

Hainz, Christa; Hornuf, Lars

Article

Crowdinvesting

CESifo DICE Report

Provided in Cooperation with:

Ifo Institute – Leibniz Institute for Economic Research at the University of Munich

Suggested Citation: Hainz, Christa; Hornuf, Lars (2016) : Crowdinvesting, CESifo DICE Report, ISSN 1613-6373, ifo Institut - Leibniz-Institut für Wirtschaftsforschung an der Universität München, München, Vol. 14, Iss. 1, pp. 67-69

This Version is available at:

<https://hdl.handle.net/10419/167252>

Standard-Nutzungsbedingungen:

Die Dokumente auf EconStor dürfen zu eigenen wissenschaftlichen Zwecken und zum Privatgebrauch gespeichert und kopiert werden.

Sie dürfen die Dokumente nicht für öffentliche oder kommerzielle Zwecke vervielfältigen, öffentlich ausstellen, öffentlich zugänglich machen, vertreiben oder anderweitig nutzen.

Sofern die Verfasser die Dokumente unter Open-Content-Lizenzen (insbesondere CC-Lizenzen) zur Verfügung gestellt haben sollten, gelten abweichend von diesen Nutzungsbedingungen die in der dort genannten Lizenz gewährten Nutzungsrechte.

Terms of use:

Documents in EconStor may be saved and copied for your personal and scholarly purposes.

You are not to copy documents for public or commercial purposes, to exhibit the documents publicly, to make them publicly available on the internet, or to distribute or otherwise use the documents in public.

If the documents have been made available under an Open Content Licence (especially Creative Commons Licences), you may exercise further usage rights as specified in the indicated licence.

CROWDINVESTING

Digitalization has already changed sectors fundamentally. By creating new ways to process information, digitalization will particularly affect those business models that are information intense. Information is at the core of the financial sector. To date, changes have occurred in the financial sector within existing firms. But they often lag behind so-called FinTech start-ups. Among them are online platforms that intermediate between individuals who want to invest their capital (investors) and ventures that need capital to pursue projects (firms). By early 2016, the UK market for crowdinvesting reached a total volume of over 200 million GBP and is the largest market in the European Union (EU). Germany is the closest contestant with an overall market volume of 60 million EUR as of January 1, 2016 (excluding movie and real estate crowdinvesting, as well as fundraising for environmental business projects) (Hornuf and Schmitt 2016).

Information plays a crucial role in each transaction on the financial market. But information is distributed asymmetrically between the parties involved in a contract with those that need capital having better information about their chances to succeed and repay than those that provide capital. Due to this asymmetry the financial sector is subject to many laws and regulations. The aim of these rules is to protect the investors and to avoid fraud. However, the rules also impose costs on firms. Many of the costs, such as auditing fees or the costs of a securities prospectus, are quite substantial and often fixed and the management has to devote a lot of time to fulfilling the respective requirements. Therefore, complying with the rules may make a financial transaction too expensive, especially for smaller firms.

In this database article we provide an overview of the regulations for crowdinvesting in selected countries. Crowdinvesting means that investors provide equity or equity-like capital to firms and participate in the uncertain future cash flows of the venture.¹ The laws for investor protection differ considerably with respect to the areas that they regulate. The regulated areas are the maximum amount that can be issued without a prospectus, the maximum amount that can be sold to an investor, the regulation of intermediating portals as gatekeepers, the disclosure requirements for firms and the need

for investor education. As our discussion below will show, there are also substantial differences between the regulations across countries within each area.

The first area we study is the maximum amount that issuers can offer to non-accredited investors without providing a prospectus. For amounts above this threshold firms have to provide a prospectus in which they specify the terms and conditions of their offer and supply information about the firm and its financial situation. With the prospectus, the investor receives more information about the firm. But preparing the prospectus is costly, also in terms of management working hours. In European countries Directive 2010/73/EU regulates the publication of a prospectus and specifies exemptions. According to the Directive, firms can raise up to 100,000 EUR without a prospectus. EU member states can, however, increase this threshold up to 5,000,000 EUR through national laws. The largest exemptions in Europe can be found in Austrian, English, and Italian laws, with firms (in Italy the implementation law restricts the issues to “innovative startups”) being able to issue up to 5,000,000 EUR without a prospectus. In early 2016, the US also legalized crowdinvesting and set a maximum threshold of 1,000,000 USD (when additional conditions with respect to the usage of a funding portal, the amount per investor and disclosure requirements are met, see below).

The second focus of regulation is on the maximum amount that a single investor can invest. Here the regulations have different base categories: the *single issuer limit* (how much money can the investor invest in a firm) and the *aggregate limit* (how much money can the investor invest in the overall crowdinvesting market). In the US an aggregate limit applies, which relates to the investor's annual income or net assets. If either his income or net assets are below 100,000 USD, he should not invest over 2,000 USD or five percent of his income or net assets (where the respective higher value applies). If either his income or his net assets are above 100,000 USD, the threshold is either ten percent of his income or net assets, but his aggregate investments should in all events not exceed 100,000 USD. The Austrian and the German regulations are similar in spirit, but set a single issuer limit, and not an aggregate limit. In Germany, the basic idea is that an individual investor should not invest more than 1,000 EUR per project without disclosing his average net monthly income or assets. However, the limit increases up to 10,000 EUR if his assets exceed 100,000 EUR. If his assets are below 100,000 EUR, he may invest up to double his average net monthly income,

¹ Please note that apart from equity, there are many other instruments through which the crowd finances firms, which are not always subject to securities regulation, but specific laws regulating investments.

but no more than 10,000 EUR. In the UK the maximum investment is restricted by an aggregate limit for retail clients. These investors are not allowed to invest more than ten percent of their net investible financial assets in unlisted equity and debt securities, unless they confirm that they receive regulated investment advice or investment management services from an authorized person. In Belgium the restriction is a single issuer limit, where investors cannot invest more than 1,000 EUR in a single firm if the issue is between 100,000 EUR and 300,000 EUR (not imposed if an issuer raises no more than 100,000 EUR).

In some countries the platforms are regulated. In the US issuers can use the above-mentioned exemptions of the JOBS Act if the transaction is conducted via a broker-dealer or the newly-created funding portal. In the UK and France portals have to be authorized by the securities regulator. In France, although the portal is not subject to a minimum capital requirement (like other financial intermediaries), it has to register with the securities regulator AMF, which subsequently monitors the portal. In Germany and Austria it is sufficient if portals are authorized by the much laxer standards of trade authorities, and not the securities regulator.

Disclosure requirements are also used. In the US the amount of information that needs to be disclosed depends on the size of the issue. For issues below 100,000 USD, for instance, it is sufficient if the principal executive officer of the firm certifies the most recent income tax returns and the financial statements. For issues between 100,000 USD and 500,000 USD, financial statements have to be reviewed by a public accountant who is independent of the issuer and uses professional standards and procedures. For issues of more than 500,000 USD, the firm has to provide audited financial statements. In France, firms have to provide simplified disclosure for issues between 100,000 EUR and 1,000,000 EUR, which resembles a *light* version of a prospectus that does not have to be certified by the securities regulator. In Germany, for issues of less than 2,500,000 EUR firms only need to provide a small information leaflet, which shall not exceed three pages and includes a salient warning note about the risk of the investment. In Austria, the disclosure requirements depend on the size and the financial instrument. For issues between 250,000 EUR (stocks and bonds) / 1,500,000 EUR (other investments) and 5,000,000 EUR a simplified prospectus is needed.

In some countries, regulations are concerned with investor education and the use of financial advice. In the US, for example, broker-dealers or funding portals need to provide disclosures related to risks and other investor education materials. Sophisticated investors in the UK, which include professional clients, retail clients who are venture capital contacts or corporate finance contacts, certified or self-certify as sophisticated investors, and high net worth investors, can crowdfund without any limitations. Retail clients need to get regulated investment advice or investment management service to be able to crowdfund, unless they certify to invest no more than ten percent of their net investible financial assets. In other jurisdictions the measures are more paternalistic. In France, for example, the regulation has two features. Firstly, issuers can only sell plain stocks or bonds to crowdfunders and cannot offer more sophisticated instruments commonly used by venture capitalists such as convertible preferred stock. Secondly, portals must inquire the previous investment experience, future investment goals and current financial situation of the investor and ensure that the risk of the planned investments is adequate for him.

The comparison of the regulation across countries shows interesting differences. Given that the crowdfunding market is emerging, it is not surprising that neither regulations themselves, nor the areas that are regulated, are uniform. In Italy, Spain and in the Scandinavian countries crowdfunding markets are still nascent. Germany, and in particular the UK, saw a steady rise in crowdfunding activities, despite the fact that regulations differed substantially. While Germany for a long time pursued a *laissez-faire* approach, by leaving certain types of investments largely unregulated, the UK established legal certainty early on. Moreover, unlike under German law, English corporate law allows the transfer of equity shares without the costly involvement of a notary and thus facilitates the direct participation of the crowd in startup firms.

Christa Hainz and Lars Hornuf (University of Trier)

Literature

Hornuf, L. and A. Schwienbacher (2016), "Should Securities Regulation Promote Equity Crowdfunding?", *Small Business Economics*, in press.

Hornuf, L. and M. Schmitt (2016), "Success and Failure in (Equity) Crowdfunding", *CESifo DICE Report* no 2/2016, in press.

Table 1

Overview of recent reforms promoting crowdinvesting, 2016

	Reform	Maximum issue w/o prospectus	Maximum amount sold to investor	Regulation of gatekeeper	Disclosure requirements	Investor education
Austria	Alternativfinanzierungsgesetz (AIFG) 2015, reform of the previous Kapitalmarktgesetz in 2013.	€ 5,000,000 (previously € 250,000), before the 2013 reform € 100,000).	Single issuer limit: 10% of net investable financial assets or twice the monthly net income; max. € 5,000 in case the investor has a net income of € 2,500 or less.	Trade authority or securities regulator authorize platform.	Minimum information disclosure regarding the issuer and financial instrument for issues larger than € 100,000 and up to € 250,000 (stocks and bonds) / € 1,500,000 (other investments) information disclosure requirements (e.g. annual statements) apply; for issues exceeding these thresholds and ranging up to € 5,000,000 simplified prospectus required.	
Belgium	Loi du 25 avril 2014 portant des dispositions diverses, published at the official journal Moniteur Belge on 7 May 2014 nr. 36946.	€ 300,000 if no investor can invest more than € 1,000; otherwise € 100,000.	Single issuer limit: € 1,000 for issues between € 100,000 and € 300,000; no single issuer limit for issues below € 100,000.			
France	Ordonnance nr. 2014-559 of 30 May 2014; Décret d'Application nr. 2014-1053 of 16 September 2014.	€ 1,000,000 (previously € 100,000).		Securities regulator authorizes platform (<i>conseiller en financement participatif</i>).	Obligation of the issuers to supply simplified documentation to investors (description of the project for which money is raised, organization chart of management, annual statements and projections, risk assessment etc.); not subject to approval by the securities regulator.	Investors must undergo a test that determines their risk profile, the results of which must be in line with the risks involved in crowdinvesting.
Germany	Kleinfußlegerschutzgesetz 2015.	€ 2,500,000 (previously € 100,000).	Single issuer limit: € 1,000 (if investor does not want to provide personal financial information); otherwise twice the monthly net income, but as a general rule no more than € 10,000 per project.	Trade authority authorizes platform.	Small information leaflet.	
Italy	Decreto Crescita 2.0 2012.	€ 5,000,000 (previously € 100,000) Only 'innovative startups' eligible that fulfill criteria (a) - (g): (a) The incorporation and business operations of the firm should have taken effect no more than 48 months ago; (b) The management is located in Italy, and the main business activities of the firm take place in Italy; (c) The annual turnover in the second year of business as stated in the last accounts does not exceed € 5,000,000; (d) The firm does not and did not make payouts to shareholders using previous corporate profits; (e) The sole or main purpose of the firm is to develop, produce and sell innovative products or services with a high technological value; (f) The firm was not established as part of a merger, de-merger or sale of a corporation or corporate entity; and (g) The firm fulfills at least one of the following conditions: 1) The firm invests at least 15 percent of the greater of the annual production costs or the production value in R&D; 2) One-third of the employees have obtained a PhD, are enrolled in a university PhD program or two-thirds of the employees have obtained an academic degree or have worked for more than three years in a private or public research institution; or 3) The firm owns a patent on an industrial, biotech or electronic semiconductor innovation or owns the right on a software, which is registered in the public software register, related to the purpose of the corporation.				
United Kingdom	PS14/4 2014.	€ 5,000,000 (previously € 5,000,000).	Aggregate limit: 10% of net investable financial assets for retail clients, who are not professional clients, venture capital contacts or corporate finance contacts, certified or self-certify as sophisticated investors, certified as high net worth investors or cannot confirm that they receive regulated investment advice or investment management services.	Securities regulator authorizes platform.		Retail clients need to receive regulated investment advice or investment management services from an authorised person unless they are professional clients, venture capital contacts or corporate finance contacts, certified or self-certify as sophisticated investors, certified as high net worth investors or invest no more than 10% of net investable financial assets.
United States	JOBS Act (Title III) 2012.	\$ 1,000,000 (previously \$ 0).	Aggregate limit: \$2,000 to \$ 100,000 annually depending on income and net wealth.	Securities regulator authorizes funding portal or broker-dealer.	If the overall amount of the issue is \$ 100,000 or less, issuers must provide most recent income tax returns and financial statements, which must be certified by the principal executive officer. For issues of more than \$ 100,000 but less than \$ 500,000, financial statements must be provided and reviewed by a public accountant, who should be independent from the issuer. The accountant must use professional standards and procedures for the review. For issues of more than \$ 500,000, the issuer must provide audited financial statements.	Funding portal or broker-dealer needs to provide disclosures, including disclosures related to risks and other investor education materials.

Source: Hornuf and Schwenbacher (2016).