out overly burdensome due diligence work. Regulations should focus on minimum information standards as we have set out in this submission.
Risk of unfair contract terms or misleading commercial practices resulting from information asymmetry.	Partially	Transaction terms must be clearly flagged to investors – e.g. equity or debt, interest rate if applicable, term of loan, secured or unsecured, rights attaching to shares, does pre-emption apply, are there information rights etc.
If the business fails or the crowdfunding platform itself fails, there is a risk that lenders or investors will lose all of their money.	Partially	A similar approach could be taken to England and Wales in relation to the Financial Services Compensation Scheme. In our submission, we reference minimum capital requirements and appropriate indemnity insurance in this area.
Risk that the return on the investment is less than expected.	No	Appropriate risk warnings and acceptance is sufficient in this area.

<p>The lack of a secondary market for equity stakes means that it is difficult to value them and they can be diluted by further equity sales.</p>	<p>No</p>	<p>This risk is something that is seen in traditional forms of investment but should nonetheless be flagged to investors as noted above.</p>
<p>Absence of dispute resolution mechanism.</p>	<p>Yes</p>	<p>Investors should understand to whom / what office specifically they may make a complaint and what the resolution process is.</p>
<p>Risk arising from conflict of interest.</p>	<p>Partially</p>	<p>Some work is needed to ascertain where the largest risk of conflict is to be found. We have referred to this in our submission.</p>
<p>Risks to businesses seeking funding through crowdfunding platforms</p>	<p>Partially</p>	<p>Potential risks in this area include (i) inadvertent legislative breaches (e.g. historic legislation) that are not specifically addressed in a proposed crowdfunding regulatory regime; (ii) platform failure – we have referred to this in our submission.</p>