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Regulation of Crowdfunding in Ireland – Crowdcube Consultation Response

Thank you for the opportunity to consult on the regulation of crowdfunding in Ireland. Crowdcube would welcome the introduction of regulated crowdfunding in Ireland.

Crowdcube is a leading equity crowdfunding platform in Europe, having raised over €275m through more than 500 crowdfunding campaigns. Crowdcube is headquartered in Exeter, UK, with offices in London and Manchester. Crowdcube is authorised and regulated by the Financial Conduct Authority. Crowdcube also has operations in Spain which are regulated separately by the Spanish regulator under the Spanish crowdfunding rules and we are expanding elsewhere in Europe. This response builds upon our experience from these regulated markets and working with industry associations, the UK Crowdfunding Association and the European Crowdfunding Network.

We welcome the opportunity to consult further with the Department of Finance on any specific questions. Please direct any follow up questions to Paul Massey, Crowdcube's General Counsel, at paul@crowdfunding.com or the phone number above.

Consultation Question 1: Should crowdfunding in Ireland be regulated?

Crowdfunding in Ireland should be regulated to allow domestic and cross-border investment in SMEs and other investment opportunities by the public. The proposed regime will be most effective and attractive to platform operators if it is compatible with MIFID to enable firms regulated in Ireland to passport their Irish regulatory permissions to other EU territories.

The Irish crowdfunding regulation should be complemented by a review of other Irish laws that impact on equity and debt finance in a crowdfunding context, including the Companies Act 2014 and Prospectus requirements.

A regulatory and legal framework that optimises the Irish territory for crowdfunding platforms will attract international platforms to locate in Ireland, offering new finance to vital sectors of the Irish economy and a platform to passport regulatory permissions into other territories of the EU.

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

Due to the diverse nature of investment opportunities that crowdfunding can support, a prescriptive list of risk types is difficult to compile and could be counter-productive to full disclosure to investors. For example, a single platform may offer investment opportunities in startup equity, units of funds or debt securities. A principles based approach to risk disclosure with good guidance offers an effective approach to regulation and management of risk by the sector and investors.

General risks applicable to early stage equity investments, such as lack of liquidity, dilution, risk of capital loss can be included in general risk warnings while a general requirement on platforms and issuers to take steps to ensure that investment offers and financial promotions are fair, clear and not misleading can ensure that more specific risks are disclosed.

The regulator and platforms should also encourage investors to diversify their investments and do their own due diligence before investing.

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?

A prescriptive due diligence requirement or checklist could mean deal specific issues are overlooked or deemed outside of due diligence requirements. The Irish regulation may wish to draw on the experience of the UK and the UK's framework. In the UK, crowdfunding platforms are subject to the Financial Conduct Authority's Handbook and associated rules and principles. This includes the principle to treat customers fairly and to follow the Conduct of Business Rules approach to regulating financial promotions, with regulated firms approving financial promotions and ensuring they are fair, clear and not misleading. This principles based approach ensures there is an obligation on firms to carry out appropriate due diligence.

The UK's principle based approach works well to ensure that appropriate due diligence is carried out for the wide variety of investment opportunities that crowdfunding offers. Crowdcube introduced a due diligence charter that we believe provides a balanced between investor protection. This charter was developed without a regulatory requirement, demonstrating that a principles based approach will lead to sensible approaches by platforms and a cost-effective means of

regulation. The Crowdcube due diligence charter can be found here: <https://www.crowdcube.com/pg/due-diligence-charter-1745>.

Crowdfunding investments can be held in a number of different ways, including directly by investors, or via a nominee that can be structured in various ways. The level of intermediation and responsibility of the platform varies in each situation and is generally subject to the contractual terms between the platform, investor and issuer company, the terms of which should be made clear to investors in advance of making the investment. It would not however be appropriate to specify particular requirements in the event of issuer bankruptcy that could stifle the flexibility of the sector or involve unrealistic legal burdens or liability on crowdfunding platforms. We believe that best practice can be developed by the industry.

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?

Specific, prescriptive information requirements are difficult to define due to the breadth of crowdfunding investment opportunities and such a regulatory requirement would risk non-disclosure of key information to investors. A principles based approach and clear guidance is preferred.

While some European states have looked at introducing a key information document, the UK has not adopted this approach to date. In practice, the industry in the UK has developed its own key information which is quickly required by investors if absent from an investment opportunity. It is therefore unnecessary to introduce specific information requirements provided there are principles of investor protection, including disclosure and the approval of information by regulated platforms.

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?

Where platforms hold client assets a proportionate regime should be in place, recognising that high capital requirements could stifle the Irish crowdfunding industry.

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

If these Regulations are to apply then a compatibility assessment would be required to ensure that the regulations are fit for purpose and proportionate and that the regulations allow passporting into other European territories. Crowdfunding requires regulations that recognise the online, digital nature of transactions and the fact that investment opportunities are widely disseminated which was not always envisaged when legacy rules were drawn up.

The Consumer Code states that it does not apply to regulated firms that are operating a MiFID service. It would therefore not seem appropriate to apply it to any crowdfunding regulations unless a carve out is introduced or the Code is updated to become MiFID compliant. While a more detailed legal analysis is required, the Consumer Code's General Principles and rules offer customer protection which in turn should help to ensure consumer confidence in the new sector. The principles based approach of the Code is an effective means of setting the regulatory framework for crowdfunding platforms. Chapter 7 on advertising appears to offer a balanced framework for regulating the advertisement of equity crowdfunding.

The SME Regulations appear geared towards credit and therefore not applicable to investment based crowdfunding.

In addition to review of these Regulations, other current laws may require review, such as the Companies Act 2014. There should be no restrictions on offering equities to the public where a regulated crowdfunding platform is used (for example, a clear exemption under section 68 Companies Act 2014 for companies raising equity finance via authorised Crowdfunding platforms) as this could stifle the industry in Ireland completely. The Prospectus Regulation offers protection for raises above the prospectus exemption threshold.

The Prospectus exemption threshold should be increased to the maximum allowable level to encourage growth of the crowdfunding sector and giving SMEs the opportunity to raise capital on a cost-effective basis.

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?

Imposing limits on the maximum level of investment that an individual may invest in a 12 month period have the potential to stifle a nascent crowdfunding industry. The limits imposed in the United States under Regulation CF have been widely criticised and serve to stifle the sector. The approach adopted in the UK is more appropriate, helping to position the UK as the leading territory in the world for investment based crowdfunding.

Under the UK rules, sophisticated and HNW individuals do not have a limit on investment while other retail investors are limited to investing 10% of their investible assets. This limit is not imposed on the platforms and it is up to retail investors to monitor their own investments and make a self-declaration before categorising themselves as a retail investor on the crowdfunding platform. This is an appropriate and effective approach. The consultation question is not correct as retail investors are not required to have investment advice in order to use crowdfunding platforms. We do not feel such an approach is appropriate or practical.

The UK approach of having investors demonstrate they understand the risks of investing prior to investment is effective. This requires investors to pass an online appropriateness test hosted by the crowdfunding platform before they confirm an investment.

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?

Regulatory costs should be kept to a minimum to allow the industry to establish itself.

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

Crowdfunding specific regulation may not need to address conflict of interest where there are other existing regulations for financial services firms that already address conflict of interest which would also apply to a regulated crowdfunding platform.

A principle based approach to avoiding conflicts of interest, taking account of disclosure is an effective means of addressing conflicts of interest and avoiding a situation where rules are too narrow or broad.

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

Alongside effective regulation and government support to raise public awareness, investor tax incentives are an important driver for early stage investment. Ireland should put in place tax incentives that mirror the UK's SEIS and EIS schemes.

