

NJORD Estonia: New regulations for crowdfunding service providers

The operations of crowdfunding platforms will be subject to pan-European rules due to Regulation (EU) 2020/1503 and Directive (EU) 2020/1504, adopted by the European Parliament in October.



THE REGULATION SHOULD BRING LEGAL CLARITY TO THE PROVISION OF THE SERVICES

In the case of crowdfunding services, it has become evident that although on the one hand, companies are looking for solutions to finance their projects through crowdfunding, the unregulated market of crowdfunding services has also led to negative examples of investors losing money. The establishment of common rules for crowdfunding platforms has been underway at the European level for several years. What improvements will the new regulation bring along?

First, the new regulation determines the crowdfunding service – matching of business funding interests of investors and project owners through a crowdfunding platform, which includes either the facilitation of granting of loans or the offering of transferable securities and instruments accepted for crowdfunding without a specific obligation and the provision of the reception and transmission of related client orders. In case a crowdfunding platform wishes to safe keep investors' assets or provide payment services in the course of its activities, the platform must have a separate authorisation for the respective financial service. Nor can a crowdfunding platform operate as a multilateral trading facility or an organised trading facility without the relevant authorisation of an investment firm or receive deposits from the public without the authorisation of a credit institution.

One of the problems in the area of crowdfunding is that under the name of crowdfunding, there are financial services offered which would require separate authorisation. The new regulation creates legal clarity for companies and investors and makes it possible to define more clearly, which services the crowdfunding platform may provide in the course of its activities and when additional authorisation is required. The preamble to the regulation also points out, as a problem, that the fragmented legal framework in the Member States creates substantial legal costs for retail investors, especially in the case of cross-border crowdfunding services.

AUTHORISATION OBLIGATION FOR CROWDFUNDING PLATFORMS

The new regulation establishes an authorisation obligation for crowdfunding platforms. The information required to apply for authorisation is essentially similar to that required for other financial services authorisation, such as a description of the programme of operations, governance arrangements and internal control mechanisms, description of operational risks, information and evidence on prudential safeguards, description of the business continuity programme, and the documents providing proof of the management's competence and reputation, etc.

The new regulation applies to crowdfunding offers with a total value of up to EUR 5 million over a 12-month period. As the Prospectus Regulation allows Member States to derogate from the obligation to publish a prospectus in a public offer of securities until the raising of funds up to EUR 8 million, Estonia has a limit that obligation to publish a prospectus is not applicable when raising funds up to EUR 2.5 million. Projects offered through crowdfunding will unequivocally be subject to a limit of EUR 5 million, which means that under this regulation, securities of up to EUR 5 million can be offered to the public through authorised crowdfunding platforms without the obligation to draw up a prospectus. Member States such as Estonia, where the obligation to draw up a prospectus has so far applied at a lower threshold, will have a transitional period to make the necessary changes at the national level.

Minimum prudential requirements are also set for crowdfunding service providers. Namely, the service provider must have own funds or an insurance policy, which at any time is at least EUR 25 000 or one-quarter of the fixed overheads of the previous year.

THE RULES ESTABLISHED TO PROTECT INVESTORS ARE SIMILAR TO THOSE ESTABLISHED FOR OTHER INVESTMENT SERVICE PROVIDERS

Under the new regulation, a number of rules have been established to protect investors, imposing similar requirements on the activities of crowdfunding service providers as on other investment service providers. Crowdfunding platforms must distinguish between sophisticated and non-sophisticated investors, just as MiFID II distinguishes between professional and retail clients. When defining an investor as a sophisticated investor, the platform should take into account the limits set out in the regulation on the income, volume of assets, or other criteria of natural and legal persons. The service provider must assess its knowledge and ability to bear losses before granting the customer access to the platform's services, and the assessment must be carried out periodically in the future.

Minimum due diligence measures that shall be taken by the crowdfunding service provider for project owners who offer their projects through their platform are also defined. The service provider must verify that the project owner does not have a criminal penalty for various infringements and that it is not a legal person established in a high-risk third country or non-cooperating region.

The crowdfunding service provider must allow for non-sophisticated investors a reflection period of 4 calendar days, during which the potential investor may withdraw the investment offer or interest related to his crowdfunding offer without giving a reason and without incurring a penalty.

A KEY INVESTMENT INFORMATION SHEET MUST BE PREPARED FOR EACH CROWDFUNDING OFFER

The crowdfunding service provider is obliged to provide investors with a key investment information sheet prepared by the project owner for each proposed project. The Regulation lays down a mandatory minimum content of a key information sheet, which in many areas is similar to the main content of a prospectus. Although the document is prepared by the project owner, the service provider must have procedures in place to verify the completeness, accuracy, and clarity of the key information sheet.

The service provider must inform the project owner when identifying that key information sheet contains misleading or missing information that is important for the return of the expected investment and, if necessary, suspend the crowdfunding offer for up to 30 days until the project owner corrects the information. At least the project owner or its administrative, management, or supervisory bodies shall be responsible for the information provided in the key investment information sheet.

RESPONSIBILITY FOR THE INFORMATION PROVIDED IN THE KEY INFORMATION SHEET

As in the provisions on prospectus liability, the Member State undertakes to ensure that the laws, regulations, and administrative provisions on civil liability apply to the natural and legal persons responsible for the information contained in the key investment information document and its translations, at least where the information is misleading or inaccurate and the key information, necessary for investors when deciding on the financing of a crowdfunding project, has been omitted from the key information sheet.



VIRGI NAEL

HEAD OF BANKING AND
FINANCE

(+372) 524 1668

VIRGI.NAEL@NJORDLAW.EE