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Equity Crowdfunding: All Regulated but Not Equal

Garry A. Gabison*

This Article describes how different countries have approached equity crowdfunding. It focuses on countries or regulatory authorities that either expressed their awareness of the phenomenon but decided to adopt a holding pattern (monitoring and investigating) or new laws and regulations. Countries like Australia have opted to reaffirm how their current set of regulations applies to crowdfunding whereas others like the United States, Italy, the United Kingdom, and France have elected to create new exemptions in an effort to facilitate equity crowdfunding. This Article compares how each country decided to regulate the different participants in the crowdfunding process. While the results of these various efforts are still mostly unseen, this Article takes an early look at the regulatory impact using one U.K. based platform as an example of how regulations can boost investment.

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I. INTRODUCTION

Crowdfunding has spread like wildfire over the last five years.¹ Much of the crowdfunding phenomenon remains concentrated in the U.S. and Europe where the large majority of crowdfunding platforms are found.² However, crowdfunding emerged into a world with existing regulations and confusion still reigns over how the rules should be applied.³ This confusion may impede the development of

1. Crowdsourcing.org has 2,933 sites listed in its directory as of May 4, 2015, up from 452 in April 2012. *Directory of Sites*, CROWDSOURCING.ORG, <http://www.crowdsourcing.org/directory> (last visited May 4, 2015); *Crowdfunding Industry Report: Market Trends, Composition and Crowdfunding Platforms*, CROWDFUNDING.ORG 2 (May 2012), available at <http://www.crowdfund.org.nl/wp-content/uploads/2012/05/92834651-Massolution-abridged-Crowd-Funding-Industry-Report1.pdf> [hereinafter *Crowdfunding Industry Report*]. Massolution reports that the crowdfunding industry has grown worldwide from \$530 million in 2009 to \$2.7 billion in 2012. See Kurt Wagner, *Why Crowdfunding hasn't Caught on in Asia*, FORBES (July 8, 2013, 3:16 PM), <http://fortune.com/2013/07/08/why-crowdfunding-hasnt-caught-on-in-asia/>. Kickstarter reported the website helped raise \$27 million in 2010 to \$480 million in 2013. 2011: *The Stats*, KICKSTARTER BLOG (Jan. 9, 2012), <http://www.kickstarter.com/blog/2011-the-stats>; *The Year in Kickstarter 2013*, KICKSTARTER BLOG, <http://www.kickstarter.com/year/2013> (last visited June 11, 2014) [hereinafter *Kickstarter 2013*].

2. “[Eighty-five percent] of crowdfunding platforms are founded in the USA and Europe, and 15% in the rest of the world with Brazil (20 platforms), Canada (12) and Australia (7) ranking among the highest.” Javier Ramos, *Crowdfunding and the Role of Managers in Ensuring the Sustainability of Crowdfunding Platforms*, JRC SCIENTIFIC AND POLICY REPORTS 17 (2014), available at <http://ftp.jrc.es/EURdoc/JRC85752.pdf>.

3. See *id.* at 25.

crowdfunding⁴ and may have threatened to temper the benefits of this new financial tool.⁵

While crowdfunding comes in four varieties (donation,⁶ reward,⁷ lending,⁸ and equity crowdfunding), this Article focuses on equity

4. *Id.*

5. Crowdfunding offers an alternative method of funding for Small and Medium-Sized Enterprises (SME) and startups. In *The Venture Crowd*, Liam Collins and Yannis Pierrakis argue that crowdfunding can not only help find the “financing gap” that SMEs experience but can also help finance startups that present returns too low to attract venture capitalist but risk too high for bank loans. See Liam Collins & Yannis Pierrakis, *The Venture Crowd: Crowdfunding Equity Investment into Business*, NESTA 17 (July 2012), available at http://www.nesta.org.uk/sites/default/files/the_venture_crowd.pdf.

6. Contributors to *donation based crowdfunding* campaigns do not receive anything for their contributions. C. Steven Bradford, *Crowdfunding and the Federal Securities Laws*, 2012 COLUM. BUS. L. REV. 1, 15 (2012). Donation based crowdfunding campaigns are also referred as *philanthropic* campaign when they raise for not-for-profit campaigns and *sponsorship* campaigns if contributors receive publicity in exchange for their participation. See, e.g., Crowdfunding, CROWDSOURCING.ORG, <http://www.crowdsourcing.org/community/crowdfunding/7> (last visited June 20, 2014). For instance, the Germany-based website FriendFund is a donation based platform that was funded in 2010 and allow campaigners to collect money for anything from their friends or the broader crowd. FRIENDFUND, <http://www.friendfund.com/> (last visited June 20, 2014). The contributors can receive tax deduction for their participation depending on the nature and the project setup. Daniel M. Satorius & Stu Pollard, *Crowd Funding, What Independent Producers Should Know about the Legal Pitfalls*, 28 ENT. & SPORTS L. 15, 17 (2010). In *Crowdfunding of Small Entrepreneurial Ventures*, Armin Schwiembacher and Benjamin Larralde argue that “not-for-organisations tend to be more successful in achieving their fundraising targets as compared to for-profit organizations and project-based initiatives,” possibly because not-for-profit put more emphasis on quality and less on profit making. Armin Schwiembacher & Benjamin Larralde, *Crowdfunding of Small Entrepreneurial Ventures*, THE OXFORD HANDBOOK OF ENTREPRENEURIAL FINANCE 378 (Douglas Cumming, ed. 2012).

7. Contributors to a *reward based* crowdfunding campaign receive some good or service in exchange for their contributions. For instance, the France-based website Ulule is a reward based platform whose participants receive the rewards as described by the project owner. FAQ, ULULE.COM, <http://www.ulule.com/about/faq/#presenting-your-project> (last visited June 20, 2014). *Reward based* crowdfunding is a form of pre-selling. As such, reward based crowdfunding has not been regulated to the extent lending and equity-based campaign often have. One project, the Polar Pen + Stylus, successfully financed in October 2014, involving magnets, raised concerns about the product safety. *Polar Pen – Modular Tool*, KICKSTARTER.COM (Oct. 16, 2013), <https://www.kickstarter.com/projects/1171695627/polar-pen-both-tool-and-toy-pen-stylus-made-from-m>. However, one consumer group, Consumers Union Policy & Action from Consumer Reports raised this concern with the U.S. Consumer Product Safety Commission. *Comments of Consumers Union to the U.S. Consumer Product Safety Commission on “Safety Standard for Magnet Sets, Notice of Proposed Rulemaking”*, CONSUMERSUNION (Oct. 22, 2013), available at <http://www.cpsc.gov/PageFiles/154051/MagnetsCPSCHearingCommentsOctober2013.pdf>. Health Canada, the Canadian Consumer Protection agency, quashed the product for safety reasons. Steve Merti, *Health Canada quashes Polar Pen because of Magnet Threat*, *Entrepreneur* out \$100k, YAHOO! NEWS CANADA (Nov. 19, 2013), <http://ca.news.yahoo.com/blogs/dailybrew/health-canada-quashes-polar-pen-because-magnet-threat-211825720.html>.

8. Contributors to a *lending based* crowdfunding campaign receive interest payments in exchange for financing a project. Lending based crowdfunding is a form of micro-lending, where contributors can select a project with an associated rate of return and maturation date. Bradford, *supra* note 6, at 19-21. For instance, the United Kingdom-based website Funding Circle is a

crowdfunding. The Security Exchange Commission (“SEC”) defines crowdfunding as “a new and evolving method to raise money using the Internet.”⁹ For the purpose of this Article, equity crowdfunding is a limited Initial Public Offering (“IPO”) conducted via an internet intermediary, often called a funding portal, and during this internet-based IPO, companies seeking funds give campaign contributors stakes into their ventures – in the form of shares – in exchange for contributions.

Securities trading and IPO in particular involve a lot of risks.¹⁰ Thus, IPOs are heavily regulated. Faced with these new types of IPO, some countries choose one of three positions: ignore this phenomenon and retrofit the applicable existing regulations; reaffirm which regulations apply; or create new regulations to deal with crowdfunding.

This Article looks at the last two positions. After briefly describing the process of equity crowdfunding in Part II, this Article looks at the European Union, a confederation of countries, and the Commonwealth of Australia, a country in Part III. Both entities opted to keep and explicitly enumerate the laws and regulations that govern equity crowdfunding. Then, Part IV of this Article looks at the United States, Italy, the United Kingdom and France. These countries elected to pass new regulations to offer more financial option to startups and investors. Finally, Part V this Article compares these different approaches and these different regulations. It uses the example of CrowdCube, a U.K. based equity crowdfunding platform, to show the impact that regulation has had on investment and investors.

II. AN OVERVIEW OF CROWDFUNDING

Crowdfunding involves three participants: the *crowd* (or *contributors*); a *crowdfunding platform*; and the *crowdfunding campaign creator*. This Part focuses on these actors investing in crowdfunding

lending based platform where people lend directly to small British businesses: the contributors get higher returns than in traditional saving accounts and business owners get funds at lower cost. *Rates & Fees*, FUNDING CIRCLE, https://www.fundingcircle.com/us/rates_and_fees (last visited June 20, 2014).

9. Crowdfunding, 78 Fed Reg. 66,428 (proposed Nov. 5, 2013) (to be codified at 17 C.F.R. pts. 200, 227, 232, 239, 240 & 249).

10. Edmund W. Kitch compares investing in securities regulation to gambling and calls for government to become consistent about its regulations by providing that if governments are fine with citizen “gambling, does it make sense to try to prevent them from investing . . . and assuming the risk that their investment is an unprofitable one? Application of the securities acts needs to adapt to modern technologies and contemporary views.” Edmund W. Kitch, *Crowdfunding and an Innovator’s Access to Capital*, 21 GEO. MASON L. REV. 887, 889 (2014).

platforms, crowdfunding campaigns, and the contributing crowd in that order.

A. Crowdfunding Platforms

As previously discussed, four types of crowdfunding exist. Platforms supporting all four types exist in Europe¹¹ but equity based crowdfunding has yet to appear in the United States.¹² Donations remain the predominant source of crowdfunding fundraising.¹³ However, the distribution of platform types is changing¹⁴ and may change even faster now that when new regulations facilitating equity-based crowdfunding are in (and are coming into) play.

Questions have been raised about the usefulness of intermediary platforms because about 75% of contributions come from the campaigner's family and friends.¹⁵ However, using a platform serves many purposes. First, platforms facilitate asking friends and family

11. An example of donation-based platforms is the 1%Club in the Netherlands. Examples of reward-based platforms are Verkami in Spain, Crowdculture in Sweden, ZEQUUS in the United Kingdom. Examples of lending-based platforms are LeihDeinerStadtGeld in Germany or Zopa in the United Kingdom. Examples of equity-based platforms are Symbid in the Netherlands and Socioinversores in Spain.

12. The U.S. has examples of donation (GoFundMe), reward (Kickstarter), and lending (LendingClub) crowdfunding platforms. Equity crowdfunding platforms also exist in the U.S. (e.g., EquityNet). They, however, work along a model that is more akin to angel networks.

13. Forty-nine percent of the \$575 million raised in 2011 came from donations campaigns, 11% of funds came through reward-based campaigns, 22% of funds came through lending-based campaigns, and 18% came through equity-based campaigns. Suw Charman-Anderson, *Crowdfunding Raised \$1.5bn in 2011, Set To Double In 2012*, FORBES (May 11, 2012, 11:20 AM), <http://www.forbes.com/sites/suwcharmananderson/2012/05/11/crowdfunding-raised-1-5bn-in-2011-set-to-double-in-2012/>.

14. In 2011, the number of platforms supporting donation campaigns grew only by 41%, while the number of platform supporting reward-based campaign grew by 79%. Crowdfunding Industry Report, *supra* note 1, at 17. The number for lending-based campaigns grew by 50% and platforms supporting equity-based campaigns grew by 114%. *Id.*

15. See Renée Ridgway, *Crowdfunding or Funding the Crowds: A New Model for the Distribution of Wealth?*, A PEER-REVIEWED JOURNAL ABOUT (2013), http://www.aprja.net/?page_id=46. One study finds a correlation between the extent of the campaign creator's network and the likelihood of reaching his/her target: "To take an average project in the Film category, a founder with 10 Facebook friends would have a 9% chance of succeeding, one with 100 friends would have a 20% chance of success, and one with 1000 friends would have a 40% chance of success." Ethan Mollick, *The Dynamics of Crowdfunding: An Exploratory Study*, 29 J. BUS. VENTURING 1, 8 (2014). Interviews conducted on behalf of JRC-IPTS confirm these findings. See generally Anne Green et al., *CrowdEmploy Crowdsourcing Case Studies: An Empirical Investigation into the Impact of Crowdsourcing on Employability*, JRC TECHNICAL REPORTS 49 (2013), available at <http://ftp.jrc.es/EURdoc/JRC85751.pdf>. Kickstarter published that of its 2.2 million people who backed projects in 2012, only 570,672 backed two or more. *The Best of 2012 - Repeat Backers*, KICKSTARTER, https://www.kickstarter.com/year/2012#repeat_backers (last visited June 14, 2012) [hereinafter *Best of 2012*]. In 2013, Kickstart had 3 million people pledge, of which "807,733 backed more than one project." Kickstarter 2013, *supra* note 1. Hence about 74% of backers back only one project in 2012 and 71% in 2013. *Id.*

for money because they remove some of the stigma associated with these requests.¹⁶

Second, the use of a platform sends a signal. Platforms lend legitimacy to the projects because these platforms check a campaigner's information and projects, and they have various other anti-fraud procedures.¹⁷

Third, public platforms reassure contributors because they allow them to observe how many other individuals believe in the project (as well as the identity of these individuals¹⁸). Platforms also play a role in preventing fraud or investment in projects bound to fail. Most platforms use the *all-or-nothing* model,¹⁹ which requires a critical mass to believe in the project before it is funded.²⁰ They only divest the funds collected to the campaign creator only if the target is reached.²¹

16. See Green et al., *supra* note 15, at 43 (finding that one interviewee "suggested that for some smaller projects 'it might be a nicer way to ask friends and family to support you.'").

17. See Ramos, *supra* note 2, at 20, 46. Blakley C. Davis and Justin W. Webb argue that the "relationships with underwriters and/or strategic alliances with established firms can also reduce the liabilities stemming from newness by enabling the venture to essentially borrow legitimacy from the external party." Blakley C. Davis & Justin W. Webb, *Crowd-Funding of Entrepreneurial Ventures: Getting the Right Combination of Signals*, 32 FRONTIERS OF ENTREPRENEURSHIP RESEARCH 1, 5 (2012).

18. If potential contributors can see who donates and see that individuals who know the campaign creator are contributing as well, they may be further encouraged to participate.

19. All-or-nothing means "that the project must be fully funded and reach its fundraising goals within a specified timeframe in order for any money to change hands." Lisa T. Alexander, *Cyberfinancing for Economic Justice*, 4 WM. & MARY BUS. L. REV. 309, 354 (2013).

20. This model assures that a critical mass of contributors believes in the project and the project passed the "*wisdom of the crowd*" sniff test. "[T]he 'wisdom of the crowd' argument states that a crowd can at times be more efficient than individuals or teams in solving corporate problems. Hence crowdfunding as a crowd would be more efficient than a few equity investors alone." Schvienbacher & Larralde, *supra* note 6, at 380. In other words, while one person may be mistaken, the crowd will, on average, be correct.

21. Ricardo Martínez-Cañas, Pablo Ruiz-Palomino, & Raúl del Pozo-Rubio, *Crowdfunding And Social Networks In The Music Industry: Implications For Entrepreneurship*, 11 INT'L BUS. & ECON. RES. J. 1471, 1472 (2012). See also Mollick, *supra* note 15, at 6, for a discussion regarding how Kickstarter puts in place checks to avoid individual self-funding the difference between the fund raised and the funds needed to trigger the divestment of the funds. Some donation-based crowdfunding platforms also use a *keep-it-all* model, where the platform divest the funds collected regardless of whether the target has been reached. See, e.g., *Fees & Pricing*, INDIEGOGO, <https://support.indiegogo.com/hc/en-us/articles/204456408-Fees-Pricing> (last visited June 24, 2014). For instance, Indiegogo affords either a fixed funding (*all-or-nothing*) or (*keep-it-all*) and demands 4% fee for the former and 9% for the latter. *Id.* One platform follows the bounty model (Bountysource), where this platform divests the funds raised to the individual from the crowd who completes the open-source software project posted by the campaign creator; the contributors get a copy of the software as well. *Frequently Asked Questions*, GITHUB (Feb. 18, 2015), <https://github.com/bountysource/frontend/wiki/Frequently-Asked-Questions>.

Finally, platforms give creators a place to publicize their projects,²² and allow them to send signals about the quality of their project,²³ to receive feedback,²⁴ and to reach a broader network.²⁵ Platforms collect a fee for their services.²⁶

Many platforms offer different kind of services under the heading equity crowdfunding. They usually cover facilitating the sale of direct equity,²⁷ offering securities in an intermediate vehicle (usually a holding company),²⁸ and offering profit-sharing contracts.²⁹ While these

22. Mollick, *supra* note 15, tested whether featuring on the platform's homepage impacted the likelihood of success and found that being featured has a positive and statistically significant effect on the likelihood of success. *Id.* at 9. "Advertising and generating publicity were seen as important resources provided by the platform." Green et al., *supra* note 15, at 47. However, the interviewees affirmed that most of the campaign creators were the one doing their own advertising; platforms gave them a place to direct interested people. "An unsuccessful campaign does not necessarily mean negative publicity if the exercise is managed well and in a way that highlights the entrepreneurship involved in putting together a project and that fundraisers have considered the risks." *Id.* at 54.

23. See, e.g., Mollick, *supra* note 15, at 8 (providing campaign organizers can signal about the quality of their project by including a video and answering questions, which both influence the success of the campaign). See generally Davis & Webb, *supra* note 17 (discussing the effectiveness of the various mechanisms through which entrepreneurs signal the quality of their ventures to attract investment). See Paul Belleflamme, Thomas Lambert & Armin Schwienbacher, *Crowdfunding: Tapping the Right Crowd*, 29 J. BUS. VENTURING 600 (2013), for a discussion on how sending the appropriate signal about the product quality will help the campaign as well.

24. "Most people use crowdfunding for raising money (90%), or to get public attention (85%) and obtain feedback for their product and services (60%)." Ramos, *supra* note 1, at 20 (internal quotations omitted).

25. *Best of 2012*, *supra* note 15, suggests 25% of contributors on Kickstarter back multiple projects and hence constitute a network of backers. "Success depends on word of mouth and relies on patrons to make that happen. Patrons are expected to publicise and recommend the project via email, Facebook, Twitter, etc." Ramos, *supra* note 1, at 37 (internal quotations omitted).

26. Some platforms charge a percentage of the amount raised, while others charge a flat fee. For instance, "[i]f a project reaches its funding target," PleasedFund.us charges "a flat fee of five per cent of the money raised." Green et al., *supra* note 15, at 39. Whereas RateSetter charges borrowers a "£115 flat fee for a three-year loan; £5 monthly charge in the rolling market." Emma Simon, *Peer-to-Peer Lenders: Zopa's Rivals Compared*, THE TELEGRAPH (Mar. 9, 2014, 6:30 AM), <http://www.telegraph.co.uk/finance/personalfinance/savings/8369316/Peer-to-peer-lenders-Zopas-rivals-compared.html>.

27. For instance, EquityNet is a crowdfunding platform that operates as an intermediary: "How do investment transactions happen? EquityNet does not handle transactions. When an investor wants to invest in an EquityNet company, they will message the entrepreneur and schedule a time to discuss the investment. The investment will happen outside of EquityNet." *Frequently Asked Questions*, EQUITYNET, <https://www.equitynet.com/faqs.aspx> (last visited Sept. 8, 2014).

28. Seedrs in the U.K., Symbid in the Netherlands, and MyMicroInvest in Belgium offer such intermediary services. For instance, Symbid, a major equity-based crowdfunding platform, organizes the investors of a successful crowdfunding investment round into a single purpose vehicle (which it calls an 'Investor Cooperative'). The investor syndicate will be heard as a group and stand behind one powerful vote representing the entire amount of the equity offered in the fundraising campaign; in other words, the whole investor syndicate gets one vote. This ensures

services are valuable, the discussion of equity crowdfunding in this Article refers to the traditional emission of direct equity shares (common shares) with or without voting rights.

B. *Crowdfunding Campaigns and Fund Seekers*

The campaign creators must strategize about their crowdfunding campaign. The strategy can be divided into three phases: before, during, and after the campaign.

Before the campaign, the campaigner must decide how much to raise money through the *equity-based* campaign and select the appropriate thresholds. The thresholds can be the keystone to a campaign: if a campaigner asks for too little, his company may lack the funds it needs later; if a campaigner asks for too much, the campaign may fail to reach the threshold.³⁰ A campaigner must also select the duration of the campaign³¹ and select a share scheme (i.e. types of shares emitted, the price of the shares, and the level of capitalization).³² A campaigner must decide whether the project can be overfunded³³ and be wary of giving away too much of the company's own capitalization.³⁴

that the investors' voices are heard, but it also keeps the business attractive to future rounds of financing, which is the key to investors' ultimate goal of liquidity. Gregory D. Deschler, *Wisdom of the Intermediary Crowd: What the Proposed Rules Mean for Ambitious Crowdfunding Intermediaries*, 58 ST. LOUIS L.J. 1145, 1186-87 (2014).

29. Companisto and Seedmatch in Germany follow a subordinated debt model. Since 2012, Seedmatch offers subordinated loans, which are debt instruments that eventually expire, which results in a Bonus Interest. See *FAQ*, SEEDMATCH, <https://www.seedmatch.de/faq> (last visited Sept. 15, 2014).

30. Ramos, *supra* note 2, at 22. An analysis of projects in Role Playing Game sector concludes that successful projects "not only raised 679% more than the unsuccessful projects (\$8251.31 for \$1058.88) but also raised 230% more than the initial goal, (i.e. projects aiming to raise smaller amounts of money were more successful in reaching their threshold)." *Id.*

31. Mollick, *supra* note 15, at 2 (finding that the length of the fundraising period has a statistically significant negative impact upon the likelihood of success of a reaching the threshold). A long period may send a negative signal with regard to the campaigner's confidence in reaching the threshold. *Id.* at 8. A short period may not allow enough time to reach the threshold. See *id.* at 13.

32. "[O]ne of the first stages in the crowdfunding process requires setting a valuation for the company so the entrepreneurs can decide how much equity to offer for the amount of capital they are seeking to raise." Collins & Pierrakis, *supra* note 5, at 23. See *id.* for a discussion regarding the challenges of pricing shares accurately and how some platforms opt for a "market-driven approach to setting valuation."

33. Mollick, *supra* note 15, at 13. Overfunding has a number of drawbacks including delays herding of funds discussed *infra* and specifically over-funded projects tend to have more delayed delivery of rewards for rewards of reward-based crowdfunding. *Id.* at 13.

34. For instance, CrowdCube specifies that the campaign designer has "the option [to] 'overfund' . . . where entrepreneurs can raise more money for their business in exchange for releasing more equity." *FAQs: What is Overfunding*, CROWDCUBE, <http://www.crowdcube.com/pg/crowdcube-faq-20> (last visited June 24, 2014). If a project is overfunded, the extra capitalisation is drawn from the campaigner's shares because the number of total shares cannot legally

The campaign creator must also select the platform.³⁵ This choice endogenously affects other decisions all of which can impact the success of the campaign.³⁶ The campaigner must finalize the design the campaign material,³⁷ which involves a delicate balance about the amount of information to disclose.³⁸

During the campaign, the fundraiser must keep working to reach his goal. Even though “[a]dvertising and generating publicity were seen as important resources provided by the platform,” the fundraiser must further advertise the campaign.³⁹ The fundraiser must reach out to his or her friends, family, and other social networks because relying solely on the platform’s network may not attract enough interest.⁴⁰ The fundraiser must be active in publicizing his project⁴¹ and must also answer questions from the crowd:⁴² in fact his or her continuous involvement impacts whether a campaign succeeds.⁴³

After the campaign, the fundraiser must continue to be responsive to the company’s investors and even reach out to them. “In seeking opportunities, investors may be looking for a business in which to invest without being directly involved, or they may be looking for a business in which they can participate more actively.”⁴⁴ The fundraiser can also benefit from investor participating because, unlike a traditional IPO, campaigners know the identity of their investors and they

change without reviewing the business charter and without trigger some dilution of capital. See *FAQs*, SEEDRS, <http://learn.seedrs.com/faqs/#what-is-overfunding-of-campaigns> (last visited June 24, 2014).

35. Platforms usually have varying models. For instance, some platforms allow for “upward flexibility” and allow an increase in the number of equity offered. See, e.g., SEEDRS, *supra* note 34.

36. See Ajay Agrawal, Christian Catalini & Avi Goldfarb, *Some Simple Economics of Crowdfunding*, 14 *INNOVATION POL’Y ECON.* 63 (2014), for a discussion detailing how different reward-based campaign decisions impact the success of campaigns.

37. See generally Mollick, *supra* note 15, for a discussion regarding the impact and the signal sent by a well-designed campaign.

38. Equity campaigners may face some information asymmetry issues with potential investors (the crowd, banks, or venture capitalist) because they understand the value of their project better than outsiders. To overcome these issues, they must disclose enough information to obtain funds from the crowd, they but may fear that disclosing too much information can detrimentally impact the value of their project. A public forum like a crowdfunding website may deter fund seekers because these kinds of forums do not lend themselves to non-disclosure agreements.

39. Green et al., *supra* note 15, at 47.

40. See *id.* at 48-49.

41. *Id.*

42. *Id.* at 50.

43. See Mollick, *supra* note 15, at 8.

44. Green et al., *supra* note 15, at 64.

may contact investors willing to share their experience and expertise.⁴⁵

After the campaign, the funds raised may remain insufficient for the fund seeker to complete his project.⁴⁶ However, a successful campaigner may use the campaign as a signal of the interest – similar to a market study – when presenting projects to seek further funds from traditional financiers like banks or venture capitalists.⁴⁷

All these choices can overwhelm entrepreneurs and deter others.⁴⁸ However, platforms have a strong incentive to help fund seekers navigate through this maze and succeed. The next section looks at the last participant in crowdfunding campaign, the investors to get a full understanding of the issues involved.

C. *The Investing Crowd: Thread with Care*

The crowd or investors participate in equity crowdfunding because they gain access to new investment opportunities, they can feel part of a bigger community, and they can network with other co-investors.⁴⁹ Investors may also participate because they can invest in not-for-profit projects and the equity invested may be written off as philanthropic donations.⁵⁰ While contributors can invest because of non-financial reasons, the majority expect to break even.⁵¹

45. Schwienbacher & Larralde, *supra* note 6, at 17 (providing a case study on *Media No Mad* (Benoot.com) and finding that “[i]n the case, investors had very diverse skills, all more or less related to the project. Therefore, letting investors have their say has to be considered as an asset rather than a liability.”).

46. Ethan Mollick & Venkat Kuppaswamy, *After the Campaign: Outcomes of Crowdfunding* 12 (Working Paper, Jan. 9, 2014) (finding that over 20% of successful crowdfunding campaigns were followed by fundraising from outside sources – from a sample of 230 Kickstarter projects), available at http://papers.ssrn.com/sol3/Papers.cfm?abstract_id=2376997. For instance, Oculus VR raised \$250,000 through Kickstarter in 2012, then obtained \$90 million from venture capitalists by 2014, and is about to be acquired by Facebook for \$2 billion. Victor Luckerson, *When Crowdfunding Goes Corporate: Kickstarter Backers Vent Over Facebook’s Oculus Buy*, *TIME* (Mar. 26, 2014), <http://time.com/39271/oculus-facebook-kickstarter-backlash/>.

47. The fundraiser can use the success of his or her crowdfunding campaign as a market study and demand estimation when he or she attempts to obtain a traditional form of financing. See Agrawal et al., *supra* note 36, at 76. Pebble, which started as a reward based crowdfunding campaign (\$10 million raised), used the crowdfunding success to obtain traditional loans (\$15 million raised). *Id.* at 63-64, 68.

48. See Green et al., *supra* note 15, at 39-73, for a complete understanding of the choices involved before and during the campaign.

49. See, e.g., Agrawal et al., *supra* note 36, 73-74; Schwienbacher & Larralde, *supra* note 6, at 18.

50. Daniel M. Satorius & Stu Pollard, *Crowd Funding: What Independent Producers Should Know About the Legal Pitfalls*, 28 *ENT. & SPORTS L.* 15 (2010) (providing that crowdfunding campaigns may be set up as not-for-profits and grant contributors some tax reliefs).

51. “For most of [investors in *Media No Mad*], the concept of investing in a company in order to make a later profit by reselling the shares was not the most important reason for investing.

Fraud, incompetence, and lack of exit strategies jeopardize equity crowdfunding. Fraud constitutes the biggest threat to crowdfunding⁵² because traditional reputational and legal enforcement methods may not work. First, fear of getting a bad reputation may not be sufficient incentive: traditional anti-fraud methods like negative reputation or goodwill may fail for crowdfunding because the Internet provides anonymity and because fund seekers do not repeatedly fundraise.⁵³

Second, legal enforcement may also fail because each individual investor, who makes small investments, does not have enough individual incentive to sue for fraud or breach of contract.⁵⁴ Fraud, however, remains rare.⁵⁵

Investors are also exposed to entrepreneurs who may be incompetent or may have miss-calibrated their projects; but this also seems rare.⁵⁶ Hence, crowdfunding may not attract only lemons but instead may attract investments that professional investors do not fancy.⁵⁷ In-

Indeed, when asked if they were expecting to make high profits from the deal, 78% answer that they are not planning to earn from it neither do they want to make a loss.” Schwienbacher & Larralde, *supra* note 6, at 16.

52. See Crowdfunding Proposed Rules, Securities Act Release No. 9470, Exchange Act Release No. 70741, 78 Fed. Re. 66,427 (proposed Oct. 23, 2013) [hereinafter SEC Rule Interpretation]; see also Collins & Pierrakis, *supra* note 5, at 24; Ramos, *supra* note 1, at 23.

53. Ross S. Weinstein, *Crowdfunding in the U.S. and Abroad: What to Expect When You're Expecting*, 46 CORNELL INT'L L.J. 427, 436-37 (2013). While fund seekers may not be repeat players, platforms are. To succeed, these platforms have incentive to avoid a reputation as a bad market place, to avoid attracting fraudulent schemes and to perform a due diligence for each project and continue to do so throughout the campaign. For instance, Kickstarter cancelled a crowdfunding campaign that showed potential signs of fraud during the campaign, after 80% of the threshold was already reached. Anton Root, *Kickstarter Pulls Plug on the Rock Smartwatch after Backer Concerns*, CROWDSOURCING.ORG (Dec. 11, 2013, 10:31 PM), <http://www.crowdsourcing.org/editorial/kickstarter-pulls-plug-on-the-rock-smartwatch-after-backer-concerns/29644>.

Platforms may associate with banks that have experience evaluating fraudulent projects. For instance, Symbid, a Dutch equity-based crowdfunding platform, “has an EU banking licence, through its finance partner Intersoft.” Ramos, *supra* note 2, at 30. This association gives the platform access to the experience of evaluating projects. Platforms can also stagger the fund release to limit the size of the funds affected. See Collins & Pierrakis, *supra* note 5, at 24. For instance, some experts recommend the use of escrow account and other disclosure requirements involving disclosing a detailed business plan and ownership. David Röhler & Karsten Wenzlaff, *Crowdfunding Schemes in Europe*, EUROPEAN EXPERT NETWORK ON CULTURE (EENC) 23 (Sept. 2011). See Ramos, *supra* note 1, at 46, for a discussion of the role that platform managers can play to prevent fraud.

54. Crowdfunding relies on small investments from many investors instead of large investment from a few investors. These small amounts may not provide each individual investor with enough incentive to sue to enforce their rights.

55. In a sample of 381 Kickstarter products, 3 issued refunds and 11 stopped responding to backers: 3.6% of the projects were incomplete. Mollick, *supra* note 15, at 11.

56. *Id.* Mollick does not distinguish between fraudulent project and incompetent entrepreneurs, but the risks remain minimal when looking at reward-based crowdfunding projects. *Id.*

57. A study found that 15.8% of reward crowdfunding campaigners sought prior funds from family and friends and 14.6% sought prior funds from external companies. See Ethan Mollick &

vestors may be willing to invest despite fraud or incompetence risks because they invest small amounts and can diversify their investment.⁵⁸

Finally, some investors (e.g., venture capitalist funds) need an exit strategy before investing because they prefer to profit by selling their investments instead of waiting for dividends to arrive.⁵⁹ Hence, they must either sell their shares back to the entrepreneur or to other investors.⁶⁰ In either case, an investor may struggle to know whether the valuation is correct⁶¹ without traditional market mechanisms.⁶² The slow development of a *secondary market*⁶³ also slows the development of the primary market;⁶⁴ hence, crowdfunding may undesirably lock in investors.

Crowdfunding has large upsides but it also has some downsides. The following Parts discuss how policymakers in various countries and federations decided to mitigate some of these downsides without negatively affecting the upsides.

III. GOVERNMENTS ARE PAYING ATTENTION TO CROWDFUNDING

This Part discusses two different types of entities: a country (Australia) and a confederation of countries (the European Union). Australia's regulating agency published a guidance (akin to a press release) about equity crowdfunding in 2012. Similarly, the European Commission released a public communication touching upon some of the same points in 2014. These two entities exemplify the intricacies of

Venkat Kuppaswamy, *When Firms are Potemkin Villages: Entrepreneurs and Formal Organization*, Table 1 (Working Paper, Jan. 25, 2014). This suggests, amongst other things, that reward-based crowdfunding can complement other form of traditional financing.

58. Rational economic theory should dictate that investors implicitly add these risks to their valuation of any project.

59. ANDREW METRICK & AYAKO YASUDA, *VENTURE CAPITAL & THE FINANCE OF INNOVATION* (2d ed. 2011) (discussing the necessity of an exit strategy for venture capitalist to invest and multiply their investment).

60. Ahlers et al., *infra* note 102, at 3 (a study of 104 equity crowdfunding projects in Australia finding "that start-ups that signal their intention to seek an exit by either IPO or a trade sale are more likely to attract investors than those planning to use other forms of exit.").

61. See SEC Rule Interpretation, *supra* note 52, at 66,457.

62. A wide literature discusses how venture capitalists evaluate startups. See, e.g., Tarek Miloud, Arild Aspelund, & Mathieu Cabrol, *Startup Valuation by Venture Capitalists: An Empirical Study*, 14 *VENTURE CAPITAL* 151-174 (2012); Joern H. Block, Geertjan De Vries, Jan H. Schumann & Philipp Sandner, *Trademarks and Venture Capital Valuation*, 29 *J. BUS. VENTURING* 525-542 (2014).

63. See, e.g., Agrawal et al., *supra* note 36, at 76, 78.

64. See, e.g., Collins et al., *supra* note 5, at 30; SEC Rule Interpretation, *supra* note 52, at 66,459.

implementing an equity crowdfunding campaign in the current regulatory climate.

Equity crowdfunding involve three actors: the crowdfunding platforms, the fundraising companies, and the investing crowd. Numerous regulations already exist and affect these actors. Individual subsections address each regulated actor.

A. *New Regulations Are Not Necessary But Clarifications May Be: The Case of Australia from 2012 to 2014*

This section investigates crowdfunding in Australia. In 2012, Australia decided to clarify the applicable regulations but did not add any new exemption to accommodate equity crowdfunding. Instead, Australia issued “guidance” on crowdfunding.⁶⁵

In this guidance, the Australian Securities and Investment Commission (“ASIC”) affirmed that crowdfunding that “involve[s] offering or advertising a financial product, providing a financial service or fundraising through securities requiring a complying disclosure document”⁶⁶ are regulated activities under the Corporations Act of 2001⁶⁷ and the ASIC Act.⁶⁸

The ASIC Guidance articulates how platforms, companies, and investors are regulated. Crowdfunding platforms must obtain “Australian financial services licence[s]” which are granted by ASIC.⁶⁹ As part of its obligations, the holder of a license must ensure that the financial services are provided “efficiently, honestly and fairly”⁷⁰ to promote consumer confidence while reducing risks and fraud.⁷¹ Holding intermediaries – like platforms and their agents – accountable helps perpetuate these goals.⁷² Promoting offerings, including having a public webpage (because they constitute “publications”), is gov-

65. Australian Securities & Investments Commission, ASIC Guidance on Crowd Funding, 12-196MR, 14 August 2012, available at <http://asic.gov.au/about-asic/media-centre/find-a-media-release/2012-releases/12-196mr-asic-guidance-on-crowd-funding/> [hereinafter ASIC Guidance].

66. *Id.*

67. *Corporations Act 2001* (Cth) s 761G (Austl.).

68. *Australian Securities and Investments Commission Act 2001* (Cth) s 12BC.

69. ASIC Guidance, *supra* note 65; see also *Corporations Act 2001* (Cth) pt 7.6, ss 910A – 917F.

70. *Id.* s 912A(1)(a).

71. Gail Pearson, *Risk and the Consumer in Australian Financial Services Reform*, 28 SYDNEY L. REV. 99, 117 (2006).

72. If they failed to fulfill their obligations, they may lose their license. See *Corporations Act 2001* (Cth) ss 914A – 915J. Acting without a license involves fines and/or imprisonment. ASIC Guidance, *supra* note 65.

erned by the ASIC Class Order 02/273 on Business Introduction or Matching Services.⁷³

Intermediaries like platforms may not have to comply with the licensing requirements if they take advantage of an exemption for offerings and to the licensing requirement. For example, platforms dealing with offering of not more than AUS \$5 million (\$4.5 million)⁷⁴ for any one business are exempt of the licensing requirement.⁷⁵ This exemption also requires that the intermediary does not have stakes in the company conducting the offering and that the publication contains information about the issuer (and the intermediary), the risks, and “statements appropriate for the particular medium.”⁷⁶ Platforms must be wary of these licensing requirements but may find ways to avoid them.

Companies fundraising through equity shares usually need to produce disclosure documents – which generally take the form of a prospectus – under the Product Disclosure Statement.⁷⁷ The Product Disclosure Statement requires that disclosure documents be timely, relevant and complete, promote product understanding, product comparison, highlight important information, and have regards to consumers’ needs.⁷⁸ In other words, the prospectus must contain information about the issuer of the equity shares, the rights and benefits accompanying these shares, the circumstance/time those rights and benefits occur, the risks associated with these shares, the costs, the return, the commission, taxation implications, dispute resolution system, and, in general, any other information that might influence an investor’s decision to acquire the shares – including audited financial statements lodged with ASIC.⁷⁹

73. ASIC Class Order 02/273 (Business Introduction or Matching Services) (May 3, 2002), available at <http://www.australiansecurities.net/docs/co02-273.pdf> [hereinafter ASIC Class Order 02/273].

74. Converting this value and other values in Australian Dollars in the rest of this paper using the Federal Reserve Board exchange rate data on December 31, 2013 (\$0.8929 to AU \$1). Board of Governors of the Federal Reserve System, *Historical Rates for the Australian Dollar*, FEDERALRESERVE.GOV, http://www.federalreserve.gov/releases/h10/hist/dat00_al.htm (last visited Aug. 18, 2014).

75. ASIC Class Order 02/273, *supra* note 73, at First Exemption s 3(h).

76. *Id.* First Exemption s 3(b). The guidance also envisages that platforms perform the function of managing the investment scheme (such as venture capitalist funds) or providing financial advice services. ASIC Guidance, *supra* note 65. These roles are discussed in more details when looking at the European Directives *infra* – but platforms usually do not perform these functions.

77. *Corporations Act 2001* (Cth) ss 706 – 707; ASIC Guidance, *supra* note 65.

78. Australian Securities and Investment Commission, Regulatory Guide 168: Disclosure: Product Disclosure Statements (and other disclosure obligations), 17-25 (Oct. 2011), available at <http://download.asic.gov.au/media/1240931/rg168-published-28-october-2011.pdf>.

79. *Corporations Act 2001* (Cth) ch 7, pt 7.9, div 2, sub-div C, ss 1013C – 1013H.

The company seeking funds must produce one of the following three documents: the required prospectus,⁸⁰ offer information statement,⁸¹ and profile statement.⁸² First, filing the required prospectus involves a comprehensive and standard full disclosure documentation, which contains enough information, including audited statements, etc., for investors to be able to make an educated investment.⁸³ Second, an offer information statement is an alternative to the prospectus requirement. It has lower disclosure requirements but requires an at-most six-month-old audited financial report.⁸⁴ This statement can be used to raise AUS \$10 million (\$8.9 million)⁸⁵ that can be aggregated over multiple fundraising events.⁸⁶ Finally, a profile statement would be much shorter,⁸⁷ but ASIC currently does not have an approved use for a profile statement.⁸⁸ A prospectus or even an offer information statement can be quite expensive because they involve audited documents.

To avoid these expensive disclosure requirements and having to file with ASIC, fundraising companies can take advantage of an exemp-

80. The Corporations Act section 705 explains the three different documents. For prospectus: “[t]he standard full-disclosure document”; or short form prospectus: “[m]ay be used for any offer. Section 712 allows a prospectus to refer to material lodged with ASIC instead of setting it out. Investors are entitled to a copy of this material if they ask for it.” *Id.*

81. *Id.* (offer information statement: “Section 709 allows an offer information statement to be used instead of a prospectus for an offer to issue securities if the amount raised from issues of securities is \$10 million or less.”).

82. *Id.* (profile statement: “Section 721 allows a brief profile statement (rather than the prospectus) to be sent out with offers with ASIC approval. The prospectus must still be prepared and lodged with ASIC. Investors are entitled to a copy of the prospectus if they ask for it.”).

83. *Corporations Act 2001* (Cth) s 710. Regulatory Guide 56 (also known as Policy Statement 56) provides regulatory guidelines to fulfil the required information based upon the Corporation Law. ASIC, Regulatory Guide 168: Disclosure: Product Disclosure Statements (and other disclosure obligations), 17-25 (Oct. 2011), available at <http://download.asic.gov.au/media/1239002/rg56.pdf>. See, e.g., Joanna Khoo, *Civil Liability for Misstatements in Offer Documents: Striking the Right Balance*, 6 *BYU INT’L L. & MGMT. R.* 49 (2010) (comparing the disclosure requirement in the U.S., U.K., New Zealand and Australia as well as the civil liability for misstatements).

84. *Corporations Act 2001* (Cth) s 712. S. M. Solaiman, *Statutory Civil Liabilities of Corporate Gatekeepers for Defective Prospectuses in Australia, the United States, the United Kingdom and Canada: A Comparison*, 35 *COMPANY LAWYER* 100 (2014), available at <http://ro.uow.edu.au/cgi/viewcontent.cgi?article=2293&context=lhapapers>.

85. *Corporations Act 2001* (Cth) s 705.

86. *Id.* s 709(4).

87. See *id.* s 714.

88. “A profile statement is a document setting out limited key information about the company and the offer. Companies can only use profile statements where ASIC has approved their use. There are currently no approved uses for profile statements.” ASIC, *Fundraising: What Disclosure Documents Do You Need to Give Potential Investors when Raising Funds?* (Mar. 13, 2015, 4:57 AM), <http://www.asic.gov.au/regulatory-resources/fundraising/what-disclosure-documents-do-you-need-to-give-potential-investors-when-raising-funds/#profile>.

tion.⁸⁹ The most notable exemption requires that the securities offering involves less than twenty non-qualified investors and less than AUS \$2 million (\$1.79 million) valuation within the last twelve months.⁹⁰ Companies may still fundraise from qualified investors without limits.⁹¹

Investors are divided in two categories: qualified and non-qualified investors. Qualified investors are sophisticated, professional, or high net worth investors.⁹² Sophisticated investors are investors who have previous experience in investing, understand the merits, risks, value, and terms of the offer.⁹³ These investors must be able to assess adequacy of the information they receive and sign a written statement acknowledging these aforementioned elements.⁹⁴ Professional investors⁹⁵ include individuals who hold licenses themselves.⁹⁶ High net-worth investors have gross assets of at least AUS \$10 million (\$8.9 million).⁹⁷

Qualified investors can invest as they see fit. In this exemption, companies can only raise funds from twenty non-qualified investors. This exemption offers a small window for crowd investors to invest in new (and old) ventures. This qualified/non-qualified dichotomy appears in a number of regulations.

The guidance offered by ASIC has served as a warning for equity crowdfunding platforms as well as companies intending to fundraise. It has reminded participants of the applicable regulations as well as the limitations to what platforms and companies may do. These regulations have not, however, prevented the development of equity crowdfunding involving the common citizen but previous crowdfunding efforts have not harnessed the potential of crowds.

For instance, since 2005, the Australian Small Scale Offering Board (“ASSOB”) has been successfully combined the Corporations Act ex-

89. *Corporations Act 2001* (Cth) s 708. See Matt Vitins, *Crowdfunding and Securities Laws: What the Americans Are Doing and the Case for an Australian Crowdfunding Exemption*, 22 J.L. INFO. & SCI. 92, 123-27 (2012) for a more in-depth discussion regarding this exemption.

90. *Corporations Act 2001* (Cth) s 708(2).

91. *Id.* s 708(8).

92. *See id.* s 708(8) – (11).

93. *Id.* s 708(10). Sophisticated investors also include individuals that invest AUS \$500,000 (\$0.45 million) in the securities in one instance or cumulatively. *Id.* s 708(8).

94. *Id.* s 708(10).

95. “An offer of securities does not need disclosure to investors under this Part if it is made to a . . . professional investor.” *Id.* s 708(11)(a) (emphasis in original).

96. *Id.* s 9 (“professional investor, subsection (a)).

97. “An offer of securities does not need disclosure to investors under this Part if it is made to: . . . a person who has or ‘controls [gross assets] of at least \$10 million.” *Id.* s 708(11)(b). If investors solely have control over the \$10 million, they will also fall under the definition of professional investors. *Id.* s 9 (“professional investor,” subsection (e)).

emption described above with the ASIC Class Order 02/273.⁹⁸ They offer to help raise up to AUS \$5 million per projects and have helped raised over AUS \$140 million (about \$125 million).⁹⁹ ASSOBS also creates a secondary market for shares.¹⁰⁰

Because of the twenty non-qualified investor constraint,¹⁰¹ ASSOBS's success has triggered some interest and it has been the subject of a study on signaling.¹⁰² Ahlers, Cumming, Günther, and Schweizer study 104 equity crowdfunding projects in Australia. They find "that startups that signal their intention to seek an exit by either IPO or a trade sale are more likely to attract investors than those planning to use other forms of exit."¹⁰³ This finding shows the importance of an exit strategy. They conclude that the "crowdfunding market operates in a largely rational manner, even among retail investors who are arguably less sophisticated."¹⁰⁴

In 2014, the Corporations and Market Advisory Committee, an advisor board for the Australian Department of Treasury, released a report on equity crowdfunding.¹⁰⁵ In this report, the committee suggests a set of rules to facilitate Australian equity crowdfunding and their possible implementation.¹⁰⁶ The proposed rules have not yet been voted upon but they may have been prompted by examples set by other countries.¹⁰⁷

98. See Australian Small Scale Offering Board, *About ASSOBS*, ASSOBS, <http://www.assob.com.au/about.asp?page=1> (last visited May 14, 2015).

99. *Id.*

100. *Id.*

101. "[T]he average amount of capital raised in a successful ASSOBS offering is around half a million dollars." Vitins, *supra* note 89, at 110-11.

102. Gerrit K.C. Ahlers, Douglas Cumming, Christina Günther & Denis Schweizer, *Signaling in Equity Crowdfunding* (Working Paper Oct. 2013), available at http://funginstitute.berkeley.edu/sites/default/files/Guenther%20Abstract_Equity%20Crowd%20Financing.pdf.

103. *Id.* at 3.

104. *Id.* at 30.

105. Corporations and Market Advisory Committee, *Crowd Sourced Equity Funding*, AUSTRALIAN GOVERNMENT (May 2014), available at [http://www.camac.gov.au/camac/camac.nsf/byheadline/pdf/final@eports+2014/\\$file/csef_report_21may2014.doc](http://www.camac.gov.au/camac/camac.nsf/byheadline/pdf/final@eports+2014/$file/csef_report_21may2014.doc).

106. They recommend that platforms must be used, be licensed, and they must encourage disclosure and control communication, *id.* at 87; fund seeker cannot aggregate more than AUS \$2 million per 12-month period, *id.* at 59-60; and investors can invest up to AUS \$2,500 per companies and AUS \$10,000 total in a 12-month period, *id.* at 144-47.

107. The report compares Australia to other countries that have such regulations already in place.

B. *Equity Crowdfunding Involves Multi-layered Regulations: the Example of the European Union Directives and Regulations*

This section focuses on the European Union Directives and Regulations. The European Union is a confederation of countries. It has an intertwined set of governing bodies (the European Commission, European Council, and the European Parliament) that passes Directives and Regulations. EU Directives are not laws and have no power: each EU Member State must implement these Directives by passing its own regulations; when writing new regulations, each Member State use these Directives as regulatory floors or ceilings depending on the phrasing. Member States must implement the Regulations as written. In other words, while these Member States can implement these Directives differently, Regulations are the same across Member States. This section discusses the Directives that the European Commission (“EC”) identifies in a Communication as having potential impact on equity crowdfunding.¹⁰⁸

Depending on the way a crowdfunding platform sets up its operation, it may fall under one or several of the following Directives. What a platform does impacts how platforms are regulated: emitting shares, holding funds, and providing financial advice are the three main regulated actions. These actions trigger different Directives and different requirements. The follow discussion explains which actions trigger what Directives.

First, crowdfunding platforms may *emit* and *sell shares* to the public. If these platforms emit and sell shares, they fall under the type of activities regulated by the Directive on Markets in Financial Instruments.¹⁰⁹ This Directive aims to harmonize financial markets across the European Union and to create a single market in financial services. In general terms, it establishes minimum rules under which investment firms operate,¹¹⁰ and more specifically, it governs any firm

108. See *Unleashing the potential of Crowdfunding in the European Union*, at Communication From the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, COM (2014) 172 final (Mar. 27, 2014), available at http://ec.europa.eu/internal_market/finances/docs/crowdfunding/140327-communication_en.pdf [hereinafter EC Communication].

109. See Directive 2004/39, of the European Parliament and of the Council of 21 April 2004 on Markets in Financial Instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC repealing Council Directive 93/22/EEC, 2004 O.J. (L 145/1).

110. Directive 2004/38, art. 1. “Member States shall require that, when providing investment services and/or, where appropriate, ancillary services to clients, an investment firm act honestly, fairly and professionally in accordance with the best interests of its clients and comply, in particular, with the principles set out” below to enhance fairness, transparency, efficiency. *Id.* art. 19.

that deals with the reception, transmission, execution¹¹¹ of transferable stock market transactions.¹¹² It states “Member States shall require that investment firms take all reasonable steps to obtain, when executing orders, the best possible result for their clients taking into account price, costs, speed, likelihood of execution and settlement, size, nature or any other consideration relevant to the execution of the order.”¹¹³

When equity crowdfunding platforms emit market shares, they must follow this direction to avoid sanctions. Each Member State has its own regulatory agency and its own licensing requirements. Crowdfunding platforms must fulfill these requirements in their home countries and request a passport to trade shares in other countries. Equity crowdfunding platforms that want to serve as a secondary market for shares may need to abide by the Directive on Markets in Financial Instruments to provide these services as well.

Second, crowdfunding platforms may *collect funds* – particularly electronic payments – from investors, and *hold these funds* before they are *transferred* to the fundraising company if the campaign is successful or *return* them to the investors if the campaign fails. These actions trigger multiple Directives. The collection of funds and movement of funds implicates the Directive on Payment Services.¹¹⁴ This Directive covers services enabling cash deposit to or from payment accounts, payment transactions from debit or credit accounts, issuing and/or acquiring payment instruments, money remittance, and payment agreed through electronic means.¹¹⁵ Therefore, when platforms collect money from investors to transfer to fundraisers, they carry out with money and therefore qualify as a payment institution. As such, the platforms must register¹¹⁶ and comply with the home Member State financial institution regulations;¹¹⁷ and, importantly, they must hold sufficient capital¹¹⁸ and implement safeguard measures.¹¹⁹

Holding funds in their own (trust) accounts also may qualify crowdfunding platforms as credit institutions, which are institutions

111. *Id.* Annex I § A.

112. *Id.* Annex I § C.

113. *Id.* art. 21.

114. Directive 2007/64/EC of the European Parliament and of the Council of 13 November 2007 on Payment Services in the Internal Market amending Directives 97/7/EC, 2002/65/EC, 2005/60/EC and 2006/48/EC and repealing Directive 97/5/EC, 2007 O.J. (L319/1).

115. *Id.* Annex.

116. *See id.* art. 13.

117. *See id.* art. 10.

118. *See id.* art. 8.

119. *See* Directive 2007/64/EC, art. 9.

that “take deposits or other repayable funds from the public and to grant credits for its own account.”¹²⁰ These institutions must comply with the Directive on Capital Requirements (“CRD IV”)¹²¹ and the Regulations on Capital Requirements (“CRR”).¹²²

This CRD IV aims to enhance risk management by credit institutions and investment firms.¹²³ Specifically, CRD IV affects the minimum level of reserve credit institutions and investment firms must hold in relation to different kinds of obligations.¹²⁴ On top of the minimum capital requirements, this Directive imposes certain buffers (countercyclical capital buffer,¹²⁵ systemic risks buffer,¹²⁶ and capital conservation buffers¹²⁷). It also imposes reporting requirement, public disclosure requirement, and prudential requirements for credit institutions and investment firms with regard to their own funds in order to limit large exposures.¹²⁸

Even if the crowdfunding platforms do not qualify as a credit institution, they may have to comply with CRD IV and CRR because they may be classed as *an investment firm*.¹²⁹ An investment firm provides services such as *the reception and transmission of orders in relation to*

120. A “‘credit institution’ means an undertaking the business of which is to take deposits or other repayable funds from the public and to grant credits for its own account.” Commission Regulation 575/2013, art. 4, of the European Parliament and of the Council of 26 June 2013 on Prudential Requirements for Credit Institutions and Investment Firms and amending Regulation 648/2012, 2013 O.J. (L 176/1).

121. Directive 2013/36/EU, of the European Parliament and of the Council of 26 June 2013 on Access to the Activity of Credit Institutions and the Prudential Supervision of Credit Institutions and Investment Firms amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC, 2013 OJ (L 176/338).

122. Commission Regulation 575/2013.

123. European Commission, Protecting Taxpayers’ Money Against Fraud: Commission Proposes European Public Prosecutor’s Office, EUROPA.EU MEX/13/0716 (July 16, 2013), available at http://europa.eu/rapid/press-release_MEX-13-0717_en.htm?locale=EN.

124. The European Banking Authority received the task of implementing calculations for fund requirement based upon information reported by individual Member State competent authorities. See Directive 2013/36/EU, art. 78.

125. “It is therefore appropriate to require credit institutions and relevant investment firms to hold, in addition to other own fund requirements, a capital conservation buffer and a countercyclical capital buffer to ensure that they accumulate, during periods of economic growth, a sufficient capital base to absorb losses in stressed periods.” *Id.* at L 176/347, ¶ 80 & art. 130, 135-40.

126. *Id.* art. 133-134.

127. *Id.* art. 129. “Member States shall require institutions to maintain in addition to the Common Equity Tier 1 capital maintained to meet the own funds requirement . . . a capital conservation buffer of Common Equity Tier 1 capital equal to 2,5% [sic] of their total risk exposure amount.” *Id.*

128. Directive 2013/36/EU, art. 1.

129. Directive 2004/39/EC, art. 4 § 1.

*one or more financial instruments*¹³⁰ – and platforms may easily qualify as investment firms because they act as intermediaries between contributors and fund seekers (including passing along orders). Platforms would thus need to comply with certain licensing requirements and hold enough capital to satisfy a capital requirement of (estimated at eight percent).¹³¹

Third, crowdfunding platforms may also *advise* investors in which companies to invest and hence trigger the Directive on Distance Marketing of Financial Services.¹³² This Directive addresses how financial services may be provided from a distance.¹³³ Under a distance financial agreement, a financial service consumer must be provided *ex-ante* with specific and clear information about the supplier, the financial service provided, the contract, and methods of redress¹³⁴ – some of this information must be provided in writing.¹³⁵ Crowdfunding platforms may need to abide by this Directive because financial services include investments.¹³⁶ Platforms will need to make the terms of investment and the extent of their involvement in the investment clear before the investors can invest, if they act as financial advisers.

Crowdfunding platform managers *may manage funds* to the point that their advice elevates the platform to *investment undertakings*. Instead of providing intermediary services, platforms may choose to pool their clients' funds, decide where to invest, and generally manage these investments. While most crowdfunding platforms will not qualify as an investment undertaking because platforms usually let investors invest in the companies of their choice, some platforms may model their operating as a collective investment undertaking or they

130. Investment services and activities include: “(1) Reception and transmission of orders in relation to one or more financial instruments. (2) Execution of orders on behalf of clients. . . . (5) Investment advice. (6) Underwriting of financial instruments and/or placing of financial instruments on a firm commitment basis. (7) Placing of financial instruments without a firm commitment basis.” *Id.* Annex I § A.

131. “The threshold [of 8 percent Common Equity Tier] is decomposed to 4.5 percent, which is the ratio that will be legally mandatory as of 1 January 2014 according to Capital Requirement Directive (CRD IV) and the Capital Requirement Regulation (CRR), a capital conservation buffer of 2.5 percent, and an add-on of 1 percent to take into account the systemic relevance of banks.” Silvia Merler & Guntram B. Wolff, *Ending Uncertainty: Recapitalisation Under European Bank Supervision*, 18 BRUEGEL POL’Y CONTRIBUTION 1, 5 (2013).

132. Directive 2002/65/EC of the European Parliament and of the Council of 23 September 2002 concerning the Distance Marketing of Consumer Financial Services and amending Council Directive 90/619/EEC and Directives 97/7/EC and 98/27/EC, 2002 O.J. (L 271/16).

133. A “financial service” means any service of a banking, credit, insurance, personal pension, investment or payment nature.” *Id.* art. 2 § b.

134. *See id.* art. 3.

135. *See id.* art. 5.

136. *Id.* art. 2(b).

may fall into a gray area. If a platform pools funds and invests these funds, it may trigger one of the following four Directives (depending on how this platform is structured and in what kind of companies it chooses to invest): the Directive on Alternative Investment Fund Managers (“AIFMs”),¹³⁷ the Directive on Undertakings for Collective Investment in Transferable Securities (“UCITS”),¹³⁸ the Regulation on European Venture Capital¹³⁹ and European Social Entrepreneurship Funds.¹⁴⁰

The four types of funds differ on whether they have a maturity date and where the fund manager invests. UCITS are usually open-ended funds that usually invest in publically traded companies whereas alternative investment funds (“AIFs”) are hedge funds and private equity funds. European Venture Capital consist venture capital funds in private companies; and European Social Entrepreneurship Funds are venture capital funds in private companies that have a social purpose. These latter two types of funds invest in young and innovative companies, which usually involve higher risks because they lack track record.

In more details, the first two Directives deal with pooling funds. The Directive on AIFMs¹⁴¹ introduced a harmonized set of rules¹⁴² for AIFs in Europe because of the risks associated with these kinds of funds.¹⁴³ AIFs “means collective investment undertakings . . . which: (i) raise capital from a number of investors, with a view to investing it in accordance with a defined investment policy for the benefit of those investors; and (ii) do not require authorisation pursuant to [the

137. Directive 2011/61/EU, of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010, 2011 O.J. (L 174/1).

138. Directive 2009/65/EC, of the European Parliament and of the Council of 13 July 2009 on the coordination of Laws, Regulations and Administrative Provisions relating to Undertakings for Collective Investment in Transferable Securities (UCITS), 2009 O.J. (L 302/32).

139. Commission Regulation 345/2013, of the European Parliament and of the Council of 17 April 2013 on European Venture Capital Funds 2013 O.J. (L 115/1).

140. Commission Regulation 346/2013, of the European Parliament and of the Council of 17 April 2013 on European Social Entrepreneurship Funds 2013 O.J. (L 115/18).

141. Directive 2011/61/EU, of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations 1060/2009 and 1095/2010 2011 O.J. (L 174/1).

142. *Id.* L 174/1, ¶ 4 (“This Directive aims to provide for an internal market for AIFMs and a harmonised and stringent regulatory and supervisory framework for the activities within the Union of all AIFMs, including those which have their registered office in a Member State (EU AIFMs) and those which have their registered office in a third country (non-EU AIFMs”).

143. *Id.* (“Recent difficulties in financial markets have underlined that many AIFM strategies are vulnerable to some or several important risks in relation to investors, other market participants and markets. In order to provide comprehensive and common arrangements for supervision, it is necessary to establish a framework capable of addressing those risks taking into account the diverse range of investment strategies and techniques employed by AIFMs.”).

UCITS Directive].”¹⁴⁴ AIFs have a minimum capital requirement¹⁴⁵ and clear enumeration policies¹⁴⁶ among other requirements. Their managers – AIFMs – have authorization requirements¹⁴⁷ and must manage risk adequately¹⁴⁸ among their various duties. The UCITS Directive targets undertakings that are for “the sole object of collective investment in transferable securities or in other liquid financial assets . . . from the public and which operate on the principle of risk-spreading;”¹⁴⁹ and that have “units which are . . . repurchased or redeemed, directly or indirectly, out of those undertakings’ assets.”¹⁵⁰ These UCITS are usually common funds managed by management companies, trusts, and open-ended variable or fixed capital company.¹⁵¹

The two latter regulations deal with venture funds. The Regulations on European Venture Capital¹⁵² and European Qualifying Social Entrepreneurship Funds impact on collective investment undertaking that invest “at least 70% of its aggregate capital . . . in qualifying investments.”¹⁵³ These qualifying investments include investments in equity and quasi-equity instruments, secured and unsecured loans, and in other venture capital companies.¹⁵⁴ Managers of a qualifying venture have certain duties toward their clients¹⁵⁵ and disclosure requirements.¹⁵⁶ They also have to report to the competent authority.¹⁵⁷ The investments that qualify under this Social Entrepreneurship Funds Directive¹⁵⁸ further require that any entity in which funds are invested “has the achievement of measurable, positive social impacts as its primary objective in accordance with its articles of association.”¹⁵⁹ These objectives include “provid[ing] services or goods to vulnerable or marginalised, disadvantaged or excluded persons, [and]

144. *Id.* art. 4 § 1.

145. *Id.* art. 9.

146. Directive 2011/61/EU, art. 13, of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations 1060/2009 and 1095/2010 2011 O.J. (L 174/1).

147. *See id.* art. 8 § 2.

148. *See id.* art. 15.

149. *Id.* art. 1.

150. Directive 2009/65/EC, art. 1 § 2.

151. *Id.* art. 1 § 3.

152. *See* Commission Regulation 345/2013.

153. *See* Commission Regulation 346/2013, art. 3 § b.

154. *Id.* art. 3 § e.

155. *See id.* art. 7-9. .

156. *See id.* art. 11-13.

157. *See id.* art. 14-16.

158. Commission Regulation 346/2013, art. 2.

159. *Id.* art. 3 § 1(d)(ii).

employ[ing] a method of production of goods or services that embodies its social objective.”¹⁶⁰

Since crowdfunding platforms raise funds from investors and invest in private companies, a broad reading of these four Directives and regulations may impact how crowdfunding platforms do business. However, these platforms usually do not raise capital from investors nor have control of the capital to the point of deciding in which companies to invest.¹⁶¹ Similarly, most platforms do not offer portfolio management and risk management services like traditional AIFs.¹⁶²

All these regulations shape platforms and how they choose to operate and compete in the crowdfunding market. Some platforms set up their operations to avoid being regulated. For instance, an equity crowdfunding platform in Spain, named SociosInversores, acts as an “intermediary between entrepreneurs and investors.”¹⁶³ This platform puts investors and fund-raisers in contact, but the two parties deal with each other directly and agree on a – possibly unique – contract.¹⁶⁴ This platform thus avoids having to comply with the Directive on Payment Services because it does not handle money. It also avoids the Directive on Markets in Financial Instruments because it does not emit any shares. The fundraising company directly collects the funds from the investors and directly emits the shares to the investors. The Directive on Distance Marketing of Financial Services may, however, still apply to SociosInversores because they may still provide advice.

These Directives and regulations present potential obstacles and landmine for platforms. They must exercise extreme care. However,

160. *Id.*

161. The investing crowd usually targets specific campaigning companies. An issue may arise if the company raising funds is a company that operates in the financial sector that these Directives target and would fall under these regulations. For simplicity of exposition, this discussion ignores the possibility that investment funds use crowdfunding platforms to further invest.

162. *Id.* Annex I (“1. Investment management functions which an AIFM shall at least perform when managing an AIF: (a) portfolio management; (b) risk management. 2. Other functions that an AIFM may additionally perform in the course of the collective management of an AIF: (a) Administration: (i) legal and fund management accounting services; (ii) customer inquiries; (iii) valuation and pricing, including tax returns; (iv) regulatory compliance monitoring; (v) maintenance of unit-/shareholder register; (vi) distribution of income; (vii) unit/shares issues and redemptions; (viii) contract settlements, including certificate dispatch; (ix) record keeping; (b) Marketing; (c) Activities related to the assets of AIFs.”).

163. “SociosInversores act[s] as an intermediary between entrepreneurs and investors but do[es] not collect or distribute any money. For their services, the platform charges five [percent] of the total amount invested in a project. This model means that the platform is able to avoid legal limitations that other crowdfunding platforms can face, particularly if they take up roles that are in some countries exclusive to banks.” Green et al., *supra* note 15, at 60.

164. *How It Works*, SOCIOINVERSOIRES.ES, <https://www.sociosinversores.es/como-funcional> (last visited Aug. 08, 2014).

they only represent part of the regulatory puzzle. The companies that use these platforms to raise fund are also regulated (in the way they use them). The following paragraphs look at these fund-seeking companies and how disclosure is central to their fund raising efforts.

The companies that *attempt to raise funds* may be impacted by the Directive on Prospectus.¹⁶⁵ This Directive impacts equity crowdfunding because it governs and harmonizes how companies present their prospectus when they attempt to raise funds through offering securities to the public in Europe.¹⁶⁶ To ensure investor protection, “the prospectus shall contain all information which . . . is necessary to enable investors to make an informed assessment of the assets and liabilities, financial position, profit and losses, and prospects of the issuer and of any guarantor, and of the rights attaching to such securities.”¹⁶⁷ This information includes the identity of directors and senior management, offer statistics, and other key information about the company and that helps calculate the risk factors.¹⁶⁸

This information must be constantly updated: the Directive requires a supplement to be published to “ensure that investors base their investment decisions on the most recent financial information”¹⁶⁹ when new audited information is available. The statements must also disclose any information that allows investors to make an educated investment and evaluate the risks of investing,¹⁷⁰ including the identity of the main shareholder, updated audited financial statements, and the like.¹⁷¹

Campaign creators who emit shares following a successful crowdfunding campaign may trigger this Directive. If it does, they must comply with the Prospectus Requirement before starting fundraising. Requiring an extensive audited prospectus imposes real cost

165. Directive 2010/73/EU, of the European Parliament and of the Council of 24 November 2010 amending Directives 2003/71/EC on the Prospectus to be Published when Securities are Offered to the Public or Admitted to Trading and 2004/109/EC on the Harmonisation of Transparency Requirements in Relation to Information about Issuers Whose Securities are Admitted to Trading on a Regulated Market 2010 O.J. (L 327/1); Directive 2003/71/EC, of the European Parliament and of the Council of 4 November 2003 on the Prospectus to be Published when Securities are Offered to the Public or Admitted to Trading and amending Directive 2001/34/EC, 2003 O.J. (L 345/64).

166. Directive 2003/71/EC, L 345/64, ¶ 1.

167. *Id.* art. 5 § 1.

168. *Id.* Annex I.

169. Committee Delegated Regulation 1392/2014, ¶ 6, of 7 March 2014 supplementing Directive 2003/71/EC of the European Parliament and Council with regard to Regulatory Standards for Publication of Supplement to the Prospectus, 2014 O.J. (L 111/36).

170. *See generally id.*

171. *Id.*

upon would-be fundraisers and hence decreases the pool of candidates who are willing to incur the cost for a chance to raise funds.

However, this Directive has exemptions.¹⁷² One exemption requires that the security offering raises less than €5 million [\$6.9 million]¹⁷³ over a 12-month period¹⁷⁴ *and* that the securities are offered to fewer than 150 natural persons.¹⁷⁵ Another exemption is “an offer of securities with a total consideration of less than €100,000 [\$138,000], which limit shall be calculated over a period of 12 months.”¹⁷⁶ Some campaigns have used this exemption: for example WiSeed in France. WiSeed, founded in 2008, is an equity crowdfunding platform that allowed companies to raise up to €100,000 until 2012 taking advantage of this exemption.¹⁷⁷

The Directive on Prospectus also *limits who may* invest: if a valid prospectus is provided, any investor can invest. Without prospectus, “fewer than 150 natural . . . persons per Member State” may invest in a company;¹⁷⁸ though, any number of qualified investors are explicitly authorized to invest.¹⁷⁹ These qualified investors must fulfill certain criteria (according to each Member State’s regulations). Generally,

172. Directive 2003/71/EC, art. 3.

173. Converting this value and other values in Euro in the rest of this paper using the Federal Reserve Board exchange rate data on December 31, 2013 (\$1.3799 to _1). Board of Governors of the Federal Reserve System, *Historical Rates for the EU Euro*, FEDERALRESERVE.GOV, http://www.federalreserve.gov/releases/h10/hist/dat00_eu.htm (last visited Aug. 14, 2014).

174. Directive 2010/73/EU, art. 1 § 1(h), *amending* Directive 2003/71/EC art. 1 § 1(h) (increasing the security offering from €2.5 million to €5 million).

175. This exemption requires that the security offering raises less than €5 million [\$6.9 million] over a 12-month period *and* one of the following requirements: that the securities are only offered to qualified investors *or* that they offered to less than 150 natural persons *or* that the equity is acquired for at least €100,000 by each investor *or* that each equity share is worth at least €100,000 each. Directive 2003/71/EC, art. 3 § 2(a)-(d).

176. Directive 2003/71/EC, art. 3 § 2(e).

177. “WiSeed, supporting projects raising up to €100,000, via investments of not less than €100 per investor, and also projects funded by less than 150 non-qualified investors.” Reid Feldman, *Review of Crowdfunding Regulation Interpretations of existing regulation concerning crowdfunding in Europe, North America and Israel*, EUROPEAN CROWDFUNDING NETWORK, (Ed. Tax & Legal Work Group of the European Crowdfunding Network) (2013). Now WiSeed allowed companies to raise up to one million euro. It partnered with a financial institution. WiSeed Press Release https://s3-eu-west-1.amazonaws.com/wiseed-public-fr/mediatheque/cp_gouvernance_030614.pdf (last visited Aug. 13, 2014). Interview of Thierry Merquiol, co-creator of WiSeed (Jul. 7, 2014), https://www.youtube.com/watch?v=PX-O_Yz_NL4 (last visited Aug. 13, 2014). The change in the French regulation discussed in more details below also allows them to raise up to similar funds.

178. Directive 2010/73/EU, art. 3 § 2(b), *amending* Directive 2003/71/EC, art. 3 § 2(b) (increasing from 100 to 150 natural persons).

179. Directive 2003/71/EC, art. 2 § 1(e)(iv).

they are either professional traders (who understand the risks associated with investing) or they are high net worth individuals.¹⁸⁰

Media No Mad exemplifies a crowdfunding effort involving less than 100 non-qualified investors. They raised €55,800 [\$77,000] from 81 investors by selling 186 shares, which equates to fifteen percent of their capital.¹⁸¹ They aimed to raise €90,000 [\$124,000] from under 100 investors.¹⁸² This venture was not completely done online; the fundraiser went physically to investors to make them sign a non-competition agreement as well as a non-disclosure agreement.¹⁸³ However, this crowdfunding venture may have failed since the site has not been updated since 2010.¹⁸⁴

During a public consultation in 2013, the European Commission found that the majority of respondents wished for some harmonization.¹⁸⁵ One way to insure harmonization is to leave the current crop of already harmonized financial regulations as they are. Table 1 summarizes the discussion above by showing which Directive or Regulation affects which crowdfunding market participant. Each Member State has, however, transposed these Directives and exemptions in their own way.¹⁸⁶ This partly explains why equity crowdfunding has developed differently in each Member State.¹⁸⁷ Adding another layer of EU regulation may help or hurt harmonization. This communication serves many purposes: it warns crowdfunding participants that the activity falls under current regulations and also informs citizens that the governing body is paying attention and may do more in the future.

180. A qualified investor must fulfill two of three following criteria:

(a) the investor has carried out transactions of a significant size on securities markets at an average frequency of, at least, 10 per quarter over the previous four quarters; (b) the size of the investor's securities portfolio exceeds EUR 0,5 million; (c) the investor works or has worked for at least one year in the financial sector in a professional position which requires knowledge of securities investment.

Id. art. 2 § 2.

181. Schwienbacher & Larralde, *supra* note 45, at 16.

182. *Id.* at 15.

183. *Id.*

184. *About*, BE NOOT, <http://benoot.com/> (last visited Aug. 13, 2014).

185. See *Digit – IPM*, EUROPEAN COMMISSION, <http://ec.europa.eu/yourvoice/ipm/forms/dispatch?userstate=cdisplayPublishedResults&form=CROWDFUNDING> (last visited July 7, 2014).

186. See *Review of Crowdfunding Regulation: Interpretations of Existing Regulation concerning Crowdfunding in Europe, North America and Israel*, EUROPEAN CROWDFUNDING NETWORK (Tax & Legal Work Group of the European Crowdfunding Network, eds. 2013).

187. Some other differences may be cultural as well as economical – such as the average income. These differences are also present in the U.S. at the state level.

TABLE 1. APPLICABLE DIRECTIVES TO INDIVIDUAL ACTORS WITHOUT NEW EXEMPTIONS

Actor	Platform	Fundraising Companies	Investors
Applicable Directives	(1) E-Money (2) Capital Requirements Undertakings for Collective Investment (3) Alternative Investment Fund Manager (4) Market in Financial Instrument	Prospectus	Prospectus

IV. OLD AND NEW REGULATIONS FOR CROWDFUNDING: THE GROWING LIST OF COUNTRIES THAT HAVE NEW REGULATIONS AND EXEMPTIONS

The United States (2012), Italy (2012-13), the United Kingdom (2013-14) and France (2014) passed equity crowdfunding specific regulations. However, the scope and implementation differ greatly. This Part describes regulations of the platform, fund-seeker, and investor regulations for each country (in order of legislative actions).

A. *The United States Limits the Investing Crowd*

First in time, the United States acted as the benchmark for equity crowdfunding regulations, but its implementation has suffered multiple delays.¹⁸⁸ Being a federation of states, the United States has multiple layers of regulations at both federal and state levels. The Securities and Exchange Commission (“SEC”) implements the federal regulations on Equity Crowdfunding via the Jumpstart Our Business Startups (“JOBS”) Act. The delayed implementation by the SEC has

188. Mary Jo White, Chairwoman of the Securities and Exchange Commission testified in front of Congress in September 2014 and specified that “While the SEC has made significant progress, more remains to be done on . . . Jumpstart Our Business Startups (“JOBS”) Act rulemakings Our responsibility is much greater than simply “checking the box” and declaring the job done. We must be focused on fundamental and lasting reform.” She also cites the lack of funds as an issue. Mary Jo White, Chairwoman of the SEC, Testimony on “Wall Street Reform: Assessing and Enhancing the Financial Regulatory System” before the United States Senate Committee on Banking, Housing, and Urban Affairs (Sept. 9, 2014), available at <http://www.sec.gov/News/Testimony/Detail/Testimony/1370542893146>.

caused a number of states¹⁸⁹ to pass their own equity crowdfunding acts¹⁹⁰ and regulatory exemptions.¹⁹¹ These efforts have some limited impacts because these state laws that regulate the offering and sale of securities (known as Blue Sky Laws) have many requirements.¹⁹² Two important ones are that the corporation must be incorporated in the state where the shares may only be sold to residents of that state.¹⁹³ The requirements have limited the development of crowdfunding to intra-state crowdfunding.

The following section focuses on interstate fund raising. In 2012, the United States passed the Jumpstart Our Business Startups Act (JOBS Act).¹⁹⁴ U.S. legislators believe that a void exists between the finances provided by banks and the ones provided by venture capitalists.¹⁹⁵ In the hopes of boosting economic growth, U.S. legislators extended investment opportunities to the whole population to fill this void (known as the financial gap or valley of death).¹⁹⁶ Talks are un-

189. Jason Wiens, *State Equity Crowdfunding Policies Hold Promise*, FORBES (May 28, 2014, 10:18 AM), <http://www.forbes.com/sites/kauffman/2014/05/28/state-equity-crowdfunding-policies-hold-promise/>.

190. See, e.g., IND. CODE ANN. § 23-19-2-2 (LexisNexis effective July 1, 2015); ME. REV. STAT. ANN. tit. 32 § 16304.6-A (2014); S. Res. 811, Reg. Sess. (Md. 2014) & H.R. Res. 1243, Reg. Sess. (Md. 2014); Michigan Invests Locally Exemption, MICH. COMP. LAWS ANN. § 451.2102a (West 2013); Washington Jobs Act, WASH. REV. CODE ANN. § 21.20.880 (LexisNexis 2014); 2013 Wis. Act 52 (Wis. 2013).

191. See, e.g., Registration of Securities – Exempt Transactions, ALA. CODE § 8-6-11 (2015); Invest Georgia Exemption, GA. COMP. R. & REGS. 590-4-2-.08 (2015); IDAHO CODE ANN. § 30-14-203 (decided on a case-by-case basis for an exemption); Invest Kansas Exemption, KAN. ADMIN. REGS. § 81-5-21 (2015); NEB. REV. STAT. § 8-1106.01 (2014); Exemption from Registration and Filing of Sales in Advertising Literature, TENN. CODE ANN. § 48-1-103 (2015).

192. SEC Rule Interpretation, *supra* note 52, at 66,427. The Commerce Clause combined with the Securities Act of 1933 limits how state entities can emit shares across state line.

193. SEC Rule Interpretation, *supra* note 52, at 66,510-11 (discussing Blue Sky laws – State Securities Laws – that limit companies formed within that state to form equity offerings to resident of that state). For instance, the first successful such crowdfunding efforts in Michigan involves Tecumseh Brewing Company and raised \$175,000 from 21 investors. *Michigan's First Investment Crowdfunding Campaign, Tecumseh Brewing Co., a Success*, LENAWEE NOW (May 2, 2014), <http://www.lenaweenow.org/michigan-investment-crowdfunding-campaign-tecumseh-brewing-success/>. This constitutes the first successful intrastate fund raising effort.

194. Jumpstart Our Business Startups Act (JOBS Act), Pub. L. No. 112-106, 126 Stat. 306 (2012) (to be codified in scattered sections of 15 U.S.C.).

195. The JOBS Act intends to “increase American job creation and economic growth by improving access to the public capital markets for emerging growth companies.” *Id.* The SEC “understand[s] that Title III was designed to help alleviate the funding gap and accompanying regulatory concerns faced by startups and small businesses in connection with raising capital in relatively low dollar amounts.” SEC Rule Interpretation, *supra* note 52, at 66,430.

196. *Id.*

derway in Congress to extend the JOBS Act exemption even further.¹⁹⁷

The U.S. Congress directed to the SEC to set and implement the rules.¹⁹⁸ First, the SEC required that any offering must be made through an intermediary, who may either follow the traditional broker-dealer registration¹⁹⁹ or may try to qualify for one of the exemptions.²⁰⁰ Platforms can abide by the new funding portal regulation to limit their cost of compliance.²⁰¹ Under this new regulation, the platforms cannot advise investors about financial investments, cannot solicit investors with regard to securities, cannot compensate employees or agents for soliciting, and cannot handle investor funds or securities.²⁰² The SEC has the authority to extend this list of prohibited activities.²⁰³ These platforms must register with the SEC and a national securities association.²⁰⁴

Congress and the SEC attempted to decrease the cost of entry for platforms; however, they put the onus on these platforms to perform some due diligence with respect to offerings²⁰⁵ and investors.²⁰⁶ These

197. Ruth Simon & Agust Loten, *Frustration Rises Over Crowdfunding Rules*, WALL STREET JOURNAL, (Apr. 30, 2014, 7:12 PM), <http://online.wsj.com/news/articles/SB10001424052702304163604579532251627028512>.

198. JOBS Act § 304(a)(2); SEC Rule Interpretation, *supra* note 52, at 66,429.

199. 15 U.S.C. § 78c(a)(23) (2015).

200. One exemption not addressed here is Rule 506, which limits the number of individuals to which the offering can be made. If the offering is made to less than 35 non-accredited purchaser, for example, it qualifies for the safe harbor. See Regulation D – Rules Governing the Limited Offer and Sale of Securities without Registration under the Securities Act of 1933, 17 C.F.R. § 230.506 (2015).

201. JOBS Act § 304(a)(1).

202. *Id.* § 304(b).

203. *Id.* SEC is, however, “not proposing at this time to exercise our discretion under Section 3(a)(80)(E) to prohibit any activities in which a funding portal may engage, other than those identified in the statute.” SEC Rule Interpretation, *supra* note 52, at 66,458.

204. 15 U.S.C. § 78o-3(a). Currently, the only national securities association is the Financial Industry Regulatory Authority. See *About BrokerCheck Reports*, FINRA, <http://www.finra.org/Investors/ToolsCalculators/BrokerCheck/P015175> (last visited May19, 2015).

205. The funding platforms must make publicly available, twenty-one days prior to launching the pitch, information regarding the issuer, and the sale/offer of securities. SEC Rule Interpretation, *supra* note 52, at 66,468. They must assure that the information is not misleading; it must deny access and remove any offering that it “believes may present the potential for fraud.” *Id.* at 66,489. The platforms are left to devise their own due diligence and can be held liable if it presents “misleading or otherwise fraudulent [advertisements], such as by implying that past performance of offerings on its platform is indicative of future results.” *Id.* at 66,488 n.623.

206. The funding platforms must ensure that all investors positively affirm the risks involved and qualify to make the investment according to the regulation (i.e., that the investors do not go above their investment limits according to the schedule established by the SEC). SEC Rule Interpretation, *supra* note 52, at 66,471.

platforms must also use the all-or-nothing model because of its considerable benefits (e.g., in limiting frauds).²⁰⁷

Next, the JOBS Act regulates company fundraising. First, the company must be a U.S. corporation. It can raise up to \$1 million in a 12-month period; this sum can be spread over multiple campaigns. Funds raised by other means (such as loan, grants, or gifts) do not count toward this aggregate sum of \$1 million in 12 months.²⁰⁸ The issuing corporations must disclose information such as name, legal status, organization, physical and website address, directors, etc.²⁰⁹ Depending on the amount (to-be) raised, the fundraiser has different filing requirements: his/her tax returns for offerings less than \$100,000; a financial statement reviewed by an independent public accountant for offerings from \$100,000 to \$500,000; an audited financial statement for offerings over \$500,000.²¹⁰ These requirements have an initial cost²¹¹ as well as a yearly compliance cost.²¹² While these disclosure requirements cost less than under the traditional IPO,²¹³ they may limit equity crowdfunding to more substantial offerings.

Finally, the JOBS Act limits how much and how frequently people can invest. All individuals can annually invest up to a tiered threshold: if the investor's net-worth plus income is less than \$40,000, then he or she can only invest up to \$2,000; if his or her net-worth and income combine to less than \$100,000, then he or she can invest five percent of his or her income in equity crowdfunding endeavors; if his or her income or net-worth is greater than \$100,000, then the limit is ten percent of his/her income in equity crowdfunding.²¹⁴ Because these rules have yet to be implemented, it remains to be seen how these limits function.

207. See Transmission or Maintenance of Payments Received in Connection with Underwritings, 17 C.F.R. § 240.15c2-4. "[T]his rule was designed to prevent fraud 'either upon the person on whose behalf the distribution is being made or upon the customer to whom the payment is to be returned if the distribution is not completed.'" SEC Rule Interpretation, *supra* note 52, at 66,473. The proposed rules require that the offering specifies a minimum amount – the threshold – as well as a maximum offering. *Id.* at 66,474.

208. *Id.* at 66,430.

209. *Id.* at 66,428.

210. *Id.* at 66,430 & 66,443.

211. For instance, the U.S. disclosing requirements have an estimated initial cost between \$18,560 to \$152,260 – depending on the size of fund raised – as compared to estimated \$1.5 million for IPOs. See SEC Rule Interpretation, *supra* note 52, at 66,521 & 66,509.

212. For instance, the U.S. disclosing requirements have an estimated annual cost between \$600 to \$33,600 – depending on the size of fund raised – as compared to estimated \$2.5 million for IPOs. See *id.*

213. *Id.*

214. 15 U.S.C. § 77d(a)(6)(B); see also SEC Rule Interpretation, *supra* note 52, at 66,430.

B. *Italy focuses on Innovative Early Stage Investment*

In 2012 and 2013, Italy passed laws and regulations that oversee how equity crowdfunding functions.²¹⁵ These laws, like the U.S. regulations, have opted to regulate platforms and investors; furthermore, these laws also regulate what kind of companies can raise funds.

First, crowdfunding must be done through an on-line platform or portals “with the exclusive purpose of facilitating the collection of risk capital on the part of the innovative start-ups.”²¹⁶ Platforms must register with *Commissione Nazionale per le Società e la Borsa*, (“CONSOB”) the regulating agency.²¹⁷ Only a bank or investment company can manage a portal²¹⁸ or register the portal for future use.²¹⁹ The managers of these portals must have at least two years’ experience in legal or economic work²²⁰ and follow a set of conduct rules including “work diligence, fairness and transparency, avoiding any conflicts of interest[.]”²²¹ The manager has the duty to keep up-to-date information on the portal²²² about the startups and disclose the risks involved, the taxation of each investment type, and etc.²²³ The regulation also

215. Legge 17 dicembre 2012, n. 221 (It.). Commissione Nazionale per le Società e la Borsa Reg. 26 giugno 2013 n. 18592 (CONSOB Reg.) (the Italian financial markets regulator).

216. CONSOB Reg. 26 giugno 2013, n. 18592, at art. 2 § d (available in English at <http://www.consob.it/mainen/documenti/english/laws/reg18592e.htm>). As of May 19, 2015, fourteen platforms were registered. *Register of Portal Managers Established Pursuant to Art. 50-Quinquies of Legislative Decree No. 58/1998*, CONSOB (Mar. 30, 2015), http://www.consob.it/mainen/documenti/intermediari/portali/gestori_portali.xml?xsl=gest_ord_en.xsl&symlink=/mainen/intermediares/portali/os.html.

217. *Id.* art. 4 § 1.

218. *Id.* “The management of portals for the collection of capital for innovative start-ups is reserved to the investment companies and banks authorised to provide the relative investment services and to the subjects entered on a special register held by Consob, providing these latter transmit the orders regarding the underwriting and trading of financial instruments representing capital exclusively to banks and investment companies.” Consolidated Law, Decreto Legislativo, 24 febbraio 1998, n. 52, art. 50-quinquies (It.), introduced by D.L. n. 179/2012, converted into L. n. 221/2012. The regulation implies that the portal may be separate, but must associate with a bank or an investment company that will provide the underwriting of the offerings. Permitted managers must be registered and must meet specific requisites. *Id.* art. 50-quinquies § 3.

219. Alternatively, the platforms can request an annotation in the special section of the register if it is owned by a bank or investment company and intends in the future to operate as a portal. CONSOB Reg. n. 18592/2013, at art. 4 § 2. One platform was automatically registered under the special section of CONSOB regulations. See *Register of Portal Managers Established Pursuant to Art. 50-Quinquies of Legislative Decree No. 58/1998*, CONSOB (Mar. 30, 2015), http://www.consob.it/mainen/documenti/intermediari/portali/banche_iv.xml?xsl=gest_spec_en.xsl&symlink=/mainen/intermediares/portali/ss.html.

220. CONSOB Reg. n. 18592/2013, art. 9.

221. *Id.* art. 13.

222. *Id.* art. 14 & 17.

223. *Id.* art. 15. Article 16 requires the disclosure with regard to the information offer.

includes a set of sanctions if the manager fails to comply with these requirements.²²⁴

The Italian regulations limit both the type of companies that can raise funds and how much they can raise. They limit fundraising to €5 million per 12 months.²²⁵ Only innovative startups, including startups with a social vocation,²²⁶ can use the prospectus requirement exemption. An innovative startup is a company that owned or controlled by natural persons, that was established less than forty-eight months prior, is subject to Italian tax or has its headquarters in Italy, has turnovers of lower than €5 million, does not distribute profits, and produces innovative products in the high technological sector.²²⁷ Innovative startups must also have at least either invested fifteen percent of their budget in research and development; or more than one-third of their employees must have research degrees (masters or doctorates); or, it must hold patents for either industrial, electronic or biotechnological inventions or inventions of new vegetable varieties.²²⁸ These requirements limit the companies that can use crowdfunding as a financial means in their early stages, which may involve more risks. Additionally, companies can only emit “financial instruments” that represent a share or stakes of the capital.²²⁹

Finally, CONSOB also regulates investors in a unique way: CONSOB requires that “at least 5% of the financial instruments offered are undersigned by professional investors or by banking foundations or by innovative start-up incubators[.]”²³⁰ This requirement serves as a stamp of approval from the professional investing community and aims to prevent fraudulent investments or investments destined to fail. However, beyond this requirement, CONSOB did not create any specific category of investors or put a limit on their investments. Investors are afforded some protection and may even change their minds before the project is fully funded – within certain limits.²³¹

224. *Id.* art. 23.

225. Decreto Sviluppo Bis, Decreto Legge 18 ottobre 2012, n. 179, art. 25 § 1.d (It.) converted into L. n. 221/2012.

226. CONSOB Reg. n. 18592/2013, art. 2 § 1.c.

227. D.L. 179/2012, art. 25.

228. *Id.* art. 25 § 2h. See *Investor Education: Important Things to Know Before Investing in Innovative Start-Ups through a Portal*, CONSOB, also press releases of the explained regulations at <http://www.consob.it/mainen/consob/publications/start-ups.pdf> (last visited Sept. 16, 2014), for an explanation of the Italian law in English.

229. CONSOB Reg. n. 18592/2013, art. 2.

230. *Id.* art. 24.

231. Investors can withdraw their order under two circumstances: first, within seven days of ordering and second, within seven days of having knowledge of a material mistake that would “influence the decision on the investment.” *Id.* art 13 § 5 & 25 § 2.

Since the new law was passed, a few platforms have registered with CONSOB.²³² Stars Up, the first platforms to be registered,²³³ completed its first successful fundraising project in August 2014.²³⁴ This platform helped raise funds for Cantiere Savona, a start-up that produces solar-motor boats.²³⁵ It raised €380,000 from forty-four investors or about €8,600 (about \$12,000) per investor. It is interesting to note that there was an eight business-day delay between reaching the fund threshold and achieving the requisite five percent threshold from professional investors.²³⁶ The tastes of professional investors may differ from those of this new investing crowd. This difference may limit the projects being funded to those that attract traditional professional investors: the five percent-professional-fund requirement may alleviate some problems of fraud, but it encourages the same funding patterns.

C. *The United Kingdom Extends Within Limits the Investing Crowd*

In 2013, the United Kingdom's Financial Conduct Authority ("FCA") affirmed that investment-based crowdfunding platforms were regulated like any broker-dealer. In addition, fund seekers need to have a valid prospectus (unless their fundraising can take advantage of an exemption). However, this new regulation did extend the definition of qualified investors.²³⁷

232. See *supra* notes 217 & 226.

233. Unicaseed technically is the first platform in the special section and completed the first equity crowdfunding project in March, 2014. See Naomi O'Leary, *Startup Completes First Equity Crowdfunding Drive in Italy*, REUTERS (Apr. 1, 2014, 2:28 PM), <http://www.reuters.com/article/2014/04/01/us-italy-crowdfunding-idUSBREA301NB20140401>. However, because this platform was operating under a different regime, it may be counted differently. See Marco Viviani, *StarsUp, Primo Portale di Crowdfunding*, WEBNEWS (Oct. 28, 2013, 5:04 PM), <http://www.webnews.it/2013/10/28/starsup-portale-crowdfunding-startup/>. Unicaseed is a subsidiary of Unicasism, which is regulated by CONSOB and the Bank of Italy. See J.D. Alois, *First Italian Equity Crowdfunding Offer Closes*, CROWDFUNDING INSIDER (Apr. 1, 2014, 9:59 PM), <http://www.crowdfundinsider.com/2014/04/35023-first-italian-equity-crowdfunding-offer-closes/>.

234. Alessandro Lerro, *Italy's First Year of Equity Crowdfunding*, CROWDSOURCING.ORG (Aug. 18, 2014, 8:17 PM), <http://www.crowdsourcing.org/editorial/italys-first-year-of-equity-crowdfunding/33287>.

235. See *Cantiere Savona SRL*, STARSUP, <http://www.starsup.it/project/cantiere-savona-srl/> (last visited Aug. 19, 2014).

236. Observation made from checking the website regularly.

237. See Financial Conduct Authority, *The FCA's Regulatory Approach to Crowdfunding (and Similar Activities)*, Consultation Paper 13/13, 4 (Oct. 2013), available at <http://www.fca.org.uk/static/documents/consultation-papers/cp13-13.pdf> [hereinafter Consultation Paper].

First, crowdfunding platforms must be licensed²³⁸ as of April 2014.²³⁹ Crowdfunding platforms will incur two types of compliance costs. Industry experts estimate that these authorization procedures will cost about £150,000 (about \$250,000)²⁴⁰ and requires six to nine months worth of compliance work before filing. The process will take a further six months (after filing).²⁴¹ The FCA estimates that the new regulation will cost an additional £3,000 (\$5,000) to already-regulated crowdfunding platforms.²⁴² The new regulation puts limitation on equity crowdfunding platforms solely with regard to promotion and requires that platforms have a compliance director.²⁴³ Some platforms have already complied ahead of the October deadline.²⁴⁴

Second, the U.K. adopted financial regulations similar to the EU Directive on Prospectus discussed above. Thus, fund-seeking compa-

238. “[I]f a crowdfunding platform enables a business to raise money by arranging the sale of unlisted equity or debt securities, or units in an unregulated collective investment scheme, then this is ‘investment-based crowdfunding’ regulated by the FCA and the firm operating the crowdfunding platform needs to be authorised.” *Id.* at 4.

239. Platforms have until the end of the transition period to comply with these registration requirements. “For investment-based crowdfunding and similar activities we proposed a transitional period allowing firms the option of either complying with the new rules from 1 April 2014, or complying with existing rules until 1 October 2014 and then applying the new rules from that date.” Financial Conduct Authority, *The FCA’s Regulatory Approach to Crowdfunding over the Internet, and the Promotion of Non-Readily Realisable Securities by Other Media: Feedback to CP13/13 and Final Rules*, Policy Statement 14/4, 12 (Mar. 2014), available at <http://www.fca.org.uk/static/documents/policy-statements/ps14-04.pdf> [hereinafter Policy Statement].

240. Converting this value and other values in British Pound Sterlings in the rest of this paper using the Federal Reserve Board exchange rate data on December 31, 2013 (\$1.6574 to £1). Board of Governors of the Federal Reserve System, *Historical Rates for the UK Pound*, FEDERALRESERVE.GOV, http://www.federalreserve.gov/releases/h10/hist/dat00_uk.htm (last visited Aug. 14, 2014).

241. Simon Deane-Johns, *Response to the Financial Conduct Authority Consultation on Crowdfunding (CP 13/13)*, 13 (citing the Fintech Challenger Business Workshop, October 2013), available at http://ec.europa.eu/internal_market/consultations/2013/crowdfunding/docs/contributions/individuals-and-others/keystone-law_en.pdf (last visited Aug. 14, 2014). It is not clear whether this cost applies only to loan-based crowdfunding platforms or both equity and loan crowdfunding platforms. Nonetheless, these costs exist for equity crowdfunding platforms as well since equity-based crowdfunding must obtain a license under the Financial Services and Markets Act 2000 and comply with Chapter 4 of the FCA’s Conduct of Business Sourcebook (COBS 4 – Communicating with clients, including financial promotions). These compliance measures impose costs on the platform for each offering; thus, the costs presented may be biased downward.

242. See Consultation Paper, *supra* note 237, at 57 & Table 11.

243. See *id.* at 47.

244. See *The Financial Services Register*, FINANCIAL CONDUCT AUTHORITY, <http://www.fsa.gov.uk/register/firmBasicDetails.do?sid=290368> (last visited July 24, 2014), for an example of a U.K. platform that has received such certification. The crowdfunding platform, Crowdcube, also specifies on its website that it received the appropriate status to emit shares. *Accreditations and Associations*, CROWDCUBE, <http://www.crowdcube.com/pg/accreditations-and-associations-80> (last visited July 24, 2014).

nies must comply with existing regulations on prospectuses.²⁴⁵ In other words, the company seeking funds must submit its prospectus to the relevant authority and have it approved; it must release a public prospectus ahead of time, a declaration of accurate information, financial information, the investment objective, organizational structure, and risk factors.²⁴⁶ This prospectus must also specify whether any of the managers have been convicted of a crime.²⁴⁷

The U.K. also adopted similar exemptions to the Directive on Prospectus discussed in more detail above. For instance, no prospectus is required for investments up to €5 million²⁴⁸ that involved fewer than 150 non-qualified investors and any number of qualified investors or for investment that does not exceed €100,000.²⁴⁹

Third, the new FCA regulation “aims to make investment-based crowdfunding more accessible to a wider, but restricted, audience of consumers.”²⁵⁰ The new regulation expands who can invest: a bigger but restricted crowd. The FCA is worried about the exposure of unsophisticated investors to these investments, thus it limits the promotion investors may receive.²⁵¹ Platforms can only directly communicate with retail clients that are certified²⁵² or self-certify²⁵³ as sophisticated

245. “The rules we consulted on do not affect or limit the applicability of existing legislation,” which are in “sections 755 and 756 the Companies Act 2006 [and] section 85 of the [Financial Services and Markets Act 2000]. . . .” Policy Statement, *supra* note 239, at 40; *see also* Financial Services and Markets Act 2000 § 84 (U.K.).

246. Financial Services and Markets Act 2000, c. 8, § 87A; *see also* *Guide to Listing Depositary Receipts*, LONDON STOCK EXCHANGE, <http://www.londonstockexchange.com/companies-and-advisors/main-market/documents/brochures/guidetolistingdepositaryreceipts.pdf> (last visited Aug. 14, 2014).

247. *Guide to Listing Depositary Receipts*, *supra* note 246, at 79.

248. The Prospectus Regulations 2012, S.I. 2012/1668; *see also* HM Treasury, *Consultation on Early Implementation of Amendments to the Prospectus Directive*, GOV.UK (Mar. 2011), available at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/81265/consult_early_implementation_amendpd.pdf.

249. Financial Services and Markets Act 2000 § 86(1).

250. Consultation Paper, *supra* note 237, at 36.

251. *Communicating with Clients, including Financial Promotions (COBS 4)*, in CONDUCT OF BUSINESS SOURCEBOOK, 4.7.7-8 (Mar. 2015), available at <http://fshandbook.info/FS/html/handbook/COBS> [hereinafter COBS]. *But see* Consultation Paper, *supra* note 237, at 38 (“We have no evidence to show that the wrong type of investor is investing in unlisted shares or debt securities. It is possible our current regulatory approach is effectively preventing this. However, we have historically identified instances of non-compliant promotion of unlisted shares by firms using mailings or telephone-based business models. We expect the proposals outlined in this [Consultation Paper] to minimise the risk of such promotions in future.”).

252. A certified sophisticated investor must: (1) have an independent certificate – at most 36 months old – proving he understands the risks associated with investing; and (2) have “signed, within the period of twelve months ending with the day on which the communication is made, [the Sophisticated Investor Statement].” COBS, *supra* note 251, at 4.12.7.

253. A self-certified sophisticated investor is an individual who has “signed, within the period of twelve months ending with the day on which the communication is made, [the Self-Certified

investors; retail clients who are certified as high net worth investors;²⁵⁴ retail clients who confirm they have received investment advice; and retail clients who will not invest more than ten percent of their net investible portfolio.²⁵⁵ This last category codified as a *certified restricted investor* is the most noticeable change. Under these new regulations, platforms can accept contributions from any investors who certify in writing that they have not and will not invest more than ten percent of their net assets in a twelve months period.²⁵⁶

In short, these updated regulations achieve two aims. First, they regulate how platforms present information about investing – specifically they require disclosure about the risks involved²⁵⁷ and the platforms are responsible for making sure that only authorized investors are contributing.²⁵⁸ Second, these new regulations extended the definition of investors beyond the traditional certified/self-certified investors and high net worth individuals. It limits investors (who willingly take on the risks) to ten percent of their portfolio;²⁵⁹ but it ultimately widens the pool of investors – and hence the funds available.

The FCA focuses its attention on investment. Even though regulations for platforms and companies were not specifically affected, including them in the newly released guideline discussion emphasizes to platforms and fund-seeking companies their obligations, their limitations, and their rights.

CrowdCube is among the most successful equity crowdfunding websites in the U.K. Having a publicly available webpage for any crowdfunding investment effort may qualify as prohibited promotion; hence, CrowdCube requires people to login²⁶⁰ and certify themselves

Sophisticated Investor Statement]”; a statement that acknowledges the risks involve with investing, worked in the financial sector with a company with at least £1 million turnover. *Id.* at 4.12.8.

254. The investor “had, throughout the financial year . . . an annual income to the value of £100,000 or more;” or “held, throughout the financial year . . . net assets to the value of £250,000 or more.” *Id.* at 4.12.6.

255. *Id.* at 4.7.10; Consultation Paper, *supra* note 237, at 38.

256. COBS, *supra* note 251, 4.7.10; Consultation Paper, *supra* note 237, at 38. Net assets do not include primary residence (including attached mortgage), mine rights, and any benefits (i.e. life insurance and service termination benefits) and who certifies that he understand the risk exposure. See Consultation Paper, *supra* note 237, at Appendix 1, Annex D.

257. Consultation Paper, *supra* note 237, at 44. (“Where reputation and learning is insufficient, better disclosure of information can help investors make more informed assessments of whether crowdfunding investments are suitable for them. It can also help reduce the risk of potential fraud.”)

258. Platforms must test investors, via the ‘appropriateness test,’ which assures that only authorized investors are contributing by “assess[ing] client knowledge and experience to check understanding of risks.” *Id.* at 58.

259. COBS, *supra* note 251, 4.7.10.

260. CrowdCube offers the following disclaimer when a member of the public attempts to access an investment pitch: “[t]his investment opportunity is not an offer to the public and is only

as qualified investors before accessing any information about offering.²⁶¹ The website also contains a warning about the risk of investing in startups.²⁶²

D. France Wants Platforms to Control the Flow of Funding

France became one of the most recent European countries to pass its own crowdfunding regulations.²⁶³ In 2014, the French Ministry of Finance created a new crowdfunding exemption following a consultation period in 2013.²⁶⁴ This new statute came into effect October 1, 2014.²⁶⁵

The French ordinance focuses first on the platforms. It creates a new status for platforms and calls them “*conseillers en investissements participatifs*,” which is an investment-crowdfunding adviser.²⁶⁶ These advisers, much like traditional financial adviser, must have the required qualifications²⁶⁷ and register with the proper authority;²⁶⁸ they must have proper civil insurance²⁶⁹ and follow a code of ethics.²⁷⁰ Advisers must also make their information public, explain how they se-

available to registered members of Crowdcube.com who have qualified and categorised themselves as able to invest.” See, e.g., *Staks*, CROWDCUBE, <https://www.crowdcube.com/investment/staks-19011> (last visited May 18, 2015). CrowdCube states that: “By registering or logging into Crowdcube.com to view the investment opportunity, you certify that you are legally entitled to view the investment opportunities, are an authorised investor and you agree to all applicable terms and conditions on this website, including this disclaimer.” *Id.*

261. CrowdCube states that “[i]n order to access the pitch you must first become a qualifying member of Crowdcube on the basis of your status as either (i) self-certified ‘high net worth investor’, (ii) certified ‘sophisticated investor’, (iii) self-certified as a ‘sophisticated investor’ or (iv) certified as a ‘restricted investor’, in each case in accordance with the FCA’s Conduct of Business Sourcebook Chapter 4.7.” *Id.*

262. Due to the new guidelines, CrowdCube now states that “[i]nvesting in start-ups and early stage businesses involves risks, including illiquidity, lack of dividends, loss of investment and dilution, and it should be done only as part of a diversified portfolio.” *Id.*

263. See Ordonnance 2014-559 du 30 mai 2014 relative au financement participatif [Ordonnance 2014-556 of May 30, 2014 on Participatory Financing], JOURNAL OFFICIEL DE LA RÉPUBLIQUE FRANÇAISE [J.O.] [OFFICIAL GAZETTE OF FRANCE], May 31, 2014, p. 9075.

264. See Frédéric Cazenave & Jérôme Porier, *La France se met à l’heure du “crowdfunding,”* LE MONDE (Oct. 20, 2013, 4:41 PM), http://www.lemonde.fr/economie/article/2013/10/20/la-france-se-met-a-l-heure-du-crowdfunding_3499710_3234.html; Frédéric Cazenave, *La France veut accélérer l’essor du financement participatif*, LE MONDE (Feb. 14, 2014, 2:54 PM), http://www.lemonde.fr/economie/article/2014/02/14/paris-veut-accelerer-l-essor-du-financement-participatif_4366520_3234.html.

265. Ordonnance 2014-559, art. 37.

266. *Id.* art. 1 § 1 at L. 547-1. Note that traditional advisers (“*prestataire de services d’investissement*”) may also serve as intermediary for these crowdfunding efforts. *Id.* art. 8.

267. See *id.* art. 1 § 2 at L. 547-3.

268. *Id.* art. 1 § 2 at L. 547-4. Note that these advisers must also submit to formation and pass the AMF test.

269. Ordonnance 2014-559, art. 1 § 2 at L. 547-5.

270. *Id.* art. 1 § 3 at L. 547-9.

lect the projects, and disclose their remuneration (which cannot be in the form of shares).²⁷¹ They must advise investors about the risks involved and publish an annual report of their activities.²⁷² Finally, they must conduct their activities through an internet website.²⁷³ Most of the ordinance focuses on this new status for equity crowdfunding platforms and puts the onus on them to perform due diligence.

The ordinance also creates an exemption to the prospectus requirement. Companies can raise up to an amount specified by decree, over twelve months, without having to adhere to the traditional prospectus requirement.²⁷⁴ A prospectus is not required because this type of fundraising does not qualify as a public offering. The decree limits the raise-able funds at €1 million.²⁷⁵ The companies that are crowdfunding must disclose a document containing minimal information for investors to invest accordingly.²⁷⁶ Neither the ordinance nor the decree limits investors.²⁷⁷

The ordinance did not create equity crowdfunding in France, but it facilitated the hoops through which platforms had to jump. It alleviated some of the costs by creating a new category of financial adviser for platforms and created a new exemption for company prospectus. For instance, WiSeed was operating before this new ordinance came into force and had already raised about €8.7 million in forty-four

271. *Id.* art. 1 § 2 at L. 547-6-A & art. 17 § 3 at L. 548-6.

272. *Id.* art. 17 § 3 at L. 548-6.

273. *Id.* art. 17 § 3 at L. 548-1. Note that the crowdfunding platforms may have to hold sufficient capital if they qualify as a limited payment establishment because it may divest funds according to the success of the campaign. Ordonnance 2014-559, art. 16 at L. 522-11-1.

274. *See id.* art. 11 at L. 411-2.

275. Loi 2014-1053, art. I at D. A 548-1, du 16 septembre 2014 relatif au financement participatif, [Law 2014-1052, art. I at D. A 548-1, of September 16, 2014 on Participatory Financing], JOURNAL OFFICIEL DE LA RÉPUBLIQUE FRANÇAISE [J.O.] [OFFICIAL GAZETTE OF FRANCE], Sept. 17, 2014, p. 15228.

276. “Une information minimale doit être délivrée aux investisseurs par la plate-forme sur son site internet. Les sociétés qui recourent à ce mode de financement ne pourront pas opter pour la confidentialité de leurs comptes.” In English: “Minimum information must be issued to investors by the platform on its website. Companies that use this method of financing will not be able to opt for the privacy of their accounts.” *Rapport au Président de la République relatif à l'Ordonnance 2014-559 du 30 mai 2014 relative au financement participatif* [Report to the President with regard to Ordinance 2014-559 on Participatory Financing], JOURNAL OFFICIEL DE LA RÉPUBLIQUE FRANÇAISE [J.O.] [OFFICIAL GAZETTE OF FRANCE], May 31, 2014, p. 9074.

277. The decree specifically limits the amount per project and per investor for lending crowdfunding. Loi 2014-1053, art. 1. Contributors are limited to _1,000 per project for loans for personal reasons (capped at a 7-year loan) and _4,000 per project for zero-rate loans for professional endeavors. *Id.* art. I at D. 548-1. The lending loans are also capped at one million euros per professional project. *Id.* Therefore, since the decree is silent on other limits for equity crowdfunding, contributors are not limited in their investment.

projects.²⁷⁸ WiSeed focuses on innovative startups (less than eight years old) in the health, biotech, digital, environment, industry and service sector.²⁷⁹ While they welcome the new ordinance because it lends legitimacy to equity crowdfunding,²⁸⁰ they have been operating as a “*prestataire de services d’investissement*,” i.e. financial adviser under the old regime through a partnership with Alternativa.²⁸¹ One of its success stories involves a biotech start-up named Antabio that raised €300,000 (about \$414,000) and, eighteen months later, sold the shares to a business angel for a forty-four percent return on investment.²⁸² This kind of result should not be generalized, but it shows the potential of equity crowdfunding for investors.

All these countries require an audited prospectus for IPO but attempted to accommodate, within limits, crowdfunding. These countries, however, differ on how they accommodated fund seeking companies. Table 2 offers a summary of the crowdfunding regulations discussed above.

278. A Propos, WiSEED, <https://www.wiseed.com/fr/qui-sommes-nous> (last visited Aug. 20, 2014).

279. Questions / Responses, WiSEED, <https://www.wiseed.com/fr/entrepreneur/lever-des-fonds-avec-wiseed/questions-reponses> (last visited Aug. 20, 2014).

280. Interview by Valerie Talmon with Stéphanie Savel, President, WiSeed (June 16, 2014) (video available at *Les enjeux du crowdfunding*, LES ECHOS (June 16, 2014, 2:33 PM), <http://videos.lesechos.fr/3624928006001> (last visited Aug. 20, 2014)).

281. Pascale Besses-Boumard, *La finance participative fait des émules*, LA TRIBUNE (Jan. 21, 2014 6:59 AM), <http://www.latribune.fr/bourse/actualite/20130122trib000744093/la-finance-participative-fait-des-emules.html>.

282. *A Model that Knew Its First Success*, WiSEED, <https://s3-eu-west-1.amazonaws.com/wiseed-public-fr/mediatheque/antabio-infographie.jpg> (last visited Aug. 20, 2014).

TABLE 2. SUMMARY OF REGULATIONS

	United States	Italy	United Kingdom	France
Platforms	Licensed	Licensed	Licensed	Licensed Insurance
Fundraising Companies	Restrictions: Yearly filings Cap: \$1 million every 12 months	Restrictions: Young, Small Innovative Companies Cap: €5 million every 12 months	Cap: €5 million every 12 months	Cap: €1 million every 12 months
Investors	Tiered investment thresholds: (1) \$2,000 for under \$40,000 net worth (2) 5% of income or net worth if income and net worth between \$40,000 and \$100,000 (3) 10% of income or net worth if income and net worth over \$100,000	5% invested from professional investors	10% of assets	No restrictions

V. DISCUSSION AND CASE STUDY

This Part compares how different countries have approached crowdfunding regulations. To conclude, this Part first compares the regulations and their consequences across the jurisdictions previously discussed. This Part finally looks at how a platform, CrowdCube and its investors, have performed under the new U.K. regulation.

A. Comparing Regulations

Countries approach the new phenomenon of equity crowdfunding in one of three ways. This Article investigates two of these three main approaches. Though it does not go into the third approach (“holding pattern”), it discusses examples that demonstrate that most countries already have in place extensive regulations for public offerings (e.g., Australia and the EU Directives/Regulations). Crowdfunding actors can comply with these regulations, though this is expensive; or, they can take advantage of their exemptions to crowdfund in a limited way.

On the one hand, creating further regulations may require revisiting previous regulations or to creating consistent new exemptions; legislators need to weigh the cost of these new regulations against their benefits. Thus, some countries may opt to let the current regulations address equity crowdfunding because these regulations are already proven and functioning – particularly when it comes to investor protection.

On the other hand, when regulators and legislators opt to follow a holding pattern, they ignore three important issues. First, some uncertainties about which regulations apply may hinder crowdfunding.²⁸³ Affirming what regulations apply would alleviate those uncertainties and send a signal about the industry.²⁸⁴ Second, current regulations may be so costly that, without an exemption, crowdfunding may not exist at all. Current regulations may create barriers to entry for large source of investment. Third, if crowdfunding does not exist in one country, citizens may still decide to invest in crowdfunding projects abroad.²⁸⁵ Some countries, like the U.K., allow foreign crowds to invest in their market and may well attract foreign funds who do not have a crowdfunding alternative at home.²⁸⁶

283. See Weinstein, *supra* note 53, at 447 (2013) (“In Germany, for instance, the basic assumption until recently was that crowdfunding platforms could only raise as much as _100,000 per project. The founder of equity platform Seedmatch challenged this paradigm though, by drawing up arrangements between investors and equity-offering companies based on ‘a so called ‘partiarisches Darlehen’ or a profit participating loan’ contract. The German financial authority recognized and accepted this bit of innovation, and Seedmatch can now raise equity rounds above the _100,000 limit, but it faces an uncertain future with regards to laws governing the screening of potential investors and fundraisers.”).

284. Even though WiSeed already complies with the current regulation, its president expressed the importance of the government legitimizing the industry with its new ordinance. See Interview by Valerie Talmon with Stéphanie Savel, *supra* note 280.

285. For instance, in the U.S., the SEC affirms that non-U.S. residents will be able to invest in the U.S. and “the [investment] limitations would apply to all investors, including retail, institutional or accredited investors and both U.S. and non-U.S. citizens or residents.” SEC Rule Interpretation, *supra* note 52, at 66,434.

286. Being able to invest abroad has a number of consequences. Platforms will compete internationally, which should decrease their fees. Projects will also compete across borders, which may decrease the number of fraudulent projects because they will need to send costly signals to get funded. Investors will be able to invest abroad and should be able to diversify their investments and decrease their shock exposure. However, this discussion is beyond the scope of this paper. For instance, Seedrs, a U.K. based website, states in 2014, six of the successfully funded projects came from outside the U.K., namely Belgium, Croatia, Czech Republic, Portugal, and Spain. All six countries did not have active crowdfunding specific regulations in 2014. Seedrs also states that investors in thirty-one countries are active on the site, which means that investors from countries without crowdfunding specific regulations were likely investing in the U.K. See Alysia Wanczyk, *2014 at a Glance, SEEDRS*, <http://learn.seedrs.com/2014-infographic/> (last visited May 26, 2015).

This Article investigated the other two approaches that countries have deployed when faced with equity crowdfunding: reaffirming which regulations apply to crowdfunding and creating new regulations/exemptions specifically for crowdfunding.

Reaffirming applicable regulations has value in itself.²⁸⁷ First, a governmental publication serves as a notice for individuals already participating in crowdfunding. Platforms are probably already aware that they are threading in a heavily regulated environment because they have lawyers on staff to deal with these regulations; yet, the public notice serves as a forewarning about the extent of the regulated activity and as a notice that they should expect some auditing. In the case of Australia, ASIC (the regulator) elected to send this guidance directly to crowdfunding platforms.²⁸⁸

Second, this governmental publication removes some of the doubts for companies seeking funds through crowdfunding and investors already investing. Companies and investors, aware of the guidance, are probably already investing; thus, it may not attract new participants and funds but it removes some uncertainties.²⁸⁹ When a governmental affirmation removes doubts about the legal framework, it decreases the cost of investing.

Third, a governmental affirmation may also attract new funds and participants. It acknowledges the existence of the practice and also shines a light on it by creating a story in the newspapers that publicizes crowdfunding. More importantly, it legitimizes the practice because the government recognizes its existence and the intricate regulations applying to the practice without prohibiting it. At the European level, the EC Communication pointed to a plethora of Directives and Regulations. In itself, it did not alleviate doubts because each Member State may have applied them differently or it did not forewarn platforms either because the EC does not regulate on its own. However, this Communication led to a few news stories in Europe and publicized the existence of this phenomenon,²⁹⁰ making peo-

287. See EC Communication, *supra* note 108, at 8 (“[T]he different [Member State] approaches may create legal uncertainty as to what rules apply to which forms [of crowdfunding], despite recent initiatives that aim to gather legal information. The public consultation confirmed the importance of legal clarity for all stakeholders.”).

288. ASIC Guidance, *supra* note 65.

289. For instance, investors and particularly the general public may not have access to the same legal advice as platforms. They may not realize the implications of investing, including the risks. An affirmation allows them to look up on their own the applicable regulations without the assistance of a lawyer.

290. See, e.g., Huw Jones, *Pour doper la croissance, la CE veut relancer la titrisation*, LES ECHOS (Mar. 24, 2014, 3:39 PM), <http://bourse.lesechos.fr/infos-conseils-boursiers/actus-des-marches/infos-marches/pour-doper-la-croissance-la-ce-veut-relancer-la-titrisation-960038.php>

ple aware that the government was investigating crowdfunding in further details.²⁹¹

Faced with crowdfunding, legislators can also decide to create a new regulation or a new exemption. The United States was the first to address crowdfunding and may do so again soon. Italy, France, and the United Kingdom – which are all applying a similar set of European Directives – have nonetheless approached crowdfunding differently.

All these regulations require that funds be raised through an internet portal and limit the raise-able funds over a twelve months period. Beyond these commonalities, each country focused on a different participant (i.e. platforms, offering companies, investors).

The United States focuses on the investing crowd and to a smaller extent on the fundraising companies. It limits the financial participation of each investor may put into crowdfunding. Platforms, acting as intermediaries, are regulated under the same registration requirements and regulations. The JOBS Act limits the amounts that can be raised, but more interestingly, the U.S. requires a continuous filing from these companies with their regulator. These filing costs may deter some small and medium enterprises and impact on equity crowdfunding.

Italy regulates all three actors but focuses on fund-seeking companies and the investing crowd. While CONSOB, the Italian regulator, has implemented a new broker category for online portals and a different compliance procedure, Italian regulation focuses more on the other two participants. First, it limits the type of companies that may raise funds, ensuring that crowdfunding provides seed financing for young innovative companies. Investing in new and innovative companies involves potentially large none-negligible risks because these companies lack a track record. To counterbalance this issue, the Italy regulator, CONSOB, requires the involvement of professional investors. More projects are posting on these equity crowdfunding websites every day but it is too soon to tell how startups will be affected.

The United Kingdom focused on the investing crowd. The U.K. regulator, the FCA, elected to allow the average citizen to invest up to ten percent of his or her net assets by making them “restricted qualified investors.” The U.K. regulator however did not address the pro-

(discussing the upcoming communication); Huw Jones, *Factbox: EU Roadmap for Expanding Long-Term Financing*, REUTERS (Mar. 27, 2014, 6:34 AM), <http://www.reuters.com/article/2014/03/27/us-eu-investment-road-map-factbox-idUSBREA2Q0P220140327> (commenting on the past communication).

291. See, e.g., EC Communication, *supra* note 108.

spectus requirement; thus, platforms must still register with the FCA and use the currently available exemptions (limiting fundraising to €5 million and only 150 non-qualified investors for instances).

France focused on the platforms. The French Ministry of Finance elected to create a prospectus exemption if the investment is done through online portal. These online portals have many requirements including a civil insurance requirement. Companies can raise up to €1 million and any contributor can participate.

Without further information, it is difficult to understand how each regulation impact crowdfunding and companies seeking funds. The next section offers the example that the U.K. regulation has had on one platform named CrowdCube.

B. *Case Study: CrowdCube in 2014*

To illustrate some of the points discussed above, I gathered data on CrowdCube. CrowdCube is among the most successful equity crowdfunding websites in the U.K. CrowdCube takes advantage of the prospectus exemption that involve fundraising effort bellow €5 million that involved fewer 150 non-qualified investors and any number of qualified investors.

I collected data from the CrowdCube website about crowdfunding campaigns that successfully closed in the calendar year 2014. CrowdCube does not keep information about unsuccessful campaigns on their website. Therefore, I focused on successful campaigns. CrowdCube does not keep information about all successful campaigns on their website either, which creates a selection bias. In their annual report, CrowdCube asserts that they funded 105 companies out of 320 projects in 2014 and collected about £35 million.²⁹² I collected information about seventy-two companies and who raised seventy-four percent of these funds.

I eliminated one company because it offered no visible equity (only rewards) and three companies because they raised money through bonds instead of equity. Sixty-eight companies, or two-thirds of the companies that successfully raised fund through CrowdCube in 2014, remain in the data analysis. The dataset contains the name of the company, the offering specifics (type of shares, price, amount targeted, capitalization offered, amount collected, capitalization granted, number of investors, highest investments), and other information about each company. I crossed the collected data with publi-

292. Rose Eliot, *Review of 2014*, CROWDCUBE BLOG (Jan. 9, 2015), <http://blog.crowdcube.com/2015/01/09/review-of-2014/>.

cally available data about each company from the United Kingdom government database.²⁹³ To compare to the active companies distribution, I used business demographic data from the U.K. Office for National Statistics.²⁹⁴

1. Campaign

Focusing on campaigns, Table 3 presents the characteristics for the successful crowdfunding equity campaign carried through Crowdcube. The sixty-eight companies offered on average £191,000 for 12.24% of equity but raised on average £278,000 for 16.75% of equity. The large majority of companies allowed for overfunding leading to an average overfunding: these companies on averaged raised 146% of the initial capital offered.

TABLE 3. CAMPAIGN CHARACTERISTICS (SOURCE: CROWDCUBE)

	<i>Average</i>	<i>High</i>	<i>Low</i>	<i>Standard Deviation</i>
Capital Offered	£190,974	£1,000,000	£35,000	178,757
Capital Raised	£278,204	£1,562,960	£45,360	278,716
Capitalization Offered	12.24%	29%	0.39%	6.52
Capitalization Raised	16.75%	35.07%	1.07%	7.69
Largest Contribution (function of total contribution)	22.1%	80.2%	6.1%	14.8
Number of Investors	142	482	19	92

From a game theory standpoint, this overfunding observation seems in line with the incentives created by the *all-or-nothing* model that Crowdcube employs: an entrepreneur receives the funds only if he reaches a pre-specified threshold; hence, entrepreneurs are incentivized to lower the threshold from what they want or need to what they can reach.

On average, 142 investors invested in each project (with a large standard deviation). A large portion of the investments comes from a

293. *Get Information About a Company*, GOV.UK, <https://www.gov.uk/get-information-about-a-company> (last visited Mar., 3 2015).

294. *Business Demography 2013*, OFFICE FOR NATIONAL STATISTICS, <http://www.ons.gov.uk/ons/rel/bus-register/business-demography/2013/rft-excel-tables.xls> (last visited May 26, 2015).

single large investor: this largest investor provides, on average, 22.1% of the capital raised. Previous crowdfunding literature discusses that the first investments often come from friends and family.²⁹⁵ Entrepreneurs may receive these large funds from their friends and family to jumpstart the process.

2. Companies

Focusing on the fund seeking companies, Table 4 presents data characteristics of the companies. Companies that use crowdfunding are relatively young: 2.61 year old on average by the time they successfully raise funds. The youngest company was a month old (Quiz the Nation) and the oldest was twelve years old (Bookbarn International).

TABLE 4. COMPANY CHARACTERISTICS (SOURCE: CROWDCUBE)

	<i>Average</i>	<i>Maximum</i>	<i>Minimum</i>	<i>Standard Deviation</i>
Company Birth	November 22, 2011	September 9, 2014	June 2, 2002	
Company Age at End of Campaign (year)	2.61	0.10	12.48	2.38
Number of Loans	0.31	3	0	0.76
Number of Team Members	5	15	1	3

Most of these companies have not successfully obtained a loan since, on average, each company has fewer than one loan. Furthermore, most of these companies are small: five employees on average. Therefore, it seems that equity crowdfunding attracts startups.

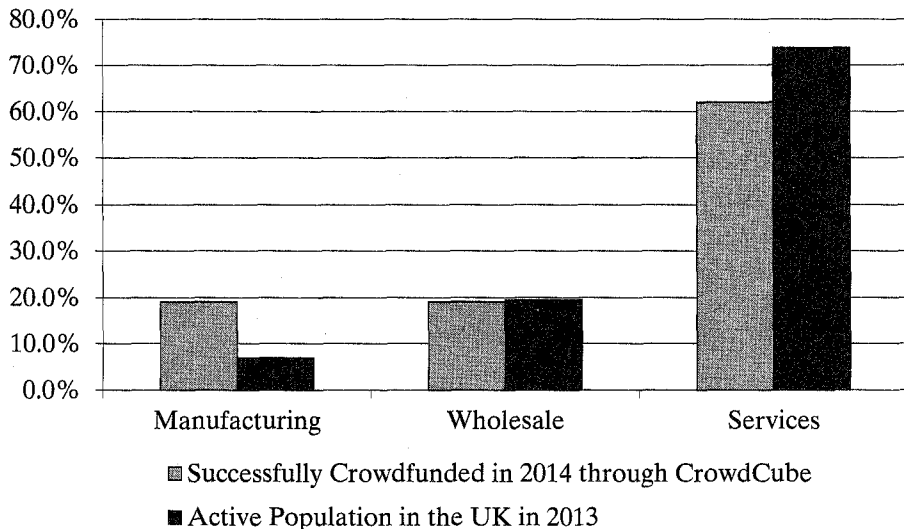
A closer look at the company distribution across sectors shows that 12 manufacturing companies, 12 wholesale companies, 39 services companies, and 5 companies that fall outside these sectors (construction and farming) successfully raised funds.

This distribution of companies – once excluding construction and farming sector – almost mirrors the distribution of active companies. Figure 1 depicts the distribution of companies that were successfully

295. See, e.g., Agrawal et al., *supra* note 36, at 67.

crowdfunded through CrowdCube in 2014 and compares it to the population of active companies in the United Kingdom in 2013.

FIGURE 1. COMPARING FUNDED COMPANIES IN 2014 AND ACTIVE COMPANIES IN THE POPULATION IN 2013 (SOURCE: CROWDCUBE; OFFICE FOR NATIONAL STATISTICS)



This figure shows that successfully funded wholesale companies²⁹⁶ are relatively close to their ratio of active companies (19.0% versus 19.4%). Funded manufacturing companies are overrepresented (19.0% versus 6.8%) whereas service companies²⁹⁷ are underrepresented (61.9% versus 73.8%).

This graph implies that a broad range of companies are successful at reaching their fundraising threshold – but more particularly manufacturing companies. Since campaign must explain how they intend to profit, it may seem more obvious through manufacturing, which may have affected investor decisions.

3. Investors and the New Regulation

The 2013 FCA regulation focused on investors. Table 5 shows summary statistics for investors in these 68 successful companies. The av-

296. Under the UK Standard Industrial Classification of Economic Activities 2007, wholesale companies include retail companies.

297. Wholesale companies are excluded from service companies because they are represented independently.

erage investment increased from £1,559 to £1,985 after the regulations.²⁹⁸

TABLE 5. INVESTOR PRE- AND POST-APRIL 2014 (SOURCE: CROWDCUBE)

	Number of Total Investments Made	Capital Raised Per Campaign	Investment Amount Per Investors	Investment Amount Per Investors (without largest investment)	Investors Per Investments	Overfunding
<i>Pre-April 2014</i>	1,910	£175,191	£1,559	£1,205	112 ²⁹⁹	143%
<i>Post-April 2014</i>	8,030	£213,828	£1,985	£1,571	157	146%

The investment per company also increased from about £175,000 to about £214,000; but the level of overfunding remains essentially the same. This observation indicates that companies did not alter their strategy to under-ask to reach the threshold.

The U.K. regulation opened investment to a new set of investors who did not previously invest. While I cannot observe where the funds come from, the regulation seems to have a liberating effect on the amount invested per person. In turn, the amount raised per company also increased; this increase may be due to raising more funds from each individual as well as more investors per campaign.

In other words, clarifying regulations may have legitimized the crowdfunding practice and seems to have dis-inhibited investment behavior: per investment, more individual invested (40% increase) and each investor invested more (around 30% increase). Investors seem to become more confident. Further research may be able to identify whether investors in crowdfunding are individuals that did not invest previously. Interestingly, crowdfunding has also attracted the attention of traditional investors like venture capital companies.³⁰⁰

298. The fifth column removes the largest big for each investment because I feared that the largest big has been put down to encourage investment from friends and family – and not investors that may be encouraged to invest. The observations remain the same: investment increased from pre- to post- regulation.

299. It is interesting to note that even before the regulation allowed for the “restricted qualified investor” category, four out of the seventeen successfully funded projects in 2014 had over 150 investors, which implies that some of the investors using the platforms had to be qualified investors.

300. See Samantha Hurst, *LOVESPACE Attracts DN Capital During Crowdfunding Campaign on Crowdcube*, Crowdfund Insider (Jun. 5, 2014, 1:46 PM), <http://www.crowdfundinsider.com/2014/06/41142-lovespace-attracts-dn-capital-crowdfunding-campaign-crowdcube/>.

This may be evidence that regulations have legitimized crowdfunding and encouraged traditional investors to also take advantage of these opportunities. It remains unclear what the impact will be on the funds available for investment.

VI. CONCLUSION

In France, Italy, the U.K., and the U.S.,³⁰¹ companies can now or will soon be able to raise funds from a large number of individuals. This may be because the local regulator changed the definition of qualified investors or created an exemption to the prospectus requirements. This plethora of regulations affects all three actors involved in the crowdfunding process and also where they crowdfund. Countries may eventually leverage their funding laws and regulations to attract more startups.

This regulatory arbitrage can work in three ways: platforms may gravitate toward one country; fund seekers may select to crowdfund within the country that has the most advantageous regulations; or investors can invest where most advantages. All three pose a dilemma for regulators. If an investor voluntarily reaches into another country to invest and voluntarily takes risks, should she or he enjoy the same protections or limits as local investors? For instance, a U.S. investor may decide that France's no limit on investment is more favorable: what if they invest in France instead of the U.S., should his investment be limited by the U.S. limits or have no limits like in France?

The same issue goes for companies: if a company voluntarily reaches aboard to draw more investors, should it be limited by the local or the foreign investment cap? A lot of those issues are not new and already have answers but the use of internet portal highlights that investment may become global and may lead to rethinking these issues.

301. The discussion in this paper ignores regulations in New Zealand, among others. New Zealand passed the Financial Market Conduct Act of 2013, which allows companies to raise up to two million New Zealand dollars over a 12-month period through a licensed platform without having to issue a prospectus – and without limit on investors aside for acknowledging they understand the risks involved (akin to the French regulation). See Financial Markets Conduct Act 2013 (N.Z.). Other countries like Canada and Germany have considered their options. For instance, in March 2014, the Ontario Securities Commission put forth draft rules including an exemption from the prospectus requirements. Ontario Securities Commission, *Introduction of Proposed Prospectus Exemptions and Proposed Reports of Exempt Distribution in Ontario* (Mar. 2014), available at https://www.osc.gov.on.ca/documents/en/Securities-Category4/csa_2014_0320_45-106_rfc-prospectus-exemptions.pdf (limiting the contribution per investor and per project).

The U.S. states have created a mosaic of regulations but investors cannot cross state lines. This is not the case for investors in Europe who may wish to invest across Member States. Investors may however be taxed several times, which is a different issue beyond the scope of this Article.

Whether the restricted home or abroad investors will inject enough funds into the economy to compensate for the fund shortage created by the financial crisis remains to be seen. As a final thought, the crowdfunding phenomenon is still in its infancy and the effect of equity crowdfunding remains unknown. Equity crowdfunding campaigns often raise funds from a few investors, each one contributing tens of thousands of dollars. We do not know whether these investors were already investing; if they were, then crowdfunding does not change the amount of investment funds available but only decreases the investment costs. More information is needed on whether crowdfunding affects the direction of the economy. While crowdfunding gives a project a chance with an investing audience, it is unclear whether investors pick projects in which they would not have invested otherwise.

