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How to make crowdfunding work in Europe

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Executive summary

CROWDFUNDING MARKETS AROUND the world have experienced significant growth rates in recent years. With an aggregate amount of almost €50 billion raised worldwide between 2010 and 2017, crowdfunding has attracted increasing economic, political and regulatory attention on the international level. However, many questions remain open on the proper design, implementation and feasibility of these markets, of which there are four general types: debt, rewards, equity, and charity (ranked by their respective volumes). The first three types of crowdfunding are comparable to existing sources of traditional financing and either complement or substitute for these sources. Investors thus expect returns or other financial benefits from these types of crowdfunding. The fourth type – charity-based crowdfunding – is purely philanthropic.

THE UNITED STATES and United Kingdom are responsible for the majority of crowdfunding transactions. The share of European Union markets (excluding the UK) is still low, with negligible cross-border activity. We argue that the lack of a clear and consistent regulatory framework in Europe is a major obstacle to the development of these markets. The European Commission proposed in March 2018 a set of measures aimed at addressing the major shortcomings of the current regulatory framework and employing instead an EU-wide regime (European Commission, 2018b).

THE COMMISSION'S PROPOSAL moves in the right direction to provide a solid basis for the development of crowdfunding markets in Europe, but has at least three major shortcomings that need to be addressed. First, an EU-wide framework needs to have a precise and transparent legal definition of crowdfunding activities, eliminating any legal confusion for investors, enterprises and platforms. Second, such a framework requires a clear stance on investor protection. We suggest including in the proposal a more refined requirement for agents who want to invest more than a certain threshold amount to undertake a 'qualified investor test'. Third, the proposal would limit crowdfunding offers to €1 million per project over a period of 12 months. We argue that this threshold is too restrictive and should be raised to €5 million in order to enable the frictionless development of investment-based crowdfunding in Europe.

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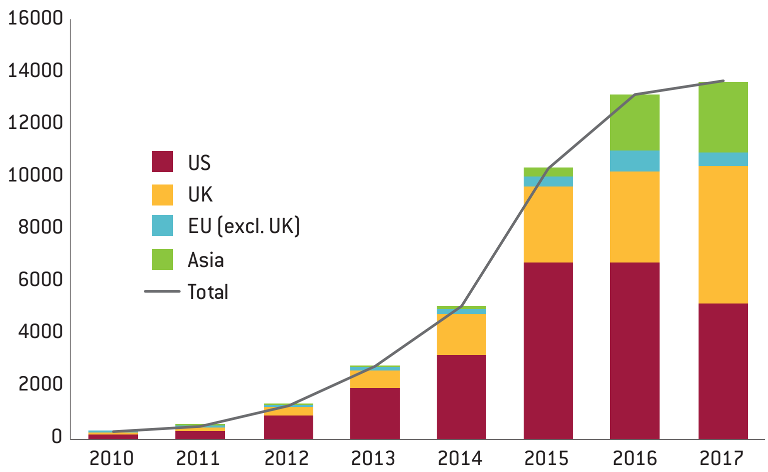
1 Recent developments in crowdfunding

Crowdfunding activity across the world has grown significantly over recent years (Figure 1). Between 2010 and 2017, approximately €48.5 billion was raised worldwide via crowdfunding. Platforms in the United States dominate the market with €25.8 billion raised in total, followed by the European Union with €16.9 billion and Asia with €5.5 billion[1]. Together, the three regions account for roughly 99 percent of global crowdfunding activity.

The rapid development of the market is best reflected by the average of the year-on-year growth rate of amounts raised between 2011 and 2017: the average growth rate amounted to roughly 80 percent in the US, 85 percent in Europe and 557 percent in Asia. However, a significant slowdown was noted in 2016 and 2017. The rate of growth of European crowdfunding remained low in comparison to pre-2015 developments and amounted to only 34 percent in 2017. Asian crowdfunding activity experienced its first significant slowdown and expanded by a mere 27.3 percent. The amount funded through platforms in the US even contracted, decreasing by 23 percent. With little to no research available into the factors behind the recent slowdown, growth of the crowdfunding industry seems to have already passed its peak – especially in the US (Ziegler *et al*, 2017, 2018).

Figure 1: Total amount raised (€ millions)



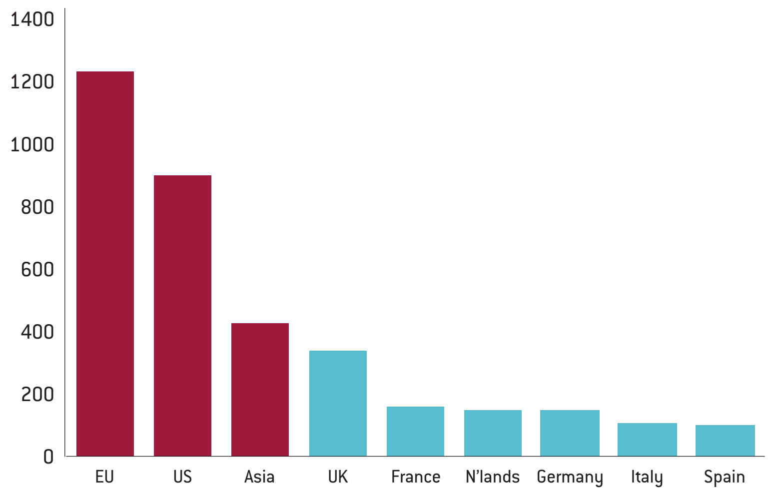
Source: Bruegel based on TAB, formerly Crowdsurfer. Note: only funded campaigns included.

Figure 2 shows the total number of platforms. Most of the 2,948 platforms are located in the EU (1,231 platforms), followed by the US with 900 platforms, and Asia with 431. Within the EU, slightly more than a quarter of the platforms operate in the UK. Other major crowdfunding locations in Europe are France (160 platforms), the Netherlands (149 platforms) and Germany (148 platforms), followed by Italy (107 platforms) and Spain (100 platforms).

In volume terms, platforms based in the UK raised 88 percent of all funds between 2010 and 2017. The UK is thus by far the most dominant player on the European crowdfunding market. On average, amounts raised through crowdfunding grew there by a considerable 85 percent each year. However, the UK also experienced a slowdown in 2016 and the volume of funds raised expanded by only 20 percent. In 2017, crowdfunding activity picked up again and growth amounted to 50 percent.

1 The data was downloaded from the TAB database, formerly Crowdsurfer, a data provider that also provided data for a European Commission study. Compared to other estimates, our sample might significantly underestimate the size of the Asian market. Massolution (2015), for example, estimated the crowdfunding volume in Asia to be around €10.5 billion in 2015.

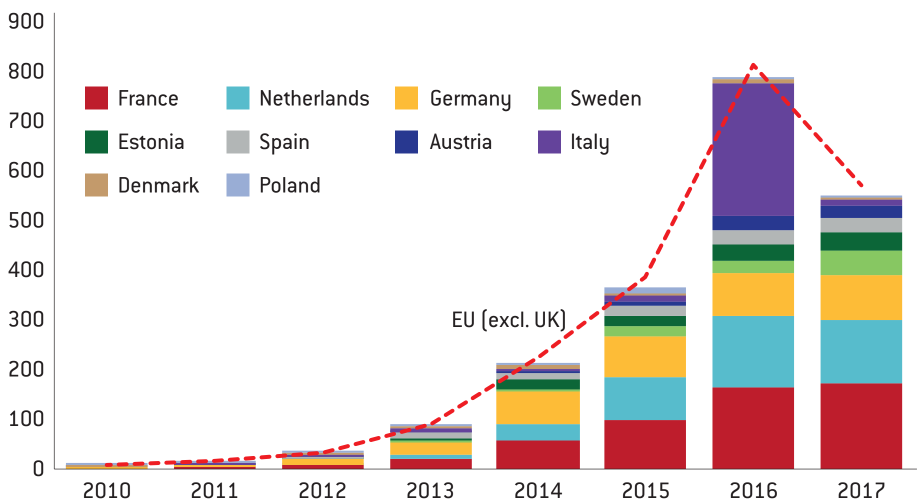
Figure 2: Number of platforms



Source: Bruegel based on TAB, formerly Crowdsurfer. Note: by platforms' main operating locations, as of January 2018.

Figure 3 shows an additional breakdown of the funded amount for other EU countries. France, the Netherlands, Germany and Italy – the largest crowdfunding markets in terms of volume aside from the UK – accounted together for 10 percent of funds raised within the EU. Crowdfunding within the four countries went through a remarkable development, with the combined amount of funds raised in the four countries growing by 120 percent per year on average between 2011 and 2017. The previously mentioned slowdown in 2017 was mainly caused by Italian platforms: the raised amount dropped from €268 million back to €10 million.

Figure 3: Total amount raised, top 10 EU member states (€ millions)

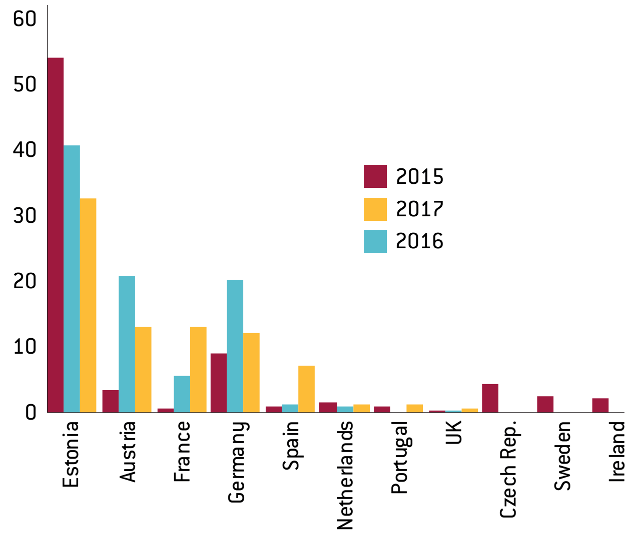


Source: Bruegel based on TAB, formerly Crowdsurfer. Note: Only funded campaigns included. Top 10 EU member states (excluding the UK), with the overall largest crowdfunding activity (raised funds) between 2010 and 2017.

Lower growth figures for crowdfunding in France, Germany and the Netherlands also characterised 2017. French platforms expanded their funding volumes by only €8.7 million (a 5 percent increase), while German platforms raised an additional €7.3 million (plus 9 percent) and crowdfunding activity in the Netherlands shrunk by €19.5 million (minus 13.3 percent). However, sizeable developments were noted for Estonian and Swedish platforms. Crowdfunding in Sweden grew by €22.8 million (88 percent) and Sweden is steadily catching up with the four major countries in the European market. The Estonian market continued its growth, increasing in size by €6.4 million (22 percent) in 2017.

Figure 4 depicts the recent trends in the cross-border activities (ie a crowdfunding platform in country A raising funds for a project in country B) of the EU's largest crowdfunding players. The total cross-border funding volume steadily increased from €28.1 million in 2015 to €54.4 million in 2016 and €73.2 million in 2017. However, funds raised through cross-border projects accounted for a mere 1.2 percent of the amounts raised via European crowdfunding in 2017. Only platforms in Estonia, Austria, France and Germany raised funds for cross-border projects that exceeded 10 percent of their operating volume. While the share of cross-border activity of UK platforms was rather small, the raised amount of €21.4 million accounted for close to a third of the overall EU cross-border activity in 2017.

Figure 4: Cross-border activity of European platforms inside the EU (% of total raised)



Source: Bruegel based on TAB, formerly Crowdsurfer. Note: Only funded campaigns included.

In summary, crowdfunding in Europe and the rest of the world has shown remarkable growth rates in recent years. While slowdowns in 2016 and 2017 might signal the end of these extraordinary growth rates, there is still significant potential. A policy framework that facilitates further growth would help realise this potential.

In particular, evidence from our sample shows that crowdfunding remains a predominantly local source of finance, suggesting the existence of a home bias. The financial literature usually shows investors to be more inclined to support domestic projects, because they feel confident that they have more knowledge and certainty about local projects, along with the respective political and environmental factors. Thus, a low level of cross-border crowdfunding activity is similar to bank lending and investment being concentrated domestically[2]. We argue that facilitating the development of European crowdfunding goes hand-in-hand with facilitating higher levels of cross-border activity. This point has been highlighted, for example, by Véron and Wolff (2015) and Demertzis *et al* (2017). These authors argue that greater cross-border financial integration is important for capital markets development because it can help increase the size and liquidity of the market and also improves transparency, reliability and comparability of available information.

Furthermore, in the context of Brexit, the overall volume of the crowdfunding market in the EU can be expected to significantly shrink. It is not clear to what extent this might impact the development of EU crowdfunding outside the UK, but the effect will most likely be negligible as long as the legal framework remains unaffected. Sections 3 and 4 provide a more

2 Lin and Viswanathan (2015) confirmed the existence of a home bias in equity-based crowdfunding based on US data. Giudici *et al* (2017) argued that local altruism positively affects reward-based crowdfunding.

detailed discussion and comparison of existing crowdfunding regulations and annex 2 of European Commission (2016) provides an overview.

2 The structure and different types of crowdfunding

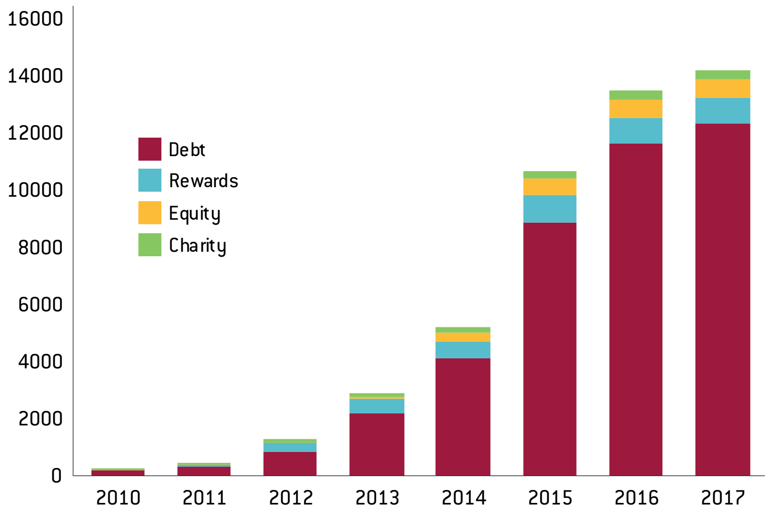
Crowdfunding can be channelled for a variety of projects. In particular, one can differentiate between four general types of crowdfunding:

- Debt-based crowdfunding, which can be compared to traditional bank lending, with peer-to-peer (P2P) loans being the predominant funding type;
- Reward-based crowdfunding, typically used for start-ups, in which donations trigger some form of reward or repayment in kind for the donor;
- Equity-based crowdfunding, or funding in return for a stake in a venture;
- Charity-based or philanthropic crowdfunding.

Each of the four categories can be further broken down into sub-types. Table A1 in the annex gives a more in-depth characterisation.

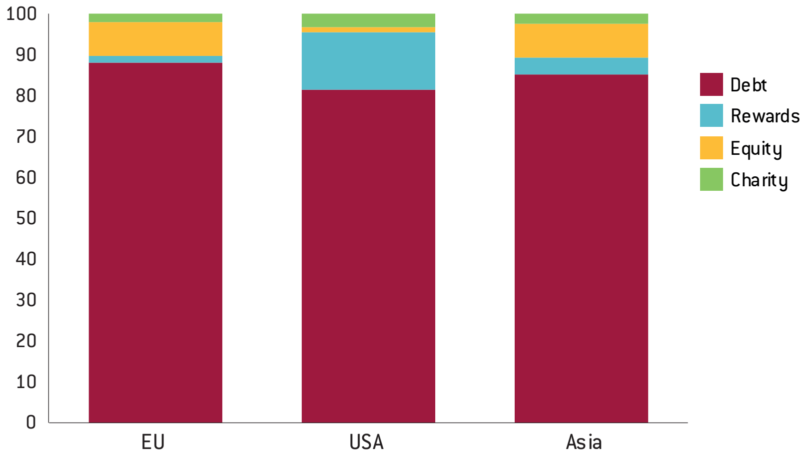
Figure 5 shows a simplified breakdown of the main project categories and the evolution of the respective funding volumes over time. With a total of approximately €40.5 billion pledged between 2010 and 2017, debt-based projects are the most popular type of crowdfunding. Reward-based projects amounted to roughly €4.3 billion, while €2.3 billion was pledged to equity-based projects. These three types of crowdfunding are comparable to existing sources of financing and can complement or even substitute them. In particular, they can provide individuals and businesses with capital that might have not been obtained through standard financing channels. Charity-based crowdfunding, on the other hand, is philanthropic by nature and is not expected to yield any rewards or financial benefits for an investor. We thus do not discuss this type of crowdfunding in more detail.

Figure 5: Total amount raised by type of project (€ millions)



Source: Bruegel based on TAB, formerly Crowdsurfer. Note: Only funded campaigns included.

Figure 6: Type of projects by region, 2010-2017 (% share)



Source: Bruegel based on TAB, formerly Crowdsurfer. Note: Only funded campaigns included.

Figure 6 shows the decomposition of the total volume raised by region and demonstrates the dominance of debt-based financing in all the major regions, with some differences. While most funds are commonly raised via debt-based projects in all of these regions, equity-based projects represent a greater share of crowdfunding activities in Europe and Asia than they do in the United States. On the other hand, reward-based crowdfunding is far more popular in the US in comparison to the other regions.

Peer-to-peer (P2P) loans are the predominant funding type within debt-based crowdfunding. Between 2010 and 2017, approximately €37.4 billion was raised worldwide in P2P loans, out of which €11.8 billion was raised in the EU. Roughly 47 percent (€5.5 billion) of European P2P loans was classified as business loans. In comparison, financial institutions in the euro area lent roughly €646 billion to non-financial corporations in 2017 alone[3]. Thus, even with its significant growth over recent years, debt-based crowdfunding is still small in scale when compared to the rest of the market.

Reward- and equity-based crowdfunding are attractive ways of financing for companies in their early stages of growth, as companies with high risk-return profiles usually struggle to obtain funds from the capital market[4]. Equity-based crowdfunding grew by only 7 percent in 2017, after a decline of 1 percent in 2016[5]. Reward-based projects raised roughly 1 percent less in 2017, continuing the downward trend. In Europe in particular, reward-based crowdfunding does not seems to have found its investors so far. With negative developments in 2016 and 2017, nominal growth has fallen back to its 2013 level.

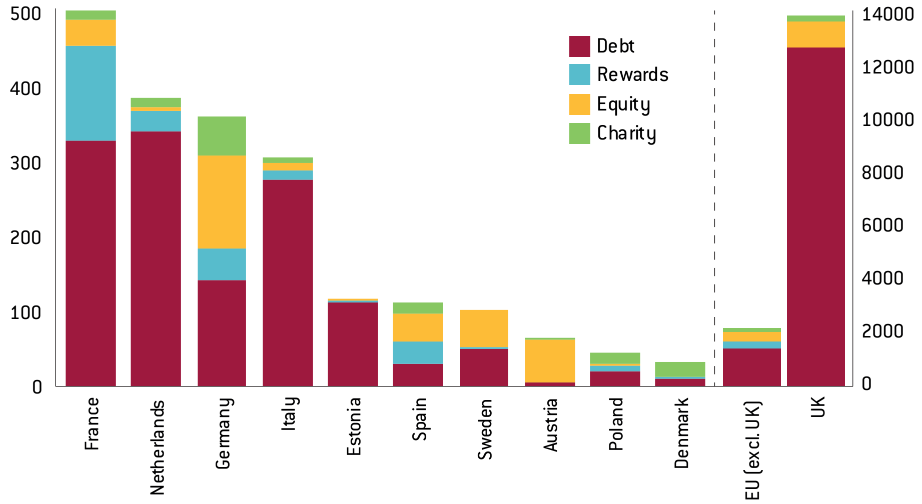
Figure 7 gives more details on the European crowdfunding structure. Between 2010 and 2017, a total of approximately €14.2 billion was pledged to debt-based campaigns in Europe, €1.4 billion was raised for equity-based and €282 million for reward-based projects. Most equity projects were conducted in the UK (€1 billion) and Germany (€126 million), while French platforms lead in the amount raised for reward-based projects (€126 million). The UK is the unmatched leader in debt-based crowdfunding (€12.8 billion), followed by the Netherlands (€341 million) and France (€330 million).

3 European Central Bank data: loans with a maturity of up to five years and an amount up to and including €1 million.

4 See OECD (2017). Chapter 2 discussed among other issues the relevance of equity-based crowdfunding for SMEs. AFME (2017) addressed in particular the shortage of risk capital in Europe.

5 For a deeper assessment of equity-based crowdfunding, see Wilson and Testoni (2014). In particular, the authors argued for a more harmonised legal framework for equity crowdfunding.

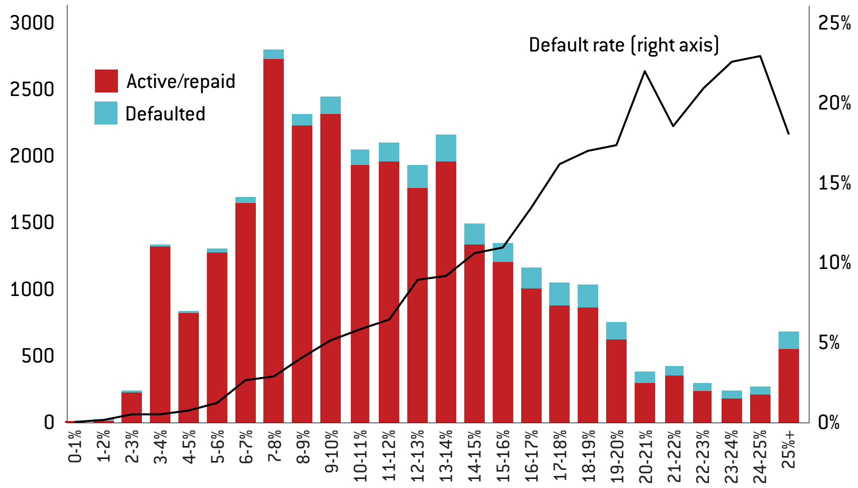
Figure 7: Total amount raised by type of project, top 10 EU member states (€ millions)



Source: Bruegel based on TAB, formerly Crowdsurfer. Note: Only funded campaigns included. EU (excl. UK) and UK are depicted on the right-hand x-axis.

Figure 8 assesses debt-based instruments in more detail, depicting the amount lent via P2P loans by their interest rate. Out of the €37.4 billion raised worldwide between 2010 and 2017, approximately €3 billion defaulted, was written off or is in arrears. This corresponds to a rate of non-performing loans (NPL) of approximately 8 percent. In comparison, 6.2 percent of total loans made by European banks in 2016 were NPLs. The corresponding NPL rates were significantly lower for the US (1.3 percent) and the UK (0.9 percent)[6]. As such, debt-based crowdfunding carries a greater risk in comparison to traditional bank lending. However, it still represents a reasonable opportunity for small-scale investors in times of overall low interest rates and yields.

Figure 8: Distribution of loans by interest rate (€ millions, 2010-17)



Source: Bruegel based on TAB, formerly Crowdsurfer. Note: Data for all debt campaigns between 2010 and 2017.

6 According to European Central Bank estimates.

3 The current regulation of crowdfunding markets

With crowdfunding growing rapidly and steadily, governments have become increasingly aware of the risks and opportunities it involves.

With crowdfunding growing in a rapid and steady manner, governments have become increasingly aware of the diverse risks and opportunities it involves. As such, calls for a regulatory framework that ensures investor and issuer protection were answered by a number of national authorities.

One of the first regulatory frameworks for crowdfunding was the American Jumpstart Our Business Startups (JOBS) Act. Adopted in 2012, its primary goal was to provide easier capital market access to early-stage businesses. After undergoing several adjustments, Title III of the JOBS Act, the so-called Regulation Crowdfunding (Reg CF) was introduced in 2016. Reg CF allowed eligible companies to raise capital through equity-based platforms with an exemption from registration for certain crowdfunding transactions. However, the regulation also included several limitations on the maximum investable amount per year, combined with tailored disclosure procedures and disqualification criteria for what Reg CF terms "*bad actors*" (ie issuers with certain criminal convictions)[7].

In Europe, a handful of regulations on investment and lending instruments exist on the European level, though they are not specifically tailored for crowdfunding-related activities[8]. A number of EU countries have therefore adopted domestic regulatory frameworks, mostly aimed at regulating investment-based crowdfunding. A detailed overview of the national regimes is presented in annex 2 of European Commission (2016).

In general, European crowdfunding platforms offering investment instruments have to obtain authorisation from the financial authorities of their home countries or must comply with the more general and strict rules set out by the European Commission, depending on the specific types of instrument offered. Therefore, different regulations for investors and issuers in terms of capital requirements, disclosure provisions and other limitations might apply.

Platforms offering investment-based crowdfunding might be authorised in three different ways:

1. If the instruments offered by the platform fall under the Markets in Financial Instruments Directive (2014/65/EU, MiFID), a so-called MiFID passport must be obtained[9]. With this in place, authorised platforms may carry out regulated investment services in their home countries and in other EU countries in accordance with the so-called single authorisation principle. However, the associated stricter limitations on capital requirements and additional disclosure demands are often regarded as too costly and burdensome.
2. In accordance to Article 3 MiFID, EU countries may choose to not apply the directive to entities for which they are the home member state. Platforms granted authorisation in such a way may only receive and transmit orders, alongside providing investment advice. Furthermore, their scope of operation is restricted to the home member state and is regulated by a domestic framework which is more suitably tailored to crowdfunding.
3. If a platform chooses to not offer any instruments regulated by the MiFID, such as non-readily realisable securities[10], authorisation has to be obtained under the relevant domestic regime.

7 See 'Disqualification of Felons and Other "Bad Actors" from Rule 506 Offerings and Related Disclosure Requirements'.

8 'Investment-based crowdfunding' is another term for equity-based crowdfunding, but also includes bonds categorised as debt-based crowdfunding.

9 See Directive 2004/39/EC.

10 A 'non-readily realisable security' is defined as a security that is not: (a) a readily realisable security; (b) a packaged product; (c) a non-mainstream pooled investment; (d) a mutual society share. A 'readily realisable security' includes securities that are admitted to listing, ie are regularly traded on an exchange in a European Economic Area country (Financial Conduct Authority (FCA) definition).

The difference between being authorised under the MiFID framework or outside of it is substantial. For example, the minimal capital requirement of €730,000 under MiFID (or €125,000 for investment firms that only manage portfolios and transmit orders) is cut to €50,000 under most national regulations. Moreover, the EU prospectus directive requires firms to prepare an often exhaustive description (prospectus) of the offered financial instruments[11]. Under most national regimes, exemptions from the prospectus requirements are allowed for projects not exceeding a threshold amount of €5 million.

Under MiFID II, implemented since January 2018, the scope of the included financial instruments has been extended and investor protection further enhanced[12]. In particular, so-called organised trading facilities (OTFs) must be authorised under the directive[13]. So far, there has been no clear ruling on whether crowdfunding platforms fall into this category. Should this be the case, however, a significant burden will be imposed on crowdfunding platforms that have so far operated outside the scope of the directive. In order to tackle this issue and provide more clarity for platforms and investors, a proposal to amend MiFID II was made in March 2018 (European Commission, 2018a).

In particular, the proposed amendment would provide crowdfunding platforms with a clear exemption from the MIFID II framework, should they receive authorisation under the additionally proposed Regulation on European Crowdfunding Service Providers (ECSP) for Business (European Commission, 2018b). Published in March 2018, this signalled – together with a prior inception impact assessment from November 2017 (European Commission, 2017a) – a changed in the Commissions' stance on regulation of crowdfunding. Previously, a simple wait-and-see approach was employed – observing market dynamics and determining best practice[14]. This stance was changed with the March 2018 proposal, with a clear aim to introduce an EU-wide framework. In order to fully assess the proposal, it is important to explore current best practices in crowdfunding regulation on a national level and to identify the major weaknesses of national regimes.

4 Best practices and the shortcomings of current regulations

The implementation of a harmonised European framework for investment-based crowdfunding could be a major step towards a more transparent and more easily-accessible market that would minimise the administrative burden for investors while strengthening investor protection. With authorisation under the MiFID directive perceived as too burdensome, the limited cross-border activity does not solely stem from investors' choices but is rather driven by platforms' decisions to operate under national regulatory frameworks that allow cross-border activity.

Some general lessons about the effectiveness of relevant European national regulations can be learned from Klöhn *et al* (2016), who analysed the German Small Investor Protection Act. One of their main criticisms was directed towards the prospectus exemption. In particular, the exemption only holds for a specific type of investment (profit-participating loans) and does not take into account other commonly-used types of loans such as silent partnerships. While both are very similar to each other, silent partnerships usually offer better investor protection because they are subject to statutory default rules. However, the latter become less and less

11 See Directive 2010/73/EU for the specific requirements.

12 See Directive 2014/65/EU.

13 An OTF is a multilateral system, ie *"a system or facility in which multiple third-party buying and selling interests in financial instruments are able to interact in the system"* (Article 4(1)(19) of MIFID II).

14 See European Commission (2016), p. 31.

attractive for crowdfunding purposes as only €100,000 can be raised without the obligation to prepare a prospectus. Klöhn *et al* (2016) argue that granting the prospectus exemption to all types of investment instruments and securities would strengthen investor protection.

The exemption from the prospectus regulation is a key part of all national regimes in Europe and applies to a much broader number of instruments than the German regulation – something that can be deemed to be a best practice[15]. In terms of the upper limit of the exemption, our sample suggests that the average amount pledged to equity-based projects in the EU is about €400,000 (average over the whole sample, 2010-17). Thus, the predominantly employed prospectus exemption threshold of €5 million does not appear to be restrictive and leaves enough room for further growth.

Klöhn *et al* (2016) also discussed the different approaches towards the subscription limit, ie the maximum amount that can be invested in crowdfunding. While some member states follow the example of the US and regulate the total subscription limit in the market (aggregate limit), most frameworks restrict the amount that can be pledged to a single issuer (single issuer limit). As the single issuer limit forces the investor to diversify his portfolio, it can be argued that it offers stronger investor protection compared to the aggregate limit. However, both can restrict the growth of crowdfunding activity.

The German legislative framework, for example, requires the investor to disclose his financial assets for investments over €1,000. Assuming that not all investors are willing to give insights into their financial assets, Klöhn *et al* (2016) suggest raising the lower bound to €5,000 and thus boosting crowdfunding activity[16]. Our data shows that the average amount pledged to debt campaigns in Europe is around €8,800 (€1,000 median), and to equity-based projects, it is €400,000 (€120,000 median). Thus, an even higher threshold should be discussed.

Best practice in setting the upper bound for investment without disclosure of additional information has yet to be established. While the two largest countries in the EU in crowdfunding terms, namely France and the UK, place nearly no limits or disclosure obligations on the investor, other national regimes follow stricter approaches. In particular, the amount a private investor can put into a single project per year without disclosing his assets or providing additional information to the authorities varies between €500 and €5,000.

In contrast to the US, national frameworks in the EU neither apply restrictions on the resale of crowdfunding instruments nor disqualify those with criminal convictions from issuing them.

All frameworks listed in annex 2 of European Commission (2016) have in common that they neither apply restrictions on the resale of crowdfunding instruments nor disqualify those with criminal convictions from issuing them. This is in contrast to the US regulatory framework (see section 3) in which such restrictions significantly help strengthen investor protection. Additionally, equity issuers in the US face much tougher disclosure requirements, such as detailed financial statements and annual reports, which must be continuously updated for as long as any crowdfunding shareholders remain. As a result, raising even small equity amounts becomes quite burdensome[17].

While the additional measures applied in the US offer more pronounced investor protection, our data shows that European platforms raised close to four times more funding for equity-based undertakings than their US counterparts. As such, European exemptions for small offerings and European lax disclosure obligations appear to have a positive effect on overall crowdfunding activity. Strengthening investor protection should be done with care in order to not disrupt the already stagnating European market for equity crowdfunding.

In summary, not many best practices among European national regimes have yet crystallised. Even though some cornerstones of the legal frameworks, such as maximum investable amounts and prospectus requirements, appear to be similar, there are significant differences in their lower and upper bounds. In particular, the scope of regulated crowdfunding instru-

15 See the table in European Commission (2016), annex 2, row on 'Size of offer (limitations or prospectus requirements)'.

16 A similar limit is already implemented in Austria.

17 Additionally, Härkönen (2017) outlined some major differences between the regulatory frameworks, focusing on the Prospectus Regulation.

ments differs from one EU country to another. While a one-size-fits-all regulatory framework might not be appropriate, the lack of a coherent regulation on the EU level creates hurdles for cross-border crowdfunding activity and thus endangers the vision of a Capital Markets Union (CMU). We argue that leaving crowdfunding regulation at the member-state level might lead to a segmentation of the market rather than the hoped-for convergence of best practices. As such, we very much welcome the proposal on EU-wide regulation of investment- and lending-based crowdfunding service providers. We discuss the proposal and other related issues in more detail in sections 5 and 6.

5 Summary of findings

While the lack of a coherent regulatory framework at EU level will most likely not hinder the regional development of crowdfunding in the member states, weak cross-border activity and often burdensome provisions are challenges for the further development of crowdfunding markets in Europe. Supporting the crowdfunding market is important, because it can provide start-ups and SMEs with much needed access to finance – a key objective of the CMU action plan. In particular, some of the priority actions outlined in the CMU plan are pointed directly at the current shortcomings in the crowdfunding market: improving cross-border distribution of investment funds and providing guidance on EU rules for treatment of cross-border investment[18].

We have identified three major shortcomings, where policy measures need to be taken:

1. **A clear legal definition of the miscellaneous crowdfunding instruments is currently missing.** In order to facilitate cross-border investment, a common foundation has to be put in place first. As national regimes allow a number of exemptions, crowdfunding platforms tend to offer instruments tailored to specific frameworks. Thus, a small firm seeking cross-border finance would need in-depth knowledge of multiple legal regimes in order to find a financing model that best fits their needs.
2. **The current regulations in the MiFID (II) framework are not designed for crowdfunding activity.** In particular, obtaining a MiFID passport is the only way for crowdfunding platforms to operate on a multi-country level. However, additional disclosure requirements and the prospectus regulation entail extra costs that are often too burdensome for platforms, issuers and investors. Moreover, parties seeking to finance themselves through crowdfunding are made up mostly of start-ups, SMEs and individuals. Compared to big investment firms for whom the MiFID framework was designed, they are far less resilient in the face of additional regulatory costs.
3. **An examination of national regimes shows few best practices.** Instead, there are significant differences between the less-restrictive frameworks (UK and France) and regimes focused more on single issuer limits and disclosure requirements (eg Germany). As such, a 'wait and see' approach will not lead to the desired convergence of national regulatory frameworks in the foreseeable future and could result in fragmentation of the crowdfunding market – directly opposing the vision of a single capital market.

In this context, European Commission (2017a) proposed several options for further treatment of crowdfunding:

1. Baseline scenario – no EU framework;
2. Building on reputational capital – a self-regulatory approach with minimum EU

18 See the European Commission's mid-term review factsheet of the CMU action plan (European Commission, 2017b).

standards;
3. A comprehensive EU approach – treating crowdfunding platforms like regulated trading venues or payment institutions;
4. The cross-border solution – a standalone opt-in EU framework.

Based on our findings, we argue strongly that only policy option 3 will be able to improve on the status quo (policy option 1) and eliminate the three major shortcomings affected European crowdfunding outlined above[19].

In particular, policy option 2 would not help to enhance cross-border activity and would in particular not overcome the conflicts between different member states' laws and regulations. While non-binding minimum standards could help member states who do not have any regulations so far to implement new national regimes, the status quo would remain unchanged. Moreover, mapping best practices would prove difficult, as there is a diversification of national regimes rather than a convergence. As such, policy option 2 would essentially not differ from option 1.

Policy option 4, on the other hand, directly addresses a key finding of this Policy Contribution – the lack of cross-border crowdfunding activity. As outlined by in European Commission (2017a), a specific standalone opt-in for platforms that wish to operate in other member states would need to be created. However, it is difficult to see how this could work in practice if national regimes are to be left unchanged. What would be the governing law for a crowdfunding platform that operates across borders? Would it be possible for a platform to operate under national regimes and the opt-in at the same time? This would not only reinforce the existing confusion felt by investors, but would impose an additional bureaucratic burden on the platforms themselves. While policy option 4 addresses an important problem, its implementation might prove even more difficult than that of policy option 3.

Taking the current status quo of European crowdfunding into account, we very much welcome the proposal for a regulation based on policy option 3. Introducing an EU wide framework for investment- and lending-based crowdfunding service providers and its implementation as an exemption under the MiFID II framework are the most reasonable steps to promote cross-border crowdfunding activity in Europe. We feel, however, that despite being a very important first step, the Commission's proposal has shortcomings that should be addressed before it is finalised and implemented.

6 Policy recommendations

The proposed regulation on crowdfunding service providers (European Commission, 2018b) is a much needed step towards enhancing the cross-border distribution of investment funds and thus has the potential to improve the overall funding situation for start-ups and SMEs in Europe. The European Commission's March 2018 proposal together with the proposed MiFID II amendment, tackle many of the issues discussed in the previous chapter. However, there is room to improve the proposal, especially in relation to investor protection.

First, as we have shown, an EU-wide framework needs to establish precise and transparent legal definitions of crowdfunding activity, eliminating any legal confusion for investors, companies and platforms. The proposal (European Commission, 2018b) includes many of the most important definitions. However, most either define very basic terms such as 'crowdfund-

19 In their analysis of the role of fintech in CMU development, ie implementation of innovative information technology in financial services such as crowdfunding, Demertzis *et al* (2017) also found shortcomings in the MiFID framework and national fragmentation of the regulatory regimes. They argued that a single European framework should be developed.

ing platform' and 'crowdfunding project' or focus solely on the crowdfunding service providers. The introduction of an EU-wide regulation presents a good opportunity to introduce more specific (legal) definitions of the multiple crowdfunding instruments mentioned in Table A1 in the annex. This would benefit investors, who would be able to more easily compare the offered investment opportunities, and would also help companies select a financing model that best fits their needs. Moreover, having solid definitions from the outset is a necessity in order to further improve or extend the framework in the future.

Second, a much more pressing issue with the proposal is its lax and rather unclear stance on investor protection. The proposal does not specify a maximum investable amount. Instead, the responsibility to assess the knowledge of investors and their ability to bear losses is placed on the crowdfunding service providers. However, if the service provider finds the investors' knowledge to be insufficient, he is only obliged to issue a warning, which does not prevent an investor from investing in a project. While we support the regulation's goal of imposing less administrative burden on investors, we suggest including a more refined requirement for agents who want to invest over a certain threshold amount to go through a 'qualified investor test'. Similar to the 'accredited investor' concept employed in US and Spanish crowdfunding regulation, the investor would have to prove that he has the necessary knowledge and ability to participate in the crowdfunding market with larger sums of money. In practical terms, a combination of both concepts is possible: investors who are not willing to fully disclose their assets and become accredited investors could instead participate in a short (online) seminar that teaches basic financial market knowledge, and then take a test that would certify their ability to operate in the crowdfunding market. As this places quite a heavy bureaucratic burden on all parties, there should be an exemptions for investments of, for example, up to €10,000 per project.

Third, another issue with the proposal is the limitation placed on offers under the proposed framework. In particular, crowdfunding offers are limited to €1 million per project over a period of 12 months. While this threshold corresponds to the European prospectus regulation, most national regimes employ an exemption for offers under €5 million (or above the proposed amount of €1 million). Our data shows that for the EU as a whole, the average amount pledged to fully funded equity campaigns was roughly €496,000 in 2017. However, while only about 15 percent of the funded campaigns were above the proposed threshold of €1 million, they raised approximately 50 percent of the total funds pledged to fully-funded equity campaigns. As such, we argue that the threshold proposed in European Commission (2018b) is too restrictive and should be raised to €5 million in order to allow for frictionless development of investment-based crowdfunding in Europe.

In sum, the proposal (European Commission, 2018b) introduces a solid foundation for an EU-wide regulation on crowdfunding. If the major shortcomings we have listed are addressed, the framework has the potential to significantly improve the crowdfunding market in Europe, especially in terms of facilitating cross-border activity and providing a clear and transparent framework that lessens the administrative burden on investors. We recommend exploring the possibility of extending the framework to other types of crowdfunding, such as reward-based projects and P2P loans. The former in particular is a popular way for many start-ups and SMEs to raise finance at the early stage of business. While this is certainly a different type of crowdfunding that does not deal with financial products, it can be offered through the same platforms. As such, having a single framework under which authorisation can be obtained for both types of crowdfunding would significantly reduce the burden on service providers and would allow consumers to benefit from economies of scale. This, however, might be included as a next step after the EU crowdfunding regulation is finalised.

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Annex

Table A1

Type	Description
Charity	
Micro-donation	A micro-donation is the donation of a very small amount of money. This form of finance is commonly used for charitable purposes.
Donations	A donation is the giving of money, without any expectation of a financial return. This form of finance is commonly used for charitable and philanthropic purposes. Donations can be very large or small and may be eligible for tax relief depending on the law of the respective country.
Micro-loan	A micro-loan is the loan of a very small amount of money. Microloans are often made to entrepreneurs in developing countries to help them establishing a business and become self-sufficient. Micro-loans may or may not be repaid, and may or may not carry interest.
Community shares	Community shares are investments in community-owned enterprises that are co-operative in nature and aim to benefit the community in which they operate. They are run democratically with investors becoming members of the organisation. The risk associated with community shares varies, depending on the individual organisation. In the UK, they are commonly shares in industrial and provident societies (IPS).
Debt	
Debenture	Similar to a bond. However, debentures are not backed by collateral.
Loan (P2P)	A loan is money given to someone for a set period of time with the expectation that it will be repaid. The loan may or may not carry interest, making it potentially profitable for the lender. Peer-to-peer (P2P) loans are loans made directly to someone by another person via a website.
Bond	A bond is a debt investment in which an investor loans money to an entity for a defined period of time.
Invoice trading	Invoice trading is the process in which small and medium-sized enterprises (SMEs) auction their invoices online, as a way to gain quick access to money that would otherwise be tied up.
Equity (shares)	An equity investment means buying shares or stocks in a company. Equity investment (known as venture capital or angel investing when referring to young companies) is a useful source of finance, as it enables growth without having to pay back the money straight away. An investor may get voting rights on company matters. Equity investments carry a high risk as the value of shares can go down as well as up, without any guarantees for investors to get back their money. A return on invested money may come when the company is bought, when an investor sells their shares at a higher price than they bought them, or when dividends are paid out from the company's profits. With start-up (new) companies particularly, an investor should expect to wait several years to make a profit in any of these ways. The majority of start-ups go out of business, but there is also the potential for very high returns.
Rewards	Rewards refer to a pledge of money in support of a project or business in return for a gift. For example, a gift could be a version of the product or an invitation to an event. Where products are given routinely as a reward for giving money, this is sometimes called pre-purchase or pre-tail, as it is similar to ordering an existing product before it has been made.
Other	
Insurance (P2P)	A mechanism that allows users to pool funds together to form a fund for insurance claims.
Revenue-sharing	In a revenue-sharing arrangement, investors agree to receive a share of the organisation's revenue in exchange for their investment. The returns to the investor will therefore depend on how successful the organisation is at selling its products or services.
Royalities	Royalties are recurring payments made in return for the use of something (such as a book or soundtrack). How much money an investor makes from an investment in royalties will depend on how much the asset is used.
Membership/ subscription	A project may offer a recurring subscription to supporters. Subscribed members receive ongoing access to the product or service they have supported.