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Eva Ambrus



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by

Eva Ambrus

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## **About the author**

Eva Ambrus currently works at the Ministry of Finance of Hungary in EU affairs. She studied French, Economics and Security studies at university level and finished her Master's degree in European Political and Governance Studies from the College of Europe.

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## **Contact details**

[eva.ambrus@coleurope.eu](mailto:eva.ambrus@coleurope.eu)

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Dijver 11, B-8000 Bruges, Belgium | Tel. +32 (0) 50 477 281 | Fax +32 (0) 50 477 280  
email [michele.chang@coleurope.eu](mailto:michele.chang@coleurope.eu) | website [www.coleurope.eu/pol](http://www.coleurope.eu/pol)

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## **Abstract**

At first it seems counterintuitive that an industry would seek regulation over itself, but from the point of view of crowdfunding, it was a logical step. Crowdfunding, as part of FinTech, is changing and challenging traditional financial institutions. The fragmentation of the EU market by national legislation on crowdfunding hindered its growth, and although FinTech is a diffuse interest, crowdfunding, as a pragmatic diffuse interest, formed legitimacy coalitions with the regulators. Utilizing Trumbull's framework on pragmatic diffuse interest, my aim is to demonstrate through this case study that the industry lobby had influenced the agenda-setting and the policy-shaping, but only to the extent that there wasn't conflicting interest from consumer groups. This is in line with previous finding on financial industry lobbying and some preliminary findings emerge, although as the proposal is still in first reading stage, the end results and conclusions remains to be seen.





## **Introduction**

This study aims to contribute to the debate regarding interest representation coalitions (specifically, between industry and regulators) and their influence on the policy-making in the EU by presenting it through the case study of crowdfunding, and in wider perspective, Financial Technologies (FinTech). My main focus will be on the motives for seeking regulation, more specifically about why would an industry such as FinTech seeks regulation. I have limited my research to the case study of the European Commission's Proposal on crowdfunding for businesses (henceforth: proposal) because of its fitness to demonstrate the influence of lobbying in the policy cycle. The proposal is in first reading stage per the ordinary legislative procedure (OLP), with the European Parliament's (EP) position being under discussion within the Council's preparatory bodies. Even though the Proposal will not be adopted until after the publication of this paper, the role of interest representation in shaping the Regulation within the policy cycle can still be traced. This paper thus contributes to the academic debate of interest representation and the timing and shaping of agendas by looking at emergence of the idea of a regulation. The original contribution of this work is the extension of Trumbull's theory about legitimacy coalitions to the FinTech sector with the case study on crowdfunding.

## **Theory**

My preliminary hypotheses are the following: FinTech is looking for regulation (a) to provide regulatory certainty (thus have the possibility to access new markets and provide greater trust to investors), (b) to drive out competition and minimise market-entry from new players, and (c) because of the cost-benefit of a regulated single market. In the theoretical framework I will primarily look into the role of coalitions from the point of view of two authors: Mancur Olson,

and his seminal work, *The Logic of Collective Action*<sup>1</sup>, and Gunnar Trumbull's *Strength in Numbers, The Political Power Of Weak Interests*.<sup>2</sup> I will argue that FinTech is a diffuse interest group, albeit a pragmatic one. To this end, I will use Gunnar Trumbull's theory that "diffuse pragmatic interest groups can be more effective than concentrated interest groups, especially if they form so-called legitimacy coalitions with either policy makers or social activists".<sup>3</sup>

### *Coalitions*

The two main theories discussed are related to the notion of interest representation coalition. Interest groups can be classified as 'concentrated' (e.g. industry sectors) or 'diffuse' (e.g. consumers). An important aspect to be considered is the legitimacy of these coalitions and legitimacy in general. The reason for forming a coalition can be diverse, but one of the main aims of interest group coalitions is to influence public policy.<sup>4</sup> Pluralism is not only present in the interest representation sphere, but in the institutional sphere of the EU as well: "given the functional segmentation of the EU institutions, their internal differentiation as well as the variations along policy areas, several authors find it impossible to identify cross-sectoral patterns of interest intermediation".<sup>5</sup>

Regarding the EU institutions, "the Commission's legal monopoly over policy initiation grants it a crucial role in agenda setting and policy formulation as well as multiplying the resources of contacts, expertise, builds consensus, raises the public profile and give credibility of its members",<sup>6</sup> which makes it an important ally to interest groups (IG) in their quest of

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<sup>1</sup> Mancur Olson, *The Logic of Collective Action*, Cambridge, Mass., USA, Harvard University Press, 1971.

<sup>2</sup> Gunnar Trumbull, *Strength in Numbers: The Political Power Of The Weak Interests*, Cambridge, Mass., USA, Harvard University Press, 2012.

<sup>3</sup> Trumbull, *op. cit.*, p. 23.

<sup>4</sup> Jonathan Pierce and Katherine Hicks, 'Advocacy Coalitions in Foreign Policy', *Oxford Research Encyclopedia*, May 2017, retrieved on the 1<sup>st</sup> of May 2019, <https://oxfordre.com/politics/view/10.1093/acrefore/9780190228637.001.0001/acrefore-9780190228637-e-355#acrefore-9780190228637-e-355-div2-1>

<sup>5</sup> Rainer Eising, 'Interest groups in EU policy-making', *Living Reviews in European Governance*, issue 3 no. 8, 2008, p. 13, retrieved on the 2<sup>nd</sup> of May 2019, <http://www.europeangovernance-livingreviews.org/Articles/lreg-2008-4/download/lreg-2008-4Color.pdf>,

<sup>6</sup> Eising, *op. cit.*, p. 12.

influence. Interest groups can find allies in different actors, thus broadening the scope of the coalition, which in turn, might elevate the legitimacy of the issue.

These three kinds of actors – activists, firms and policymakers – all have strong incentives to organise or to advocate for strong interests, (...) each must overcome the challenge of presenting its own narrow interest as publicly legitimate, and one of the strategies they use to do so is to form coalitions with one another.<sup>7</sup>

### *Concentrated and diffuse interest*

Olson's view was that "concentrated interests have a bigger chance of success of influencing because they have better resources to coordinate those interests".<sup>8</sup> Moreover, Trumbull argues that "diffuse interests have typically failed to find representation in public policy not due to a failure of coordination, but because of a lack of perceived common interest".<sup>9</sup> Sometimes this lack of common interest goes back to the self-interest of the actors in free-riding, defined as "benefiting from a collective good without having incurred the costs of participating in its production".<sup>10</sup> Nevertheless, both Olson and later James Q. Wilson argue that with selective incentives (private benefits for contributing to collective goods), the free-rider problem can be mitigated.<sup>11</sup>

Coalitions can be connected to these incentives, giving in return more legitimacy to these coalitions. Trumbull identified three types of legitimacy coalition: (1) state-activist, (2) industry-activist and (3) state-industry coalitions. In the latter case, the industry is "seeking or supporting the regulation of a diffuse interest to extend its market or raise regulatory barriers to new entrants".<sup>12</sup> Regarding the regulation on crowdfunding, this is a plausible explanation. One important aspect to all of these coalitions is the legitimacy narrative. These narratives define the shared interest of the formed coalition and thus frames the policy discourse. In the case of

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<sup>7</sup> Trumbull, *op. cit.*, pp. 22-23.

<sup>8</sup> Olson, *op. cit.*, p. 34.

<sup>9</sup> Trumbull, *op. cit.*, p. 8.

<sup>10</sup> Heather Savigny, 'free riding', Encyclopaedia Britannica, retrieved on the 1st of May 2019, <https://www.britannica.com/topic/free-riding>

<sup>11</sup> Pamela E. Oliver, 'Formal Models of Collective Action', *Annual Review of Sociology*, Vol. 19, 1993, p. 279.

<sup>12</sup> Trumbull, *op. cit.*, pp. 23-25.

diffuse interests, the two dominant ones are the narratives of access and the narratives of protection.<sup>13</sup> The narrative of protection is in line with Olson's thoughts on 'exclusive' groups, stating that "the firm in an industry want to keep new firms from coming in to share the market".<sup>14</sup>

In the case of crowdfunding and FinTech in general, both narratives (access and protection) are present. Turning from the point of view of the industry, this type of legitimacy coalition is beneficial for the EU institutions as well. Legitimacy (both input and output legitimacy) is especially important for the Commission. It is generally agreed that input legitimacy is important in the view of public consensus and participation in the policy-making process, while output legitimacy is connected to the quality of the policy and thus to technical expertise. From this follows that where technical expertise is needed (output legitimacy) the industry lobby will be more active, and the presented case study will sustain partially this statement.

### *Methodology and Case Selection*

Regulation of a new technology is a complicated matter; the ever-broadening scope of digitisation touches more and more sectors which need different answers. FinTech is a broad umbrella term used for the digitisation of the financial sector. The regulation on crowdfunding (for businesses) is the first to have been proposed by the Commission after monitoring it since 2013. While we can argue that FinTech in itself is a diffuse interest group (based on its size as well as the different types of services they provide), crowdfunding can be seen as a pragmatic diffuse interest. As per Trumbull's view, it created a legitimacy coalition with the legislators, and it was possible because it had a clear common goal: a pan-EU regulation for scaling-up their businesses. I consider the Proposal to be the first one in a step-by-step EU-level regulation

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<sup>13</sup> Trumbull, *op. cit.*, pp. 24-27.

<sup>14</sup> *Ibid.*, p. 37.

of the FinTech sector. Regarding the case study, my aim is to demonstrate that the industry has been seeking regulation for its own interest, but it is also in the interest of the EU as it is a step towards the Capital Markets Union.

The empirical focus of the paper concerns lobbying success in the EU – the Commission and the European Parliament – regarding the crowdfunding regulation by the method of degree of preference attainment. This method looks “at the outcomes of political processes and compares these with the ideal goals of actors. The distance between an outcome and the ideal point of an actor is the indicator of the influence of the actor”.<sup>15</sup> The basis of the analysis is the 35 published opinions of the respondents to the public consultation regarding the proposal in which I analysed the unity of (or conflict within) the lobby and examined it alongside the proposal of the Commission and the text adopted by the Parliament.

The fact that stakeholders in some cases submitted very similar opinions on key issues points to a high level of coordination within the crowdfunding lobby. Chalmers argues that lobbying unity is one of the most important pre-requisites for lobbying success, and that “industry unity is most powerful when lobbying demands favour a more stringent regulatory approach relative to what is being proposed by decision-makers”.<sup>16</sup> Contrasting Olson’s and Trumbull’s theories, I look into the lobbying and coalitions on the Proposal. The interesting outcome is that the preferences of the lobby has been more reflected in the EP’s adopted text than the Commission’s. The latter has come to the attention of the Regulatory Scrutiny Board, which criticises the Commission for not taking into account the views of the stakeholders.<sup>17</sup>

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<sup>15</sup> Daniel Rasch, *Lobbying Success in the European Union: The Role of Information and Frames*, New York, USA, Routledge Press, 2018, p. 8.

<sup>16</sup> Adam W. Chalmers, ‘Unity and conflict: explaining financial industry lobbying success in European Union public consultations’, *Regulation and Governance*, 26 November 2018, p. 2.

<sup>17</sup> European Commission, ‘Regulatory Scrutiny Board Opinion on the Proposal for a regulation of the European Parliament and of the Council on European Crowdfunding Service Providers (ECSP) for Business’, SEC(2018) 131 final, 8th of March 2018. retrieved on the 1st of May 2019, [https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=PI\\_COM:SEC\(2018\)131&from=EN](https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=PI_COM:SEC(2018)131&from=EN), p. 1.

This study is not comprehensive, as the proposal has not been adopted and the procedure is still ongoing. The Council has put forward on the 15<sup>th</sup> of October 2019 the three-column tables comparing the institutions' opening positions for the forthcoming trilogies,<sup>18</sup> this paper reflects mainly on the position of the European Commission and the European Parliament.

During my research I have focused on the impact assessment (IA) of the Commission and the responses to it, and the position papers of consumer rights (BEUC) and the European Crowdfunding Network (ECN), as I identified it as one of the coordinators on the subject. This does not represent the whole spectrum of the lobbying done on the matter, as I did not process data from EP hearings and meetings or preferences of Member States.

### **Policy cycle of the regulation**

The current evolution of FinTech can be dated back to the global financial crisis of 2008. Crowdfunding, as the bitcoin, was only a marginal trend but gained impetus in the last decade. The regulation of new technologies has benefits for both sides (the industry and the regulator), as it is able to promote legal certainty, create a market for new technology, ensure the interoperability between these new technologies and existing laws, and generate trust.<sup>19</sup> The proposal's aim was to bridge these issues, as they are all interconnected. Legal certainty enables trust by ensuring the interoperability of existing legal frameworks and emerging technology, thus giving impetus to the market. The next step is the background on the proposal itself and the ideas behind it.

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<sup>18</sup> Council of the European Union, 'Proposal for a Regulation of the European Parliament and of the Council on European Crowdfunding Service Providers (ECSP) for Business - Three-column tables comparing the institutions' positions, 12868/19, 15 October 2019, retrieved on the 9<sup>th</sup> of January 2020, [https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CONSIL:ST\\_12868\\_2019\\_ADD\\_2&from=EN](https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CONSIL:ST_12868_2019_ADD_2&from=EN)

<sup>19</sup> Michèle Finck, *Blockchain, regulation and governance in Europe*, Cambridge, UK, Cambridge University Press, 2019, pp. 150 – 153.

### *Proposal on European Crowdfunding Service Providers (ECSP) for Business – timeline*

In this part I will highlight some issues raised during consultations and expert group meetings, as it will become evident that the same issues discussed later in the consultation for the impact assessment were present from the beginning. The timeline will be in chronological order, starting from 2013 until today.

The Commission has been monitoring the crowdfunding sector since 2013, when it launched its first public consultation. In September 2014, the European Crowdfunding Stakeholders Forum expert group was set up under the DG for Financial Stability, Financial Services and Capital Markets Union (FISMA). The idea of an EU-wide authorization was already present here, at the policy cycle agenda-setting phase.

By 2014 one of the trends can be more generally identified: the different speed of maturing of markets (the UK being the most mature, followed by France and Germany).<sup>20</sup> The Commission's position was that it would be too early to legislate, as it could hinder innovation, but “will assess national regimes and best practice and monitor the evolution of the crowdfunding sector”.<sup>21</sup> At this time, national regulations on crowdfunding were starting to emerge: some Member States regulated the securities-based crowdfunding under the MiFID (Markets in Financial Instruments Directive), giving them pass porting rights throughout the EU, while other Member States have exempted crowdfunding firms from the obligations of MiFID, and still others developed their bespoke regimes outside the MiFID framework.

In 2015 a public consultation by the Commission on building a Capital Markets Union was published. By far the most replies came from industry associations (148), thus showing active industry lobbying, and respondents identified regulatory barriers, difference in market conditions and legal status as the main barriers to the development of appropriately regulated

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<sup>20</sup> Business Angels Europe, *'The European business angels market – an approximation'*, 2015, p. 2, retrieved on the 1st of May 2019, <http://www.business-angels.de/wp-content/uploads/2015/12/BAE-Book-final.pdf>

<sup>21</sup> European Commission, *Minutes of the European Crowdfunding Stakeholders Forum 4th meeting*, *loc. cit.* p. 4.

crowdfunding platforms.<sup>22</sup>

After the United Kingdom's European Union Membership referendum on the 23<sup>rd</sup> of June 2016, the British Commissioner responsible for Financial Stability, Financial Services and the Capital Markets Union, Lord Hill, resigned. His portfolio was given to Valdis Dombrovskis, Vice-President responsible for the Euro and Social Dialogue, which gave a new dynamism to the project. Somewhat taking over the work of the European Crowdfunding Stakeholders Forum, but on a larger scope, the Financial Technology Task Force (FTTF) was set up in November 2016, and in March 2017 the Commission launched the public consultation on FinTech. Again, the fragmentation of the market, the difficulty to scale up, and the differences in consumer/investor protection came up. Regarding the possible solutions, the majority were for a European level legislation, but there were diverging opinions if it should be a new instrument or an adoption of an existing one (e.g. MiFID II, PSD2, Prospectus Directive, etc.).<sup>23</sup>

The European Parliament in May 2017, by its own-initiative, called on the Commission to prepare a FinTech Action Plan in the framework of the CMU.<sup>24</sup> The FinTech Action Plan was presented in March 2018 by the Commission, and part of the action plan is the regulation on EU crowdfunding for business, which came out in March 2018.

Arriving at the Proposal of the Regulation, it can be seen that the FinTech firms in the EU, as well as specifically crowdfunding firms, have been actively interested in some level of European regulation. Both the documents of the consultations and the minutes of the expert groups sustain my hypotheses that the industry was looking for regulation (1) to provide regulatory certainty; (2) to level out the market; and (3) for economic reasons (cost-benefit of a single regulated market). The interaction of the two driving forces for regulation in the

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<sup>22</sup> European Commission, *Feedback Statement on the Green Paper*, *loc. cit.*, p. 7.

<sup>23</sup> European Commission, *Annex. Detailed summary of individual responses*, *loc. cit.* p. 14.

<sup>24</sup> European Parliament, *resolution of 17 May 2017 on FinTech: the influence of technology on the future of the financial sector*, P8\_TA(2017)0211, 17 May 2017, retrieved on the 19th of April 2019, [http://www.europarl.europa.eu/doceo/document/TA-8-2017-0211\\_EN.html?redirect](http://www.europarl.europa.eu/doceo/document/TA-8-2017-0211_EN.html?redirect)



framework of Trumbull's narrative theory, 'access' and 'protection', are both present throughout the history of the crowdfunding regulation.

## **Lobbying**

Regarding interest groups, there seems to be a marked difference in FinTech and crowdfunding. In the case of FinTech, banks and financial institutions were more active; according to the data of Integrity Watch, out of the top 10 organisation, five are banks, and of those that were not banks, three had interests connected to the United States (Depository Trust and Clearing Corporation – DTCC, Nasdaq and APCO). The other influential organisations are Financial Future (NGO), Qed (meeting organiser) and EUROFI (NGO), all of them representing traditional financial institutions (banks, stock exchanges, firms).

As for crowdfunding, there are only three entities in the register: two companies (Fundingcircle holding plc and Seedrs limited), and one professional consultancy. The two companies mentioned are also members of the European Crowdfunding Network (ECN), which is an NGO “promoting adequate transparency, (self) regulation and governance while offering a combined voice in policy discussion and public opinion building”.<sup>25</sup> The ECN itself is affiliated with the European Federation of Financial Advisers and Financial Intermediaries (FECIF), representing European financial advisers and intermediaries, and it is in partnership with the European Commission.

The crowdfunding lobby would be effective, according to Olson's theory, because it is a relatively small, concentrated group inside the diffuse interest group of FinTech. Incentives to form a coalition were those of the resources shared: expertise, information, and coordination of interests. These give smaller group greater effectiveness: “organising meetings is easier, as

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<sup>25</sup> European Crowdfunding Network, 'about us', retrieved on the 30th of April 2019, <https://eurocrowd.org/about-us/>

well as every member can feel that their contribution to the solution matter”.<sup>26</sup> Regarding coordination (and in a way, effectiveness), the organisation of the group of experts of the Commission can be put into evidence: for crowdfunding stakeholders, rules of procedure have been put into place, detailing working from agenda-setting to reimbursements.<sup>27</sup>

Incentives to form groups and coalitions are not only economic, they are also social and rational. This is especially interesting in the case of new technologies such as FinTech and crowdfunding, as it can help build social trust by blending into more traditional structures (as associations). On the fact that the business lobby is highly organized and deemed powerful, Olson notes that it “must be due in large part to the fact that the business community is divided into a series of ‘industries’, each of which contains only a fairly small number of firms”.<sup>28</sup> But as we will see, this does not mean that these groups are able to *always influence* or that they have all the power.

Taking into account the legitimacy question, the background of FinTech, and of the legislation on crowdfunding, we can see how per Trumbull’s theory, the industry (FinTech/crowdfunding) and the legislator (EU) formed a legitimacy coalition. One important component of legitimacy coalitions is narratives, the way that an issue is framed. These narratives have a pragmatic and normative role. For the pragmatic role, the crowdfunding lobby shared a set of concerns that, in their view, deserved public redress. This concern is an example for the narrative of access. In the case of crowdfunding specifically the fragmented market of the EU, the difficulty of firms to scaling up, fuelled by the fear that the US and Asia may surpass the EU irrevocably all contributed to the narrative of access. For countering these problems the maturing of the FinTech market in general would be preferable for European start-ups, as they

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<sup>26</sup> Olson, *op. cit.*, p. 53.

<sup>27</sup> European Commission, *Rules of procedure of the Commission group of experts – European Crowdfunding Stakeholders forum*, retrieved on the 30th of April 2019, [http://ec.europa.eu/transparency/regexpert/index.cfm?do=groupDetail\\_groupDetailDoc&id=27286&no=1](http://ec.europa.eu/transparency/regexpert/index.cfm?do=groupDetail_groupDetailDoc&id=27286&no=1)

<sup>28</sup> Olson. *op. cit.*, p. 143.

could grow, scale-up and compete on a global scale.

The other narrative presented is that of protection. The narrative of protection concentrates on integrity, transparency and consumer protection.<sup>29</sup> This in a way tied their economic interest to a broader diffuse interests (investors/consumers), thus enabling more trust and legitimacy, while not necessarily producing additional burdens. These two narratives were in line with the objectives of the Commission, which were (1) to enable crowdfunding platforms to scale up and (2) enhance investor trust by strengthening the integrity / transparency of crowdfunding platforms.<sup>30</sup>

### *Preference attainment*

As we have seen, before any new proposal for regulation, the Commission initiates an impact assessment (IA). The Regulatory Scrutiny Board criticized the Commission's Impact Assessment on three points, notably that it did not explain the urgency of the initiative, the analysis of the preferred option is not developed enough, and the report does not reflect enough the views of stakeholders.<sup>31</sup> What is also striking is that there has not been a stakeholder consultation for the IA of this Proposal, although the IA described the results on previous consultations and launched a feedback opportunity on the Proposal.

It would also seem that the EP has taken into consideration the stakeholders' opinions more than the Commission since their positions are more in alignment with each other. I will start by summarizing the European Consumer Organization's (BEUC) position paper<sup>32</sup> on the issue, followed by the position papers of the ECN (European Crowdfunding Network),<sup>33</sup> then discussing the issues separately in detail.

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<sup>29</sup> Trumbull, *op. cit.*, p. 28.

<sup>30</sup> European Parliament, Initial Appraisal of a European Commission Impact Assessment, *op. cit.*, p. 2.

<sup>31</sup> European Commission, *Regulatory Scrutiny Board Opinion*, *loc. cit.*, p. 1.

<sup>32</sup> BEUC, 'European Commission's legislative proposal on crowdfunding – a missed opportunity!', position paper, 5th of September 2018, retrieved on the 1st of May 2019, [https://www.beuc.eu/publications/beuc-x-2018-075\\_regulation\\_on\\_european\\_crowdfunding.pdf](https://www.beuc.eu/publications/beuc-x-2018-075_regulation_on_european_crowdfunding.pdf), p. 3.

<sup>33</sup> ECN, 'Support for – and Proposed Improvements to – the European Commission Proposal for a Regulation on European Crowdfunding Service Providers (ECSP) for business', statement, 19th of March 2018, retrieved on the 1st of May 2019, <https://eurocrowd.org/2018/03/19/crowdfunding-service-provider-regulation/>

On the 5<sup>th</sup> of September 2018, BEUC published its position paper on the legislation. Its main concern is that the legislation considered only concerned the interests platforms, and less so its users. Its main objection is that no EU-level consumer protection was set regarding crowdfunding; the preferred option was the opt-in for EU-wide licence. This opt-in licence would have differentiated between those platforms that wish to remain under the national regime (so not opt-in), and those that do opt-in, and are obliged to higher standards of consumer protection. The UK national treasury raised this point as well in the IA, worried about regulatory arbitrage.<sup>34</sup> Regarding specific steps on consumer protection, mixed success has been achieved with the text adopted by the EP.

The ECN published three position paper for the three main actors: one for the Commission in March 2018; one for the EP (with a complete voting list recommendations on compromise amendments) in October 2018; and an open letter to the Member States in December 2018. For the Commission, the ECN made a list of common propositions (concerning all of its members), loan-specific propositions, and investment-specific propositions (concerning lending-based and investment-based crowdfunding service providers, CSPs). For the EP, it prepared a detailed list of amendments and recommendations, and for the Council it prepared a general paper, describing the general problems faced by the CSPs and asking them to consider supporting the ‘29<sup>th</sup> regime’ (meaning EU-level regulation).

During my research I have identified 11 main issues that arose during the IA. In my analysis, I concentrated on the response of businesses, NGOs and institutions (vs individuals).

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<sup>34</sup> European Commission, *Impact Assessment consultationm* F7895, HM Treasury opinion, 27 November 2017, retrieved on the 1st of May 2019, [https://ec.europa.eu/info/law/better-regulation/initiatives/ares-2017-5288649/feedback/F7895\\_en?p\\_id=124034](https://ec.europa.eu/info/law/better-regulation/initiatives/ares-2017-5288649/feedback/F7895_en?p_id=124034)

## Main Issues identified regarding the Proposal

### 1. Scope

The Commission's Proposal defines the scope of the Regulation as "investment and lending- based crowdfunding activities under a single regime, excluding donations, reward and lending to consumers for consumption".<sup>35</sup> The lobby was unified in their demands to clarify the definitions and to ensure that the proposed regulation clearly recognises the differences between lending and investment-based crowdfunding and target project owners and proposed measures adapted to each. The EP differentiated a little more in its adopted text, stating "... where a CSP *operates a digital platform open to the public in order to match or facilitate the matching of prospective investors or lenders*".<sup>36</sup> Also on the definitions (art.3), the EP differentiated between direct crowdfunding service and intermediated crowdfunding service.

### 2. Regime

The idea that emerged was the co-existence of either national or EU-level licences. The lobby mostly agreed on the EU-licence, although Spanish, Italian and French stakeholders raised their concern about regulatory arbitrage or that only a few, well-established platform would operate transnationally. Regarding investor protection, the European Federation of Financial Advisers and Financial Intermediaries (FECIF) argued that "national provisions which are usually beneficial to investors and consumers would be undermined by the current Proposal",<sup>37</sup> which is also in line with BEUC's view. Although the co-existence of the regime

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<sup>35</sup> European Commission Proposal for Regulation of the European Parliament and of the Council on European Crowdfunding Service Providers (ECSP) for Business, COM(2018) 113 final, recitals 10 and 11, retrieved on the 1st of May 2019, <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=COM:2018:0113:FIN>

<sup>36</sup> European Parliament, *Text adopted provisional edition, European Parliament legislative resolution of 27 March 2019 on the proposal for a regulation of the European Parliament and of the Council on European Crowdfunding Service Providers (ECSP) for Business*, P8\_TA-PROV(2019)0301, recital 1, retrieved on the 1st of May 2019, [http://www.europarl.europa.eu/RegData/seance\\_pleniere/textes\\_adoptes/provisoire/2019/03-27/0301/P8\\_TA-PROV\(2019\)0301\\_EN.pdf](http://www.europarl.europa.eu/RegData/seance_pleniere/textes_adoptes/provisoire/2019/03-27/0301/P8_TA-PROV(2019)0301_EN.pdf)

<sup>37</sup> European Commission, *Impact Assessment consultation*, F11422 European Federation of Financial Advisers and Financial Intermediaries (FECIF) retrieved on the 1st of May 2019, [https://ec.europa.eu/info/law/better-regulation/initiatives/ares-2017-5288649/feedback/F11422\\_en?p\\_id=181605](https://ec.europa.eu/info/law/better-regulation/initiatives/ares-2017-5288649/feedback/F11422_en?p_id=181605)

went through, more safeguards regarding consumer/investor protection did get into the legislation (due diligence, know-your-customer, disclosure, information requirements).

### 3. *Authorization*

The Commission's Proposal initially gave power to the ESMA (authorization, supervision, fines), which was contested by Belgian and Austrian stakeholders (regarding the principle of subsidiarity) during the consultation. The initial assessment on the IA by the EPRS, as quoted earlier, criticized the Commission for not addressing in depth the future competences of ESMA. The Economic and Monetary Affairs Committee voted on its position on the 27<sup>th</sup> of March 2019, stating in a press release: "MEPs agreed that a prospective ECSP would need to request authorisation from the NCA of the member state in which it is established, rather than from the ESMA, as initially proposed by the European Commission".<sup>38</sup> This was a win for the lobby, as well as the Member States.

### 4. *Minimum Capital Requirements*

It was not envisaged in the provision, but it was something that the BEUC wanted – investor protection. It did get amended in the adopted text by the EP, and it was also the position of the ECON committee. Although no exact amount was prescribed, it was still a partial win for BEUC. Regarding national authorisation, the French national regime has a minimal capital requirement depending if the platform is licensed under MiFID, and if so, depending on whether the investment service and activities; as for the UK regulation, a minimal requirement is own funds of €50,000.<sup>39</sup>

### 5. *Fundraising threshold*

Initially, the Commission wanted the EU-level threshold to be below €1 million before the Prospectus Regulation should apply. A prospectus contains "information that must be

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<sup>38</sup> European Parliament, 'New EU rules to boost crowdfunding platforms and protect investors', retrieved on the 1st of May 2019, <http://www.europarl.europa.eu/news/en/press-room/20181105IPR18253/new-eu-rules-to-boost-crowdfunding-platforms-and-protect-investors>

<sup>39</sup> European Commission, Commission Staff Working Document, Impact Assessment, *loc. cit.*, p. 82.

provided by companies that want to attract investors, raise capital and finance their growth”.<sup>40</sup> The lobby was united in asking the regulator to “raise the investment threshold to €8 million (the maximum prospectus threshold a MS can set under Article 3(2)(b) of Prospectus Regulation on an EU-wide basis, with a cap on investment from residents of any given MS equal to that country’s prospectus threshold”.<sup>41</sup> This change was amended by the EP in its adopted text, which was a win to the industry lobby.

#### 6. *Disclosure to investors – Key Investment Information Sheet (KIIS)*

Transparency and trust-building was one of the aims of both the industry and the regulator. Although there was unity in the aim, the scope of disclosure was different. The Commission proposed the publication of a KIIS, with the detailed information in the annex covering basic information like whether the offer is (not) approved or verified by ESMA or an NCA and a risk warning. The document should be drafted in at least one of the official languages of the EU. The main opposition to the KIIS was that it should not be applied to credit platforms (or crowd lending), as stronger performance indicators already exist. The ECN suggested “key financial figures and ratios which have been used as the base for the platform to perform its analysis be permitted in lieu of full accounts, as is the market practice, in lieu of a hyperlink to financial statements. This information should be uniform for all offers on a given platform, thereby facilitating the comparison”.<sup>42</sup>

The EP amended this article to differentiate between direct crowdfunding services and indirect crowdfunding services. By these changes, KIIS will need to be provided by direct crowdfunding services as set out in the annex (as well as the risk warning), while the new subparagraph (4a) of the article indicates that indirect crowdfunding services shall inform in

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<sup>40</sup> European Commission, ‘securities prospectus’, retrieved on the 1st of May 2019, [https://ec.europa.eu/info/business-economy-euro/banking-and-finance/financial-markets/securities-markets/securities-prospectus\\_en](https://ec.europa.eu/info/business-economy-euro/banking-and-finance/financial-markets/securities-markets/securities-prospectus_en)

<sup>41</sup> European Commission, *Impact Assessment consultation*, F10621 European Crowdfunding Network AISBL retrieved on the 1st of May 2019, [https://ec.europa.eu/info/law/better-regulation/initiatives/ares-2017-5288649/feedback/F10621\\_en?p\\_id=181605](https://ec.europa.eu/info/law/better-regulation/initiatives/ares-2017-5288649/feedback/F10621_en?p_id=181605)

<sup>42</sup> ECN, *Support*, *loc. cit.*, point 2.

their KIIS “detailed information of the service provider, its systems and controls for the management of risk, financial modelling and its historic performance”.<sup>43</sup> Although KIIS is mandatory for both types – funding and lending, its content is differentiated, so it can be said that the lobby has reached some success in this area.

#### 7. *Information requirements (risks)*

The BEUC was lobbying to have a mandatory entry knowledge test before consumers could invest. It was mirrored in the opinions of France’s Financial Market Authority and UFC – Que Choisir. Foundingcircle (and, *inter alia*, ECN), was lobbying for entry tests to be based on appropriateness rather than suitability, and the outcome of an investor’s simulation should not mandate the investor’s exclusion. This was in the original Commission Proposal and has been retained by the ECON Committee, and the amendment asks for “the verification by crowdfunding service providers that the proposed services offered are appropriate for investors (entry knowledge test and simulation of the ability to bear loss)”.<sup>44</sup> What has changed in the amendment is that after the test, if an investor is deemed unsuitable (and explicitly warned of the risk), the investor still can invest on the platform. The other change is more technical: the Commission wanted to adopt delegated acts to carry out the arrangements, while the EP suggested that “in cooperation with the EBA, ESMA shall develop draft regulatory technical standards”.<sup>45</sup>

This was a win-win (or compromise, depending on which side we view the result) for the BEUC and the ECN, as the scope of the entry test has been enlarged, now incorporating the investor’s experience and financial situation, but, the investor can still invest even if it is unsuitable to do so according to the test. Elements from the narrative-framework described earlier of the narrative of access and of protection are present on the French and British national

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<sup>43</sup> European Parliament, *adopted text.*, *op. cit.*, art. 16, paragraph 4a.

<sup>44</sup> EP ECON position, <https://oeil.secure.europarl.europa.eu/oeil/popups/summary.do?id=1560302&t=e&l=en>

<sup>45</sup> European Parliament, *adopted text.*, *loc. cit.*, art. 15, paragraph 6.



regulation. While in France, “platforms must have a restricted-access website with the following characteristics: access to details of the offers reserved to potential investors who have given personal details, read the risks and expressly accepted them; website shall propose several projects”,<sup>46</sup> for suitable investors, the British regulation states that CSPs have “requirement not to disguise, diminish or obscure important items, statements or warnings”.<sup>47</sup>

#### 8. *Due diligence*

The next issue was that of the due diligence of the platforms. Due diligence is “the care that a reasonable person exercises to avoid harm to other persons or their property”.<sup>48</sup>

The Commission Proposal had “effective and prudent management” in lieu of due diligence for article 5, stating that CSPs “shall establish, and oversee the implementation of, adequate policies and procedures to ensure effective and prudent management, including the segregation of duties, business continuity and the prevention of conflicts of interest, in a manner that promotes the integrity of the market and the interest of their clients”.<sup>49</sup>

The ECN and Seedrs were against that the article should specify the information required, while the BEUC was for a minimum requirement in the area. In national regimes the consumers/investors are better protected in general (especially if they are under the MiFID II regime), making it is a logical step to have similar safeguards on the EU level despite industry opposition. Nevertheless, a new article 5a with a mandatory minimum level of due diligence has been adopted by the EP, including “evidence that the project owner has no criminal record (specified further) and that the project owner is not established in a non-cooperative jurisdiction and effectively complies with Union or internationally agreed tax standards on transparency

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<sup>46</sup> European Commission, Commission Staff Working Document, Impact Assessment, *loc. cit.*, p. 85.

<sup>47</sup> *Ibid.*

<sup>48</sup> Merriem-Webster dictionary, ‘*due diligence*’, retrieved on the 1st of May 2019, <https://www.merriam-webster.com/dictionary/due%20diligence>

<sup>49</sup> European Commission, *Proposal for Regulation*, *op. cit.*, art. 5, p. 21.

and exchange of information”.<sup>50</sup> This was a win for the consumers/investors and for consumer protection and a loss for industry lobbying.

#### 9. *Conflict of interests and alignment of interests*

Regarding conflict of interests, the original Proposal from the Commission stated that CSPs “shall not have any financial participation in any crowdfunding offer on their platform”.<sup>51</sup> There was an agreement on the part of the industry against this prohibition (Financement Participatif France, Lendix and ECN); their recommendation was to allow alignment of interest as long as it is *pari passu* (same terms, information and fully disclosed). The rationale behind it was that this interest can create an alignment rather than a conflict of interests and help build trust.

The EP amended article 7 paragraph 1, contradicting the Commission: “by way of derogation from the first paragraph, CSP may hold a financial participation in a crowdfunding offer on their crowdfunding platforms when information on that participation is made clearly available to clients by publishing clear and transparent selection procedures – and with ESMA drafting a regulatory technical standard”.<sup>52</sup> The EP also amended a new article 7a on alignment of interests, which was in line with the industry lobby interest on the matter: “crowdfunding platform may participate in the funding of a project up to 2% of the capital accumulated and a success fee may be granted to the CSP when the project exits successfully from the platform”.<sup>53</sup> It is an obligation to explicitly inform on their website their alignment policy.

#### 10. *Anti-money laundering legislation (AML)*

There was a broad consensus from the lobby that “it needs to be clarified that the platforms are subject to anti-money laundering legislation (AML), the proposed safeguards in

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<sup>50</sup> European Parliament, *text adopted, op. cit.*, art. 5a.

<sup>51</sup> European Commission, *Proposal for Regulation, op. cit.*, art. 7, paragraph 1.

<sup>52</sup> European Parliament, *text adopted*, art. 7, paragraph 1 and 7.

<sup>53</sup> European Parliament, *text adopted, loc. cit.*, art. 7a.

Art 9 draft regulation to minimise the anti-money laundering risks of crowdfunding transactions are not sufficient at all”.<sup>54</sup> An amendment on recital 24 provided some clarifications:

With a view to further ensuring financial stability by preventing risks of money *laundering* and terrorism financing, *and taking into account the maximum threshold of funds that can be raised by a crowdfunding offer in accordance with this Regulation*, the Commission should assess the necessity and proportionality of subjecting CSPs, *authorised under this Regulation to some or all of the obligations for compliance with national provision implementing the AML directive*.<sup>55</sup>

This may seem a technicality, but again, showed the will of the industry to actively pursue transparency and increase trust from customers.

### *11. Payment service*

Regarding art. 9 on providing payment services, there was unity from the industry and associations to “clearly recognise the possibility for platforms to be registered as a Payment Agents of Payment Service Providers (as defined in Article 4(11) and Article 19 of Directive 2015/2366/EU)”.<sup>56</sup> The rationale behind it is that under PSD 2, crowdfunding platforms can become Payment agents. The EP amended the article to include “*or an agent providing payment services*”.<sup>57</sup> This was again a win for the industry lobby.

## **Discussion**

### *The role of institutions*

One of the peculiarities of my research was the fact that the text adopted by the EP seemed to reflect more the preferences of stakeholders than the Proposal of the Commission. One of the reasons that EP could be more receptive to the ideas of the industry is that the IA on the Proposal took place from March to May 2018, so the EP had the opportunity to review the inputs. Secondly, the ECN has done tailored lobbying to the institutions (Commission,

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<sup>54</sup> European Commission, *Impact Assessment consultation*, BitKom, *op. cit.*, ECN, *op. cit.*

<sup>55</sup> European Parliament, *adopted text, op. cit.*, recital 24.

<sup>56</sup> European Commission, *Impact Assessment consultation*, Lendix, *op. cit.*

<sup>57</sup> European Parliament, *text adopted, op. cit.*, art. 9, paragraph 4.

Parliament and Council) and represented a unified point of view from the industry. I have found it striking that no discussion emerged on the possible effect of Brexit, as London is the capital of FinTech (and crowdfunding) in Europe.

One of the reasons why changes have been made to the Proposal both by BEUC and the ECN is that on one hand, “citizen groups often end up being more successful in EU legislative politics than business interests because they have two institutional allies – the European Commission and the European Parliament”,<sup>58</sup> and on the other, on highly technical issues information is a currency that industry and business interests can use, thus it is “effective in narrowing the gap between the policy positions of the lobbyist and the policy maker where that gap is large”.<sup>59</sup>

#### *The success of the industry lobbying*

The industry, as we have seen, was looking for a more unified legislation, but lost on some accounts (information disclosure, consumer protection) vis-à-vis the diffuse interest of consumers. Still, as a pragmatic diffuse interest, it was able to secure some benefits (no capital requirements, maximum threshold, differentiation in lending and equity, payment service agents, conflict of interest). Regarding the issues discussed in the previous part, it is relevant that the industry has success lobbying when there was no opposition from the consumers (e.g. BEUC) or when they shared aims. It was still successful as a pragmatic diffuse interest and was able to play both narrative of market access and consumer protection, while securing their preferred options.

Regarding my hypothesis, did the industry achieve its goals? My preliminary hypotheses were the following: FinTech is looking for regulation to (a) provide regulatory certainty (thus open to new markets and provide greater trust from investors); (b) as well as to drive out

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<sup>58</sup> Dür et al., *op. cit.*, pp. 133-134.

<sup>59</sup> Dür, *op. cit.*, p. 143, 148.

competition and minimize market-entry from new players; and (c) because of the cost-benefit of a regulated single market.

For (a), the co-existence of regimes is a step towards harmonization, but the EU-wide licence does reach this aim and will give the ability to reach the whole EU market if a provider chooses to do so. By harmonising the fundraising threshold to 8 million euros as per the Prospectus Directive, hopefully more cross-border projects will succeed. The information, disclosure, due diligence and conflict of interest requirements, among others, will increase trust from investors.

Regarding (b), drive out competition, the dual-regime can be effective, as there are already some bigger platforms working in different Member States who will benefit and probably will be able to scale up faster than others. The question of regulatory arbitrage is not completely resolved: if there is a national CSP, under the stricter MiFID regime and an EU-licensed HSP enter the market, the latter one will have an advantage. Even though recital 8 states that “those providers that have been authorised by under MiFID or bespoke regimes are excluded from this regulation”, recital 25 states that “Member States should not be allowed to impose additional requirements on crowdfunding service providers that are authorised under this Regulation”. It is my understanding that it would be problematic if e.g. in a Member State a nationally authorized CSP under MiFID regime (higher requirements) is present and an EU-licensed CSP enters the market with lower requirements.

As reviewed earlier, depending on the business model firms might be cooperating or competing, but the emergence of some key players in the field of crowdfunding is foreseeable in the near future. The question remains, will it be a European one?

As for (c), cost-benefits, the IA of the Commission calculated greater compliance costs (direct), especially for domestic players for platforms and higher compliance costs (direct) to implement new disclosure requirements for firms. Some indirect benefits for investors would

be portfolio diversification (“a small fraction of EUR 720 billion”), and for platforms the network effect (of scaling up), which would benefit them between 20 and 25 billion euros. Regarding the costs, for (1) authorization it would be between 5,000 and 10,000 euro one-off fee per licence and 1,000 – 2,000 euro recurrent fees (e.g.: update of authorization), for (2) organizational rules, 5,000 – 25,000 euro one-off (communication, data protection, fit and properness, KYC and due diligence rules, record keeping), and 7,500 – 10,000 euro recurrent (IT system and data storage), so all in all, a once off fee of between 20,000 – 24,500 euros and the same amount yearly by the Commission’s calculation.<sup>60</sup>

Those platforms that are regulated under MiFID are exempt to most of these costs (as they have to comply already). The IA has been criticized by the EP on these accounts as well:

In this context, it has to be noted that the IA does not explain the method of these estimations. Their evidence-base is sometimes not transparent, for instance relating to the indirect benefits of the expansion of crowdfunding in the single market, estimated under the preferred option 4 at €20 or €25 billion, the potential cost savings of €29 billion for platforms or the potential stock of cash available to investors is estimated to be around €720 billion.<sup>61</sup>

On the one hand, it is still more beneficial to adhere to one regime than to several different across the EU. On the other hand, these costs might be too high for small platforms, thus driving them out of competition.

## Conclusion

The combination of a legitimacy coalition between the industry and the regulator, as well as the industry looking for stricter regulation, provided success in lobbying. By appealing to both the access and protection narratives, the pragmatic diffuse interest of crowdfunding achieved its aim of EU-level regulation, which means market access. Financial regulations are well-suited for *typical case studies*, as there are many cases in the literature, with different

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<sup>60</sup> IA., pp. 73-75.

<sup>61</sup> Esther Kramer and Maria Gimeno, ‘Initial Appraisal’, *op. cit.*, p.4.

outcomes. Dür et al.'s case study on the reform of the EU's financial market rules (MiFID II) found that "regarding agenda-setting power, the Commission has become a policy entrepreneur and this has limited the agenda-setting power of business interests".<sup>62</sup> As for business unity, sectoral interests can differ greatly, and this is true for FinTech as well. After the financial crisis, the businesses found itself on the defensive vis-à-vis regulation, but still, as in the case of crowdfunding, they could shape the regulation to benefit its interest.

Trumbull's case study was the regulation of the consumer credit markets, and he found that "two kinds of coordination is needed for diffuse interest: one requires active or passive support of the policies and the other is a common set of principles and goals".<sup>63</sup> In case of FinTech, the emergence of these types of coordination is still under way, if there will be one, while in the case of crowdfunding, it has been done. There has been opposition from consumer interest (BEUC) regarding transparency and information requirements, but the European Crowdfunding Network (ECN) and the European Federation of Financial Advisers and Financial Intermediaries (FECIF) seemed to help coordination of interests.

Agenda-setting and agenda-shaping have an important role, especially in the timing of legislation, which is one of the issues on regulating emerging technology— either it is too early and innovation suffers, or it can be 'too little – too late'. This is one of the reasons why information is highly valuable in consultations with different stakeholders; for example, social media companies began as start-ups, and as they matured, they became harder to regulate. It seems that the most livable and profitable solution is the "regulatory sandbox" model, where innovative start-ups can experiment and scale up while having active discourse with the regulator who can overview the developments in the sector, thus building trust on both sides (and for the investors/consumers as well).

Coalition building is important for the lobby for many reasons, but one of them is the

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<sup>62</sup> Dür et al., *op. cit.*, p. 94.

<sup>63</sup> Trumbull, *op. cit.* p. 124.

unity of interest. If they can show one-voice to the regulators, it is more plausible that they will be heard, especially on highly technical issues. But coalitions are not only important on the inside of the industry, they are also important outside of it. Legitimacy coalition between the crowdfunding industry and the regulators helped legitimize the Proposal for the regulation, as both corroborated on the need for regulation because of the fragmented market, scaling up of firms, and the possible missed opportunity of crowdfunding for start-ups.

The analysis of the Proposal for crowdfunding regulation undertaken here has extended our knowledge of on legitimacy coalition by utilizing Trumbull's framework on the case study. Considerably more work will need to be done to determine how the EU-level FinTech regulation will take shape, if there will be a pan-EU regime and if so, what role 'regulatory sandboxes' will play in it. This will determine whether sandboxes will become another venue for lobbying, another layer in the complex, multi-level and pluralist world of interest representation in the EU.



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