REGULATION OF CROWDFUNDING

Public Consultation
April 2017

An Roinn Airgeadais
Department of Finance

Public Consultation Paper:

Regulation of Crowdfunding

Department of Finance

April 2017

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1. Introduction

Crowdfunding is a way in which finance can be raised from a large number of individuals or institutional investors, to fund a business, project or personal loan through online web-based platforms.

It is a type of market-based finance that could help stimulate funding to small and medium-sized enterprises (SMEs) as well as personal lending. Crowdfunding also provides consumers and small investors with access to investment opportunities that offer a higher rate of return, at a higher risk, than is generally available from traditional credit institutions.

In the European Union, there is no dedicated harmonised regulation for crowdfunding and the existing European financial services legislation was not designed with crowdfunding in mind. A number of EU Member States have either implemented domestic regulation for crowdfunding or are in the process of considering introducing regulation.

Crowdfunding is not currently a regulated activity in Ireland and, in June 2014, the Central Bank of Ireland issued an information notice that alerts consumers to this fact and highlights specific risks that potential investors should be aware of. The information notice can be accessed via the following link:

https://www.centralbank.ie/consumer-hub/consumer-notices/consumer-notice-on-crowdfunding-including-peer-to-peer-lending

The Department of Finance and the SME State Bodies Group is now considering how to facilitate the development of crowdfunding in Ireland for the benefit of the economy while also ensuring adequate protection for small investors and consumers.

The objective of this consultation is to seek the views of interested parties on whether a regulatory regime would be appropriate for the crowdfunding sector, or if such a regime (or limited regime) with its inherent obligations and costs would be an impediment to the development of crowdfunding in Ireland. Any comments and views that respondents might have on the costs and benefits of regulating crowdfunding, as compared with the current situation are welcome.

2. The Consultation Process

The consultation period will run for a six week period until 2 June 2017. Any submissions received after this date may not be considered.

Observations and comments are welcome on any aspect of crowdfunding, and not just the issues identified in this consultation paper.

The preferred means of response is by email to: crowdfundingconsultation@finance.gov.ie

Alternatively, your response may be posted to:

Crowdfunding Consultation
Financial Services Division
Department of Finance
Upper Merrion Street
Dublin 2, D02 R583
Ireland

Please include your contact details if responding by post.

2.1 Freedom of Information

Responses to this consultation are subject to the provisions of the Freedom of Information Acts. Parties should also note that it is the intention that responses to the consultation will be published on the Department's website www.finance.gov.ie after the deadline for receiving the submissions has passed.

It is important to be aware that unless you clearly identify any commercially or personally sensitive information in your submission, you are making a submission on the basis that you consent to it being made available in full on the Department of Finance website. Potentially defamatory material will not be placed on the website.

2.2 What happens after this Consultation?

Submissions received to this public consultation will be published on the Department of Finance website. They will be used to inform the future development of regulatory policy on crowdfunding in Ireland.

3. Overview of Crowdfunding

Crowdfunding is an alternative means by which individuals and businesses can access finance that does not involve raising finance from one single source such as a bank; rather, crowdfunding involves obtaining small amounts of individual funding from a large number of different sources. Usually funding is provided by individual investors; however, companies and institutions can also provide finance through crowdfunding platforms.

Digitalisation and the internet have facilitated the development of crowdfunding as an alternative source of finance for both individuals and businesses, enabled by crowdfunding platforms. These online platforms match lenders and investors with businesses or individuals seeking funding and arranges payments and repayments between them.

Crowdfunding is a new and evolving industry and encompasses a diverse variety of unique and innovative business models. There are a number of different types of crowdfunding that fall in to two general categories, non-financial and financial. This paper briefly outlines the key types of crowdfunding: donation and reward based, peer-to-peer and investment based crowdfunding.

Crowdfunding investors are, in the main, expected to be individual consumers. The understanding of consumer in the context of this consultation paper will be broad and taken to mean anyone who uses crowdfunding platforms, either to provide or obtain funds.

3.1 Non-financial return crowdfunding: donation or reward based Crowdfunding

Non-financial return crowdfunding refers to types of crowdfunding where there is no expectation of any financial return on the part of the funders providing money. Generally, this type of crowdfunding is referred to as donation or reward based crowdfunding. In this type of crowdfunding, a small donation or contribution is made by a large number of individuals to support or sponsor a charitable cause or business. It is essentially philanthropic or charitable in nature. In some cases, funders may receive a non-financial reward such as a nominal promotional gift or product. This type of crowdfunding can encompass the idea of pre-payment whereby the funds raised are used to develop and produce a product that will eventually be provided to people who have paid in advance.

In EU Member States where crowdfunding is regulated, only one country (Portugal) has introduced specific regulation for non-financial forms of crowdfunding. The general position appears to be that, where there is regulation of crowdfunding, it is introduced for financial types of crowdfunding only.

Non-financial crowdfunding is not considered to involve lending or investment type activity as there is no expectation of financial return and therefore will not be considered as part of this public consultation.

3.2 Financial Return crowdfunding

Financial forms of crowdfunding involve the expectation of a financial return on behalf of the lender or investor. There are three general types of crowdfunding within this category: peer-to-peer business lending; peer-to-peer consumer lending; and investment based crowdfunding.

3.2.1 Lending models of crowdfunding (Peer-to-Peer)

The lending model of crowdfunding is also referred to as peer-to-peer (P2P) lending. There are two general types of the lending crowdfunding model: consumer and business. In both cases, lenders lend money through crowdfunding platforms; the difference is whether it is lent to support a business or another individual.

3.2.2 Peer-to-Peer Consumer Lending

Peer-to Peer-Consumer Lending is where individual or institutional lenders provide money to individual consumers, as opposed to a business, through a crowdfunding platform as a loan in return for repayment with interest. The crowdfunding platform facilitates the matching of borrowers and potential lenders.

If crowdfunding platforms facilitating Peer-to-Peer Consumer Lending were to become active in Ireland, they could potentially be regulated by the Competition and Consumer Protection Commission as credit intermediaries under the *Consumer Credit Act 1995.* However, as this legislation was enacted at a time when the development of crowdfunding platforms was not foreseen, it is unlikely that such regulation, on its own, would be sufficient or effective.

3.2.3 Peer-to-Peer Business Lending

Peer-to-Peer Business Lending involves multiple individual or institutional lenders who provide money to a business (as opposed to an individual). This money is provided as a loan by the lenders that is to be repaid with interest. The crowdfunding platform facilitates the matching of borrowers and potential lenders. Examples of platforms that facilitate Peer-to-Peer Business Lending in Ireland are Linked Finance[1] and Grid Finance[2].

3.2.4 Investment model of Crowdfunding

The investment model of crowdfunding generally involves the provision of funds by individuals or institutional investors to businesses in return for unlisted equity or debt securities.

The investment model of crowdfunding mostly concerns individual or institutional investors taking an equity share in a company, although investment may also be through other types of financial instruments. With this type of crowdfunding, multiple funders invest money for a share in a business or project and/or any profits or revenue generated. Rather than a simple repayment of the amount given with interest, the investor receives an equity share in the business. The crowdfunding platform facilitates the matching of investors with businesses.

3.3 Role of Crowdfunding platforms

Crowdfunding is facilitated by online web-based platforms that enable businesses and individuals who wish to raise funds to interact with potential investors. Financial pledges can be made and collected through the platform.

These online platforms facilitate the matching of lenders/investors who provide the funds to businesses who need them and arrange the payments and repayments thereof. They allow businesses to pitch their business idea online in order to seek funding. Crowdfunding platforms generally match lenders/investors with projects/businesses according to common interest as well as risk appetite.

Crowdfunding platforms may carry out a certain degree of due diligence and have certain criteria for eligibility that must be met before a business may use the platform to seek funding. However, in Ireland, there is no regulatory requirement that compels them to do so. In the case of loan-based crowdfunding, the platforms may also help determine the interest rate either by offering fixed rates or through an online auction involving potential funders bidding to offer funds at different rates. In the case of the equity model of crowdfunding, the platform may help in determining the valuation of the company seeking funds.

[1] https://www.linkedfinance.com/
[2] https://www.grid.finance/

3.4 Benefits and Risks of Crowdfunding

As crowdfunding is currently unregulated in Ireland, there is no formal protection for consumers, investors or businesses, whereas the Deposit Guarantee Scheme protects depositors in the event of a bank, building society or credit union authorised by the Central Bank of Ireland being unable to repay deposits. This scheme requires credit institutions to contribute annually to a fund, based on their covered deposits and degree of risk. Given the nature and risks of crowdfunding, coverage of the Deposit Guarantee Scheme would not be feasible.

Some key benefits and risks associated with crowdfunding have been identified by the European Banking Authority[3], the European Securities and Market Authority[4], the European Commission[5], the International Organisation of Securities Commissions (IOSCO)[6], the Central Bank of Ireland[7] and the Economic and Social Research Institute (ESRI)[8].

3.4.1 Brief Overview of some of the benefits associated with Crowdfunding

Some key advantages of crowdfunding from the perspective of the Irish Economy include:

- Financial forms of crowdfunding can be a valuable source of funding for SMEs either as a complement, or as an alternative, to traditional bank finance.
- May be a source of finance for SMEs and start-up companies that are unable to access traditional bank finance or venture capital.
- Irish SMEs are overly reliant on bank finance and crowdfunding can provide a diversification of funding sources for Irish SMEs and as a result, may create greater competition in the SME finance market.
- It is a fast and cost efficient means for businesses to obtain finance necessary to start up or expand.
- Promotes innovation and social entrepreneurship.

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[3] https://www.eba.europa.eu/documents/10180/983359/EBA-Op-2015-03+%28EBA+Opinion+on+lending+based+Crowdfunding%29.pdf
[4] https://www.esma.europa.eu/sites/default/files/library/2015/11/2014-1378_opinion_on_investment-based_crowdfunding.pdf
[5] http://ec.europa.eu/finance/general-policy/docs/crowdfunding/160428-crowdfunding-study_en.pdf
[6] http://www.iosco.org/research/pdf/swp/Crowd-funding-An-Infant-Industry-Growing-Fast.pdf
[7] http://www.centralbank.ie/press-area/press-releases/Pages/ConsumerNoticeCrowdfunding.aspx
[8] https://www.esri.ie/pubs/JACB201561.pdf

- There are also non-financial benefits to enterprises in using crowdfunding to obtain finance. Crowdfunding raises awareness and the profile of the business providing publicity as well as finance.
- Crowdfunding provides an opportunity for businesses in terms of market testing and validation at an early stage of product development.

The above list is not exhaustive and respondents are encouraged to highlight other potential advantages and benefits of crowdfunding in their response to this consultation.

3.4.2 Brief Overview of some of the risks associated with Crowdfunding

The risk associated with crowdfunding fall into two general categories. The risks arising from investment choice and risks arising from the reliance on crowdfunding platforms that facilitate the investment process.

These risks include:

- Consumers may not fully understand the greater risks involved with crowdfunding and may equate investing via crowdfunding platforms with safer options, such as bank deposits, which have guaranteed returns, unlike crowdfunding.
- Crowdfunding is also exposed to the risks associated with traditional credit provision and credit institutions. These include identity theft, money laundering[9], terrorism financing and data protection.
- In order to take advantage of the lower costs associated with technology, platforms operate solely through an internet portal or website. This means that there is a potentially increased chance of fraud due to the inherent anonymity that the internet offers.
- There is a risk of misleading or insufficient information about and a lack of disclosure by businesses on crowdfunding platforms. Misleading information is particularly likely to be provided in promotional and advertising material and may not be independently verifiable by potential lenders/investors who are providing funds. As a result, there is a risk to lenders/investors that their decision to invest is not fully informed.
- There is a risk of unfair contract terms being imposed or misleading commercial practices being used by businesses on crowdfunding platforms at the expense of retail lenders/investors due to the information asymmetry between the parties.
- Crowdfunding is particularly attractive for start-up businesses; however, there is a high failure rate of start-ups. This means there is a risk to investors of losing some or

[9] Further work may be needed to determine whether crowdfunding platforms conduct an activity that would be covered by Part 4 of the *Criminal Justice (Money Laundering and Terrorist Financing) Act 2010*

all of their money should the business receiving the loan or investment fail, or the borrower default on loan repayments.

- Investors may also risk losing some or all of their investment if the crowdfunding platform itself fails. This is due to the fact that crowdfunding platforms in Ireland are not covered by prudential rules, including capital and liquidity requirements, and are also not covered by client asset rules or conduct of business rules.
- There is a risk that the return on the investment is less than expected.
- There may not always be a secondary market to sell shares or an equity interest, resulting in a lack of liquidity. It can be difficult to accurately value shares and investment value can be diluted by further equity sales.
- There is an absence of dispute resolution and redress mechanisms.

There are also certain risks to the enterprises seeking funding through crowdfunding platforms. These include:

- Potential lack of transparency surrounding the risk assessment that is carried out by the crowdfunding platform.
- Committed funds not being received as lenders are not able or willing to pay.
- Opportunity cost if there is a delay in payments being processed by the platform
- Risk that intellectual property may not be adequately protected prior to funding being received and original and innovative ideas could be copied by others.
- Borrowers do not receive the protections provided by the SME Regulations[10].

The above list is not exhaustive and respondents are encouraged to highlight other potential risks of crowdfunding in their response to this consultation.

3.4.3 Brief Overview of the costs associated with regulation of Crowdfunding

There would be a number of costs associated with the regulation of crowdfunding, including:

- The cost of Central Bank resources required to regulate the industry, the costs of which would be recoverable via the industry levy on the sector (in line with all other regulated sectors).

[10] Central Bank (Supervision and Enforcement) Act 2013 (*Section 48*) (*Lending to Small and Medium Sized Enterprises*) Regulations 2015 (*S.I. No. 585 of 2015)*

- The compliance costs for industry in terms of seeking initial authorisation and the ongoing reporting requirements which would be commensurate with the level of industry risk identified by the Central Bank.
- The increased costs for users of the platforms, which would reduce returns and increase the cost of equity/credit.

The above list is not exhaustive and respondents are encouraged to highlight other potential costs of crowdfunding in their response to this consultation.

3.5 Crowdfunding in the European Union

In 2015 it is estimated that approximately €4.1 billion was raised through equity investment or loan based crowdfunding platforms by businesses across the EU and it is estimated that there are now more than 500 platforms providing a range of services in the EU[11].

The European Commission's Action Plan on Building a Capital Markets Union identified crowdfunding as a "fast-growing and innovative funding channel" and a way of expanding the funding choices available to SMEs. In its most recent report, the Commission situates crowdfunding in the "broader universe of technological advancements with potentially transformative implications for the financial systems, its intermediaries and users ("FinTech")."

The Commission established a Crowdfunding Stakeholder Forum to support policy development in this area and recently published a comprehensive guide to crowdfunding in the European Union that may be of interest to respondents. It is available via the following link:

https://ec.europa.eu/growth/tools-databases/crowdfunding-guide_en

The European Commission has indicated that it does not intend to introduce EU laws for crowdfunding, but that it will continue to review developments in the sector, and will continue to meet twice per year with regulators and representatives of the sector. Several Member States including Austria, Belgium, Finland, France, Germany, Italy, the Netherlands, Portugal, Romania, Spain and the United Kingdom have domestic regulatory regimes in place for crowdfunding. Other EU Members states are currently considering developing regulatory regimes.

The Commission is currently planning a study to assess the potential for development of cross-border crowdfunding business, and how existing EU legislation applies and interacts

[11] http://ec.europa.eu/finance/capital-markets-union/docs/building-cmu-action-plan_en.pdf

with existing and upcoming national regulatory frameworks in cross-border situations. This assessment will consider the potential of crowdfunding (both investment-based and loan-based) as a source of funding for European businesses, as well as investor protection aspects.

3.5.1 Existing EU financial services legislation and the regulation of crowdfunding

Crowdfunding is a recent, innovative and continually evolving activity and, as such, existing EU legislation was not specifically designed with crowdfunding in mind. However, depending on their business model, investment based crowdfunding platforms may potentially come under the remit of the Markets in Financial Instruments Directive (MiFID), the Prospectus Directive[12] and the Alternative Investment Fund Managers Directive (AIFMD).

MiFID could apply to crowdfunding platforms in one of three ways: the platform could be directly authorised as an investment firm/credit institution, it could be operated by an authorised investment firm/credit institution or as the tied agent of an authorised investment firm/credit institution. Were MiFID to apply to crowdfunding platforms, they would have to comply with initial capital requirements, conduct of business rules and the requirements of the Anti-Money Laundering Directive[13].

However, crowdfunding platforms can structure their activities so as to avoid MiFID, and the experience to date is that the vast majority of platforms across the EU structure their business so they do not come under the Directive's remit.

In addition to MiFID, the Payments Services Directive (PSD) and a number of other pieces of European legislation may also be relevant[14]. However, despite the potential applicability of a wide range of European law to crowdfunding platforms, there are a number of regulatory gaps where crowdfunding platforms do not come under the remit of MiFID or any of the other

[12] It should be noted that the current Prospectus Directive is currently being revised and the Council agreement for a Prospectus Regulation (June 2016) raised the minimum exemption threshold from €100,000 to €500,000 for the purpose of smaller issuances, in particular facilitating investment based crowdfunding.

[13] http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32015L0849&from=EN

[14] The ESMA report https://www.esma.europa.eu/sites/default/files/library/2015/11/2014-1378_opinion_on_investment-based_crowdfunding.pdf also references the AIFMD, the Prospectus Directive, the Market Abuse Directive, the European Venture Capital Funds Regulation, the European Social Entrepreneurship Funds Regulation, the Distance Marketing of Financial Services Directive, the Third Anti-Money Laundering Directive, the Unfair Commercial Practices Directive, the Misleading and Comparative Advertising Directive, the Unfair Terms in Consumer Contracts Directive, the Consumer Alternative Dispute Resolution Directive, the Consumer Credit Directive and Mortgage Credit Directive and the E-commerce Directive.

EU legislation[15]. This is reflected in the decision of some EU Member States to develop domestic regulatory regimes for Crowdfunding.

Respondents are invited to submit comments on existing EU financial services legislation and its applicability to crowdfunding platforms in Ireland.

3.6 Current regulatory situation in Ireland

Crowdfunding is not currently a regulated activity in Ireland. In June 2014, the Central Bank of Ireland issued an information notice which alerts consumers to the fact that crowdfunding is not a regulated activity in Ireland and of specific risks around crowdfunding that potential investors should be aware of. The information notice can be accessed via the following link: http://www.centralbank.ie/press-area/press-releases/Pages/ConsumerNoticeCrowdfunding.aspx

If a crowdfunding platform intends to offer ancillary services that are regulated (e.g. payment services), an authorisation is needed from the Central Bank of Ireland as far as these services are concerned, since these services may only be performed by banks or other authorised financial institutions.

The financing of SMEs tends to be locally and geographically limited. In Ireland, SMEs generally only seek finance within the Irish credit market. As crowdfunding platforms are based on the internet, they could potentially enable SMEs to source financing outside national borders. Currently crowdfunding is primarily carried out on a national basis and there is a low volume of cross-border activity.[16]

According to a European Commission study in 2015[17], seven platforms have funded 85 projects and/or raised a total of €2.01 million in Ireland and the Cambridge Centre for Alternative Finance has observed that €3 million was raised on Irish online alternative financing platforms in 2015[18].

It is worth noting that the Commission Study in 2015[19], which mapped market trends before and after national regulatory events in the UK, Italy and France, found no observable market changes from time series data after national regulatory events in France and the UK and found that in Italy regulation had a limiting effect on levels of equity crowdfunding.

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[15] https://www.esma.europa.eu/sites/default/files/library/2015/11/2014-1560_advice_on_investment-based_crowdfunding.pdf

[16] European Commission Staff Working Document On Crowdfunding, available at: http://ec.europa.eu/finance/general-policy/docs/crowdfunding/160428-crowdfunding-study_en.pdf

[17] https://ec.europa.eu/info/sites/info/files/crowdfunding-study-30092015_en.pdf

[18] University of Cambridge Centre for Alternative Finance (2016), *Sustaining Momentum – The 2nd European Alternative Finance Industry Report*.

[19] https://ec.europa.eu/info/sites/info/files/crowdfunding-study-30092015_en.pdf

3.7 Objective of this Public Consultation

The objective of this Public Consultation is to seek the views of anyone who has views on:

- consumer and investor protections;
- crowdfunding as a viable alternative source of finance and its potential implications for financial stability; and
- the costs and benefits of a regulatory regime for crowdfunding.

The Department would particularly welcome the views of crowdfunding platforms operating or considering operating in Ireland, individuals who invest or who would consider investing via crowdfunding in Ireland, and businesses who have raised or would considering raising funds via crowdfunding in Ireland.

All responses to this public consultation should consider whether a regulatory regime for crowdfunding with its specific protections and associated costs/requirements would impede or encourage the development of the crowdfunding sector. This overarching consideration should be borne in mind when responding to the subsequent questions as the additional regulatory requirements covered by questions 2 to 9 may impede the sector's future development.

4. Crowdfunding Consultation Questions

Interested parties are invited to make submissions regarding the following questions. There are ten questions in total and each one is followed by an explanatory paragraph. It is not necessary for each submission to address every question, and respondents are invited to submit general comments about any aspect of the costs and benefits of regulating financial crowdfunding compared to the present situation that they deem relevant along with any other policy measures that could be taken.

To assist respondents a table is included in Appendix 1. This table lists the risks outlined earlier in this document and invites general comments on each of the risks as well as seeking a yes, no or partial answer on whether the risk should be regulated. In considering this feedback, the Department must consider whether a regulatory system would make crowdfunding infeasible. Completing this table is optional; it is intended to assist respondents in providing input on the risks associated with crowdfunding.

Consultation Question 1: Should crowdfunding in Ireland be regulated?

The European Commission has indicated that it does not intend to introduce harmonised regulation of crowdfunding in the near term and therefore if crowdfunding is to be regulated in Ireland it will have to be solely on a national level. Respondents are invited to submit their views on whether or not crowdfunding should be regulated in Ireland and comment on any other potential policy measure that could also be taken. These views should take account of the benefits, risks and costs of regulation.

Consultation Questions 2(a)–(h) should be considered in the event that a regulatory regime for financial forms of crowdfunding were to be developed in Ireland.

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

This paper outlined some key risks associated with crowdfunding for consumers, investors and businesses, these risks are addressed more specifically in the subsequent questions. The main purpose of any potential regulatory regime should be to ensure appropriate levels of protection for investors, in particular small investors and consumers. In this context, respondents are invited to identify the risks that should be addressed in any potential regulatory regime. In responding to subsequent questions, respondents should consider that higher regulatory obligations may lead to higher costs and diminish the benefits of crowdfunding platforms.

Consultation 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?

At present, there is no requirement in Ireland for crowdfunding platforms to carry out any form of due diligence on businesses seeking funding and neither is there any such obligation for lenders/investors to do so either. This is in contrast to traditional lenders who would seek to assess the creditworthiness of a borrower before providing a loan or an investor who may seek business plans and financial projections before making investment decisions. There is no obligation on crowdfunding platforms to put in place a procedure in the event of either default, insolvency or bankruptcy on the part of a borrower who has received funds.

Consultation 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?

It is important that businesses provide potential funders with sufficient information about the business so that they can make an informed decision on whether or not to invest. For example, such information could include the business trading name, address and company registration number, its principals or owners, the intended use of the funds raised, a business plan, financial projections, accounts and details of any products that the business intends to create.

Consultation 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?

As outlined earlier, crowdfunding is not currently regulated by the Central Bank of Ireland and therefore is not subject to the prudential rules, client asset rules or conduct of business rules that traditional investment and banking activity are.

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

The Central Bank of Ireland currently has a number of codes in place to protect SME and consumer borrowers, the two main ones being The "SME Regulations"[20] and The Consumer Protection Code[21]. Banks must comply with the requirements of these Codes when dealing with SMEs and consumers. One means of regulating crowdfunding platforms could be to extend the remit of these codes to crowdfunding platforms and require that they comply with them, however, this would require legislative change.

Consultation Question 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?

In other jurisdictions, including the United Kingdom and the United States of America, there are limits imposed on the amount that individuals can invest through crowdfunding platforms. In the UK, regulation of crowdfunding means that retail clients must confirm that they will receive regulated investment advice or authorised investment management services, and certify that they will not invest more than 10 per cent of their net investible financial assets (this is to ensure that the investment does not affect their primary residence, pensions or life cover) unless they are high net worth investors or self-certify as sophisticated investors. The purpose of these restrictions is to ensure that investments are only promoted to consumers who understand them or have the financial capacity to absorb losses and to protect unsophisticated, retail investors.

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

Any regulation of crowdfunding must strike an appropriate balance between the benefits of regulation in terms of protecting those who provide or receive funds through crowdfunding and the cost of compliance with regulation for platforms. As well as a financial cost for platforms in complying with regulation, there is a risk that unsuitable regulation could hinder innovation and impede the growth of the crowdfunding industry.

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[20]https://www.centralbank.ie/regulation/processes/consumer-protection-code/Documents/Central%20Bank%20(Supervision%20and%20Enforcement)%20Act%202013%20(Section%2048)%20(Lending%20to%20Small%20and%20Medium-sized%20Enterprises).pdf

[21] https://www.centralbank.ie/regulation/processes/consumer-protection-code/Documents/120430%20Code%20interpretations%20FINAL.pdf

A potential challenge in imposing a regulatory regime is the time and cost involved in becoming regulated and gaining the requisite authorisation. This can be particularly prohibitive in the case of small companies and start-ups that may lack the resources and expertise to meet the regulatory requirements.

It is likely that if the cost of regulation, including the industry levy, is significant for crowdfunding platforms then the platforms may not be feasible or they may then seek to pass on this cost through the fees charged to enterprises seeking funding.

Consultation 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

One of the potential regulatory issues that might arise in relation to crowdfunding is a possible conflict of interest that could lead to consumer detriment. Conflict of interest is where those involved in the running and platform may also invest through the platform. This could provide for a situation that is very similar to insider trading by companies and poses a similar competitive disadvantage to retail consumers in the case of crowdfunding. Additionally there may be an incentive, if a new crowdfunding platform is seeking to establish a presence in the market quickly, to downplay risks and overemphasise possible returns.[22]

Another area where a potential conflict of interest has been identified is that investors could become over reliant on some of the automated services offered by crowdfunding platforms for choosing their investment portfolio.[23] This could potentially provide platforms with an incentive to match lenders/investors with loans/companies that do not suit the investors risk profile or risk appetite.

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

As outlined, the focus of this public consultation is to seek views regarding the appropriate regulatory treatment of crowdfunding. However, regulation is just one policy measure and there are potentially other non-regulatory measures and incentives that could be implemented in order to support and encourage the development of the crowdfunding industry.

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[22] FCA Public Consultation available at https://www.fca.org.uk/publication/consultation/cp13-13.pdf

[23] IOSCO Report, "Crowdfunding: An Infant Industry Growing Fast", available at: http://www.iosco.org/research/pdf/swp/Crowd-funding-An-Infant-Industry-Growing-Fast.pdf

Appendix 1

Template Table for Responses on Risks Associated with Crowdfunding

Risk	Should this Risk be Regulated? Yes/No/Partially	Comment
Lack of understanding of risky nature of crowdfunding by consumers.		
Risk of identity theft, money laundering, terrorism financing, data protection and fraud.		
Misleading and insufficient disclosure of information by businesses on crowdfunding platforms.		
Risk of unfair contract terms or misleading commercial practices resulting from information asymmetry.		

If the business fails or the crowdfunding platform itself fails, there is a risk that lenders or investors will lose all of their money.		
Risk that the return on the investment is less than expected.		
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.		
Absence of dispute resolution mechanism.		
Risk arising from conflict of interest.		
Risks to businesses seeking funding through crowdfunding platforms (see page 10 for further detail).		