

REVIEW OF CROWDFUNDING REGULATION

Interpretations of existing regulation concerning crowdfunding in Europe, North America and Israel



EUROPEAN
CROWDFUNDING
NETWORK



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IMPRESSUM

Review of Crowdfunding Regulation. Interpretations of existing regulation concerning crowdfunding in Europe, North America and Israel, 2014

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Ireland

1 Recent developments in the market of Crowdfunding in Ireland

During the last 12 months there were the following significant developments in Ireland regarding Crowdfunding:

In October 2014 the Irish Government published a National Policy Statement on Entrepreneurship. With regard to access to finance, the document noted that alternative financing activities like Crowdfunding can be valuable sources of funding to startups. This could be used as a complement to traditional bank funding or also an alternative means of finance if bank credit is declined to an enterprise. One of the action points in this document was to undertake a rolling review of new and innovative sources of funding for entrepreneurs, including Crowdfunding.

For the time being, there is no legislation or regulation in Ireland which specifically deals with Crowdfunding and for this reason the Central Bank of Ireland (“**Central Bank**”) issued a consumer notice on Crowdfunding in June 2014. It alerted consumers that various protections do not apply to consumers of Crowdfunding. It noted that the Central Bank’s codes of conduct do not apply to Crowdfunding platforms and it warned that complaints in relation to Crowdfunding cannot be made to the Financial Services Ombudsman as they are not regulated firms. The Central Bank also pointed out that consumers are not offered protection under the Irish Deposit Guarantee Scheme or under an Irish investor compensation scheme.

The Central Bank’s notice sets out specific risks to consumers when participating in Crowdfunding. These include the risk of failure of the platform with a potential loss of some or all of their money. The Central Bank also pointed out the risk of misleading or insufficient information disclosure, unfair contract terms and misleading commercial practices. There is also the issue of the absence of dispute resolution and dispute mechanisms.

The Central Bank concluded its notice by stating that it intends to actively monitor developments in Crowdfunding and to work closely with the European authorities in this regard.

In Ireland, the following types of Crowdfunding are possible:

1.1 **The Equity Model (individuals make investments in return for a share in the profits or revenue generated by the company/project)**

Crowdfunding platforms in Ireland do not currently focus on the Equity Model though some do offer it as an option available to companies / projects seeking funding. Lending to corporates in Ireland is not a regulated activity whereas the regulatory regime for the equity model is not as straightforward. Offers need to fall within the exceptions in the Prospectus Directive as discussed below.



1.2 The Lending Model (individuals lend money to a company or project in return for repayment of the loan and interest on their investment)

The Lending Model of Crowdfunding is the principal form of Crowdfunding currently being offered in Ireland. Lending to corporates is not a regulated activity in Ireland. The regulatory regime for lending focuses on lending to consumers. Under the Crowdfunding Lending Model a platform could fall within the meaning of “credit intermediary” set out in the Consumer Credit Act 1995 if it is deemed to be engaged in the business of arranging the provision of credit to a consumer. The Consumer Credit Act 1995 defines “consumer” as a natural person acting outside their business. It is feasible that a Crowdfunding platform could be engaged in the business of arranging credit for a project through a natural person rather than an incorporated body where that natural person’s involvement is outside his / her business. It should be noted that it is not particularly difficult to obtain authorisation as a credit intermediary under the Consumer Credit Act 1995. The process is more of a notification rather than an application for authorisation of a financial institution which is more onerous.

1.3 The Donations or Rewards Model (individuals provide money to a company or project for benevolent reasons or for a non-monetary reward)

Rewards Crowdfunding is not currently regulated in Ireland, as it does not involve investment or lending. Crowdfunding has been discussed in parliament as an important future source of funding for charitable causes and community initiatives. However, there is no proposed legislation or regulation currently being considered.

It is worth noting that the credit union movement is particularly strong in Ireland. Credit unions are established for the purpose of providing low-cost credit to individuals who have a so-called “common bond” meaning a community connection usually based on a geographic area or workplace. A recently published Report of the Commission on Credit Unions suggested that credit unions be permitted to lend to small and medium sized enterprises and charitable / community initiatives within their common bond. If these initiatives are adopted credit unions could prove to be a more structured alternative to Crowdfunding with respect to certain activities.

2 Recent developments regarding Crowdfunding regulation in Ireland

No recent developments regarding Crowdfunding regulation took place in Ireland during the last 12 months.

3 Current regulation of Crowdfunding in Ireland

3.1 Approval and licensing by the Central Bank

Irish law does not recognise or regulate Crowdfunding as a distinct means of raising finance.

A “banking business” requires an authorisation from the Central Bank. The legislative definition of banking business is very broad but the Central Bank focusses on deposit taking as the essential banking



business which triggers the requirement for authorisation. If an entity is not taking deposits, while it may be caught by other licensing requirements it will not be required to hold a bank licence.

It should be noted that section 7 of the Central Bank 1971 contains a broad prohibition on holding oneself out to be a banker. Section 7(2) provides that a person shall be deemed to hold himself out as a banker if, being a body corporate carrying on any business, the name of the body includes any of the words "bank", "banker" or "banking" or any word which is a variant, derivative or translation of or is analogous to any of those words. Therefore, a Crowdfunding platform is limited in the scope of the names it can use and must avoid any name that may infer that it conducts banking business.

There are no financial services rules in Ireland designed specifically for Crowdfunding. However, when a company pitches to investors on a crowd-funding platform, such a pitch is typically considered an "offer to the public". Equity Crowdfunding may be impacted by prospectus rules (as far as the issuer is concerned) and by financial promotion rules (as far as the issuer and platform are concerned).

3.2 Investment Services

It is illegal for a firm to "act as in investment firm, claim to be an investment firm or represent that the person is an investment firm in Ireland..." without the relevant authorisation/passport/exemption. An investment firm is a firm that provides investment services to third parties on a professional basis. Investment services under the Irish Regulations which implements the Markets in Financial Instruments Directive (the "**MiFID Regulations**") are the same as those set out in Annex 1 of MiFID. The Investment Intermediaries Act 1995 ("**IIA**") also regulates investment services and can apply to some activities not otherwise covered by MiFID. Investment advice is the most relevant IIA service in the case of Crowdfunding. Investment advice is regulated as an investment service under the IIA and MiFID, however, under the IIA advising a person on where they should get investment advice will itself constitute investment advice.

The reception and transmission of orders for financial instruments and the execution of orders on behalf of clients constitute "investment services" under the MiFID Regulations. The reception and transmission of orders for such instruments are core activities for Equity Crowdfunding. Such services can only be provided by authorised investment firms. The process of authorisation is expensive and lengthy, and the level of regulation and consumer protection is significant.

3.3 Prospectus Directive

The offering of securities to the public in Ireland is subject to the Prospectus Directive including the broad exemptions contained in that Directive. Note that the Prospectus Directive was a maximum harmonisation Directive and the Irish implementing regulations (SI No 324 of 2005) therefore one can assume that the Irish implementing regulations reflect the provisions of the Prospectus Directive itself.

Equity Crowdfunding may be impacted by prospectus rules (as far as the issuer is concerned) and by financial promotion rules (as far as the issuer and platform are concerned). An offer of securities to the public cannot be made without a prospectus, unless one of the exemptions is applicable. The preparation and approval process for a prospectus is incompatible with the nature and objectives of Crowdfunding. Failure to issue a prospectus when one is required is a criminal offence. Offers are exempt where the total consideration of securities offered within Ireland is less than EUR 100,000 over a 12 month period.



3.4 Regulation of Crowdfunding under the AIFMD regime

The Alternative Investment Fund Managers Directive (“AIFMD”) was implemented in Ireland on 16 July 2013 and applies in effect from 22 July 2013. During implementation in Ireland no additional requirement (i.e. gold-plating) was added to the requirements set out in the AIFMD itself.

An AIFM is a legal person whose regular business is managing one or more alternative investment funds or “AIF”. An AIF is defined in Article 4(1)(a) as follows:

“AIF” means collective investment undertakings, including investment compartments thereof, 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 Article 5 of Directive 2009/65/EC [the UCITS Directive]”

Given the above definitions, the provision of services relating to Crowdfunding is capable of constituting management of an AIF. However, there is an exemption in the AIFMD for managers with total assets under management of less than EUR100 million.

3.5 Licence under the Payment Services Regulations

The business of money transmission is regulated by two statutes in Ireland, the first is the European Communities (Payment Services) Regulations 2009, Statutory Instrument No. 383 of 2009 (“**PSD Regulations**”) which implement the European Union’s Payment Services Directive, Directive 2007/64/EC (“PSD”). The PSD was a so called “maximum harmonisation” Directive, that the Member States were required to implement in total and were not permitted to either add additional requirements (so called gold plating) or provide for measures that are less than those set out in the PSD. We can confirm that Ireland’s implementation of the PSD through the PSD Regulations was consistent with this maximum harmonisation requirement and as such the PSD Regulations reflect very closely the requirements of the PSD itself.

Separately Part IV of the Central Bank Act, 1997 regulates a money transmission business which is defined as “... a business that comprises or includes providing a money transmission service to members of the public.” “Money Transmission Service” is defined as meaning a service that involves transmitting money by any means, other than such a service provided by a regulated entity or on an ancillary basis to other business conducted by an entity.

Therefore money transmission services which are not otherwise covered by the Payment Services Directive might be regulated by the Central Bank Act 1997 if they come with the definition of a “money transmission business”.

However, it is possible for Crowdfunding platforms to avoid the provision of payment services or money transmission in the course of their services, and so avoid the necessity for registration or authorisation under the PSD Regulations or the Central Bank Act 1997. The current Crowdfunding platforms operating in Ireland use the services of regulated payment service providers as the means through which a potential investor can transmit fund to a company / project. In this way the Crowdfunding



platforms do not transmit the funds themselves and are not required to be regulated to provide payment services.

4 Lessons learned from Ireland's regulation for a possible harmonized European Crowdfunding regulation

4.1 Role model ("dos")

There are currently no lessons that can be learned from Ireland's regulation for a possible harmonized European Crowdfunding regulation.

4.2 Aspects that should be avoided ("don'ts")

There are currently no lessons that can be learned from Ireland's regulation for a possible harmonized European Crowdfunding regulation

5 Conclusion

There is no legislation or regulations in Ireland which specifically deals with Crowdfunding. The financial regulation legislation in place is designed to regulate other business models. Therefore, Crowdfunding platforms need to ensure that they do not inadvertently provide a service which is regulated as part of legislation regulating, inter alia, investment services, banking business and / or payment services.

In Ireland, the lending activities of Crowdfunding platforms can be provided to corporates without any requirement for regulation provided the platform does not also provide investment services or payment services. A Crowdfunding platform may require authorisation as a credit intermediary if it is engaged in the business of arranging credit for consumers, being persons acting outside their business. Crowdfunding platforms cannot use the term "bank" or represent themselves as carrying on the business of banking. Equity Crowdfunding may come within the scope of the Prospective Directive and the AIFMD Regulations unless the exemptions set out above can be availed of.

The development of a Crowdfunding market and the regulation of Crowdfunding, in Ireland, are at a very early stage. However, given that the market is developing at a faster pace elsewhere in the European Union, and elsewhere, it would be timely for the EU Commission to propose legislation specific to this sector.



6 Contact details of the author

Joe Beashel, Partner

joe.beashel@matheson.com



Matheson
70 Sir John Rogerson's Quay
Dublin 2
Ireland

T: +353 1 232 2000

www.matheson.com

Eoin McManus, Associate

eoin.mcmanus@matheson.com

