



**LEGALINK**  
INTERNATIONAL BUT PERSONAL

# EQUITY CROWDFUNDING & PEER-TO-PEER LENDING

2019 1ST EDITION



## INTRODUCTION

Crowdfunding has already an established and proven recognition worldwide as a powerful alternative financing tool. Three main points should be signaled in this respect. On the one hand, the volume of the crowdfunding market keeps increasing sharply at global level. On the other hand, the crowdfunding market is very dynamic as new crowdfunding platforms have recently started to operate. Finally, the projects to be financed through crowdfunding platforms are more and more diverse.

In this context, at a time when crowdfunding regulation is subject to discussion around the globe (namely in the context of the Proposal for a EU Crowdfunding Regulation), it seems important to assess the legal responses from various relevant jurisdictions, in respect to Equity Crowdfunding and Peer to Peer Lending. Such is the purpose of this publication.

This book is dedicated to the memory of Georg Van Daal, Former Deputy Head of Legalink FinTech Forum. Georg was a brilliant lawyer and a partner at Ekelmans & Meijer from 2014 to 2018. He was key to the structuring and to the development of this project but unfortunately could not live to see its final form. He is dearly missed.

October 2019

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## Equity Crowdfunding

For the purposes of the following, 'equity crowdfunding' means raising capital in an offering of shares (or instruments convertible into shares) through an online platform

### **1. Has your country introduced specific laws or regulations governing equity crowdfunding, or is it regulated under general securities or other laws?**

Investment-based models of funding which involve people buying shares or debt securities or units within an unregulated collective investment scheme such as those usually sold via equity crowdfunding platforms fall within the scope of UK regulations, which are set out in the Financial Services and Markets Act 2000 (FSMA) and the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (RAO).

In accordance with section 19 of FSMA, a person must not carry on a regulated activity in the UK unless they are authorised by the FCA or an exempt person. A regulated activity is a specified kind of activity if it is carried on by way of business and relates to a specified investment or property of any kind. There is also a general prohibition on financial promotion in section 21 of FSMA (see question 5 below).

Articles 25(1) and 25(2) of the RAO confirm that arranging deals in investment is a specified activity. The specified activity covers both arranging deals in investment and making arrangements with a view to participation in deals in investment. To be a specified activity, the activity must relate to a specified investment. Article 25 confirms several types of specified investment, including securities such as shares. Equity crowdfunding therefore falls within the definition of specified activities and, as a result, the authorisation of the Financial Conduct Authority (FCA) is required to carry on legally the activity in the UK.

There are threshold conditions that must be satisfied to successfully obtain FCA authorisation. The conditions cover matters such as legal status, office location, supervision, resources and the applicant's suitability and business model. For more information please see <https://www.handbook.fca.org.uk/handbook/COND/1/?view=chapter>.

Due to the potential for capital losses, investment-based crowdfunding is regarded as a high-risk investment activity by the regulator, the FCA. On 1 October 2014 the FCA introduced new Conduct of Business Source Book (COBS) rules regarding financial promotions relating to 'non-readily realisable securities', which by definition include shares sold via equity crowdfunding platforms. The rules were created to ensure sufficient regulation of equity crowdfunding and include marketing restrictions, so firms may only make direct offer promotions to retail consumers who meet certain criteria and must check whether customers understand the risks if they do not take regulated advice (see answer to question 5 below for further details).

The FCA Handbook (published online) also provides rules applicable to equity crowdfunding activities,

some of which have been created specifically to ensure adequate protection is in place for those investing in equity crowdfunding.

Unlike loan-based crowdfunding (see below), the FCA has not published a summary of the FCA Handbook rules relevant to equity crowdfunding. However, it appears that most of the rules listed will apply to both types of crowdfunding. The FCA summary can be found at <https://www.fca.org.uk/firms/project-innovate-innovation-hub/loan-based-crowdfunding-platforms-summary-our-rules>.

## **2. If your country regulates equity crowdfunding, what are the names of the government agencies responsible for regulating it?**

The Financial Conduct Authority is the main regulator responsible for regulating investment-based crowdfunding.

## **3. Are there limits on the amounts that can be raised by crowdfunding companies?**

There are no general limits in the UK to the amount that can be raised by equity crowdfunding, but if the amount raised exceeds the thresholds set out in the prospectus rules, additional requirements apply (see answer to question 5 below for further information on the prospectus rules).

There are certain restrictions regarding the financial promotions that can be made to retail clients who have not received regulated advice, i.e. less than 10% of their net assets (please see answer to question 4 below for further details).

Certain crowdfunding platforms themselves may limit (if not prohibit) equity crowdfunding amounts.

## **4. Are there restrictions on the types of purchasers to whom shares can be offered?**

COBS

The COBS rules are contained in the FCA Handbook (<https://www.handbook.fca.org.uk/handbook/COBS/4/?view=chapter>) and contain a prohibition on direct offers of financial promotion. A firm must not communicate or approve a direct-offer financial promotion relating to a non-readily realisable security to or for communication to a retail client unless certain conditions are met.

The conditions to be met are specified in COBS 4.7.7 R as follows:

- Condition 1: Unless 4.7.8 R applies (see below), the retail client recipient of the direct-offer financial promotion is one of the following:
  - (a) certified as a 'high net worth investor' in accordance with COBS 4.7.9 R;
  - (b) certified as a 'sophisticated investor' in accordance with COBS 4.7.9 R;
  - (c) self-certified as a 'sophisticated investor' in accordance with COBS 4.7.9 R;
  - (d) certified as a 'restricted investor' in accordance with COBS 4.7.10 R.

- Condition 2: the firm itself, or the person who will arrange or deal in relation to the non-readily realisable security, will comply with the rules on appropriateness (see COBS 10 and 10A) or equivalent requirements for any application or order that the person is aware, or ought reasonably to be aware, is in response to the direct offer financial promotion.

In addition, each of the categories of investor in COBS 4.7.9 must have signed, within the period of 12 months ending with the day on which the communication is made, a statement in the form set out in COBS 4.12.6 R, 7 R and 8 R respectively.

A restricted investor is a retail client who certifies, within the period of 12 months ending with the day on which the communication is made, that they will not invest more than 10% of their net assets in non-readily realisable securities in accordance with 4.7.10 R.

COBS 4.7.8 R allows direct-offer financial promotions to retail clients if:

- The firm itself will comply with the suitability rules (COBS 9 and 9A) in relation to the investment promoted; or
- The retail client has confirmed before the promotion is made that they are a retail client of another firm that will comply with the suitability rules (COBS 9 and 9A) in relation to the investment promoted; or
- The retail client is a corporate finance contact or a venture capital contact.

Effectively 4.7.8 R provides an exception for those retail clients that receive regulated investment advice or investment management services from a regulated person. If this does not apply, then the financial promotion can only be made if the retail clients satisfy the two conditions in 4.7.7 R.

- A 'retail client' is a client who is neither a professional client nor an eligible counterparty (investment firm, credit institution etc.).
- A 'direct-offer financial promotion' is a financial promotion containing an offer by a firm/another person to enter into a controlled agreement with any person who responds to the communication or an invitation to any person who responds to the communication to make an offer to the firm or another person to enter into a controlled agreement. Equity crowdfunding would fall within this definition.
- A 'non-readily realisable security' is a security which is not a readily realisable security, a packaged product, a non-mainstream pooled investment or a mutual society share. A 'readily realisable security' includes securities which are admitted to listing/regularly traded on an exchange in an EEA state. Equity crowdfunding will likely involve 'non-realizable securities' for start-up companies, and therefore the new FCA rules will apply.

Companies Act 2006 (CA)

The CA restricts the marketing of shares. In accordance with section 755, a private company limited by shares or limited by guarantee and having a share capital must not offer to the public any securities of the company, or allot or agree to allot any securities of the company with a view to their being offered to the public. Companies must therefore ensure when participating in equity crowdfunding that offers are not being made to the public.

Pursuant to section 756(3), an offer is not regarded as an offer to the public if it can properly be regarded, in all the circumstances, as:

- a) Not being calculated to result, directly or indirectly, in securities of the company becoming available to persons other than those receiving the offer, or
- b) Otherwise being a private concern of the person receiving it and the person making it.

Private companies who intend to raise funds via equity crowdfunding could potentially rely on section 756(3)(a) above. It is common practice for investors to have to set up an account and sign into a crowdfunding website. The platform may be structured in such a way that there is a clear process that has to be followed/accepted for setup, and offers are only made to those with registered accounts. It could therefore be argued that the offer is not made to the general public as a whole.

A potential flaw in this argument is that section 756(2) provides that an offer to the public includes an offer to 'any section of the public, however selected'. As crowdfunding becomes more popular and the number of registered investors receiving offers increases, it is likely that companies will be unable to rely on this argument. Other options may need to be considered, for example, converting from a private limited company to a public limited company so that one of the exemptions in the Public Offers of Security Regulations 1995 would apply (the list of exemptions has recently been revised to implement the EU Prospectus Regulation 2017/1129 as of 21 July 2018).

## **5. What information needs to be disclosed to potential purchasers, and are offer documents or marketing materials required to be registered or approved by your country's regulators?**

### Prospectus Rules

Section 85 of FSMA confirms that it is unlawful for transferable securities to be offered to the public unless a prospectus approved by the FCA has been made available to the public before the offer. However, FSMA also provides exceptions to this requirement. A person/firm does not have to make an approved prospectus available to the public if:

- the offer is made to/directed at solely qualified investors;
- the offer is made to/directed at fewer than 150 people per EEA state (other than qualified investors);
- the offer is within a minimum total consideration per investor of €100,000.
- the offer is within a minimum specified denomination per unit of €100,000.
- the offer is within a total consideration in the EEA of less than €8 million (increased from the previous limit of €5 million).

If a prospectus is required, section 87A of FSMA sets out what content must be included within the

prospectus. A prospectus will not be approved by the FCA unless the prospectus contains all necessary information. This includes information necessary to enable investors to make an informed assessment of the issuer of the transferable securities (assets, liabilities, finances, prospects) and the rights attaching to the transferable securities.

The Prospectus Rules in the FCA Handbook summarise the requirements of FSMA and provide guidance on the drawing up of a prospectus and the process for obtaining approval from the FCA.

## Financial Promotion

Section 21 of FSMA provides that a person must not, in the course of business, communicate an invitation or inducement to engage in investment activity or to engage in claims management activity, unless:

- That person is authorised under FSMA (authorised by the FCA in accordance with section 31 of FSMA).
- The content of the communication has been approved (specifically for the purposes of enabling the financial promotion to be communicated by the unauthorised person free of the restriction under section 21 of FSMA) by an authorised person in accordance with the FCA rules.
- The communication is covered by an exemption. Exemptions from the financial promotion restriction are contained in the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (SI 2005/1529) (FPO).

There are over 70 exemptions in the FPO. These apply to certain types of communication (e.g. introductions, one-off communications), communications to certain people (e.g. investment professionals, certified high-net-worth individuals, sophisticated investors), communications from certain people (e.g. journalists, insolvency practitioners) and company communications. It is worth considering the exemptions to see if the particular promotion used for crowdfunding falls within their scope. However, to ensure compliance with FSMA it would be best to ensure that financial promotions come from or are approved by an authorised person.

A company raising funds via equity crowdfunding will prepare marketing documents which will constitute a financial promotion. The content of such financial promotion must be authorised in compliance with section 21 unless it falls within one of the three exemptions above.

Chapter 8 of the Perimeter Guidance Manual (PERG) provides the FCA's guidance on the financial promotion restriction. The content of PERG is just guidance and is not binding on the courts but may be considered.

COBS 4 of the FCA Handbook (discussed above) also sets out rules in relation to financial promotions and should be complied with by equity crowdfunding platforms.



**6. Is there any requirement for an equity crowdfunding platform and/or its operator, or a crowdfunding company, to be licensed or registered or to comply with any particular rules?**

Please see the answer to question 1. If the platform is deemed to be carrying out a specified activity, FCA authorisation will be required and the FCA Handbook (where applicable) must be complied with.

**7. Please provide any additional information you feel is important to understanding the regulation of equity crowdfunding in your country.**

Social Media

The FCA has issued guidance on social media and customer communications. Social media is a key facility for lots of crowdfunding platforms. It is therefore important to ensure that its use also complies with FCA regulation.

To be within the scope of FCA regulation, a financial promotion must be 'in the course of business'. If a platform is seeking capital for a company already in operation, this will be 'in the course of business', whereas contacting family/friends via social media to raise start-up capital prior to formation of the company will not be a financial promotion and will not be the concern of the FCA.

It is important when using personal social media accounts to ensure that any posts that are personal should be made distinguishable from communications of the company 'in the course of business.'

The same FCA rules are applicable to financial promotions via social media. Users should be mindful of the FCA rules when using social media for this purpose, including in relation to:

- Restricted word/character limits- financial promotions must still be 'clear, fair and not misleading' (principle 7 of Principles of Business) despite these limits. Promotions must also include risk warnings, which can consume a large chunk of the allowed words/characters.
- Multiple communications - even if an array of tweets, posts and web pages have been used to promote an investment, each communication will be considered as a standalone promotion and must comply with the FCA rules.
- Unsolicited promotions - social media is a method for easily making unsolicited promotions. The FCA guidance provides a reminder that the same FCA rules apply.

This should also be considered for loan-based crowdfunding discussed below.

**8. Please identify a point of contact at your firm for equity crowdfunding-related enquiries.**

## CONTACT

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## Peer-to-Peer Lending

For the purposes of the following, 'peer-to-peer lending' means lending by individuals to businesses or other individuals where an online platform is used to match lenders with borrowers.

### 1. Has your country introduced specific legislation or regulations governing peer-to-peer lending, or is it regulated under generally applicable laws

A combination of specific and general rules relating to peer-to-peer lending (also commonly referred to as loan-based crowdfunding) is incorporated into UK law.

In 2013, the FCA introduced article 36H of the RAO to improve the regulation of loan-based crowdfunding. Article 36H introduced a new regulated activity of 'operating an electronic system in relation to lending' and, given certain conditions are met, this will be a specified activity requiring FCA authorisation.

The conditions that must be met are as follows:

- a) the system operated by the operator must be capable of determining which agreements should be made available to the lender and borrower (whether in accordance with general instructions provided to the operator by the lender and borrower or otherwise).
- b) the operator, or another person acting under an arrangement with the operator or at its discretion, receives payments due under the agreement from the borrower, and makes payments due under the agreement to the lender.
- c) the operator, or another person acting under an arrangement with the operator or at its discretion, undertakes to perform or to appoint or direct another person to perform either or both of the following activities:
  - i. taking steps to procure the payment of a debt under the agreement; or
  - ii. exercising or enforcing rights under the agreement on behalf of the lender.

Article 36H applies to 'agreements' only apply if conditions 5 or 6 are satisfied:

(5) The condition in this paragraph is that the lender is an individual or relevant person.

(6) The condition in this paragraph is that the borrower is an individual or relevant person and—

(a) the lender provides the borrower with credit less than or equal to £25,000, or

(b) the agreement is not entered into by the borrower wholly or predominantly for the purposes of a business carried on, or intended to be carried on, by the borrower.

Therefore, lending between lenders or borrowers who are not individuals or certain types of non-corporate businesses where the amount borrowed is over £25,000 will not be classed as a regulated activity under article 36H.

If the tests for 'operation of the electronic system in relation to lending' and 'agreement' are satisfied, then the platform will be carrying out a specified activity under the RAO which is a regulated activity under the FSMA. The platform will therefore require FCA authorisation in order to carry on its business. Charities and authorised representatives of directly FCA authorised firms are exempt from article 36H activity.

The FCA Handbook rules, and specifically those rules confirmed by the FCA as applying to loan-based crowdfunding, must be complied with following authorisation. Guidance should also be followed. The FCA confirmed rules include:

- The Principles for Business (PRIN)
- Senior Management Arrangements, Systems and Controls (SYSC)
- Threshold Conditions (COND)
- Statements of Principle and Code of Practice for Approved Persons (APER)
- The Fit and Proper Test for Approved Persons (FIT)
- General Provisions (GEN)
- Fees Manual (FEES)
- The Interim Prudential Sourcebook for Investment (IPRU(INV))
- Conduct of Business (COBS)
- Client Assets (CASS)
- Supervision (SUP)
- Decision Procedures and Penalties (DEPP)
- Dispute Resolution: Complaints (DISP)
- The Perimeter Guidance Manual (PERG)
- Financial Crime: a guide for firms (FC)
- The Unfair Contract Terms and Consumer Notices Regulatory Guide (UNFCOG)

With regard to the Senior Management Arrangements, Systems and Controls rules, the FCA introduced specific requirements in SYSC 4.1 for firms running loan-based crowdfunding platforms. The rules require firms, amongst other things, to take reasonable steps to ensure that arrangements are in place to ensure that existing loan agreements facilitated by the platform will continue to be managed and administered in accordance with the contract terms, if at any time the firm becomes unable to continue operating the platform.

## **2.If your country regulates peer-to-peer lending, what are the names of the government agencies responsible for regulating it?**

The Financial Conduct Authority regulates peer-to-peer lending in the UK.

## **3.Are there any limits on the amounts that can be lent?**

There are currently no limits in the UK on the amount that can be lent to an individual through a crowdfunding platform. However, new FCA rules are to be introduced in 2019 (see below).

Certain crowdfunding platforms may limit peer-to-peer debt-based crowdfunding (for example, in the

form of a maximum pledge amount per investor/lender).

#### **4. Are there any restrictions on the types of persons who can lend and/or borrow, or restrictions on the rate of interest that can be charged?**

At question 9 we have set out details of the new FCA rules that come into force at the end of 2019. One of these rules is that the rules relating to a direct-offer financial promotion for non-readily realisable securities (previously only applicable to equity crowdfunding) will now also be applicable to P2P lending. This means that the conditions set out above for equity crowdfunding will also have to be met for loan-based crowding. Direct-offer financial promotions will only be acceptable to the FCA if made to 'retail clients' falling within the categories set out at COBS 4.7.7R.

Restrictions have been introduced in the UK in relation to high-cost short-term credit (HCSTC) (including payday loans).

A HCSTC, as defined by the FCA handbook, is a regulated credit agreement being a borrower-lender agreement or a P2P agreement where the APR is equal to or exceeds 100% and either:

- a financial promotion made indicates that the credit is to be provided for a short term or for up to a maximum of 12 months; or
- the credit is due to be repaid or substantially repaid within a maximum of 12 months of the date on which the credit is advanced.

A HCSTC does not cover:

- credit agreements secured by a mortgage or a charge or pledge;
- credit agreement where the lender is a community finance organisation; or
- a home credit loan agreement, bill of sale loan agreement or overdraft.

If the peer-to-peer crowdfunding satisfies the above definition, the following limits apply:

- an initial cost cap of 0.8% per day, meaning interest and fees charged must not exceed 0.8% per day of the amount lent.
- a £15 cap on default fees – if a borrower defaults, fees must not exceed £15. Firms can continue to charge interest after default but not above the initial rate; and
- a total cost cap of 100% – borrowers must never pay more in fees and interest than 100% of what they borrowed.

#### **5. Is there any requirement for the online platform and/or the lenders to be licensed or registered or to comply with any particular rules?**

Please see question 1 above. FCA authorisation is required if article 36H is satisfied and the platform is conducting specified activity.

#### **6. Are there any requirements applicable to marketing and promotional documents and activities?**

The Consumer Credit Sourcebook (CONC 3) deals with financial promotions and communications with customers. As discussed in question 7, CONC is only applicable to some peer-to-peer agreements, so not all crowdfunding platforms are required to comply.