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Crowdfunding and the 'Alternativfinanzierungsgesetz' in Austria

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Introduction

Crowdfunding has grown significantly in the past few years, and governments have become aware of the opportunities and risks involved in this new type of entrepreneurial funding. In particular, securities-based crowdfunding (also called 'crowdinvesting'), which involves the issuance of securities such as shares, (convertible) bonds and participating notes, offers opportunities for the general public (the 'crowd') to invest direct or indirectly in entrepreneurial, innovative start-ups. However, although prior regulation has enabled securities-based crowdfunding restrictively, many European countries have recently adapted their national regulation to facilitate and broaden, but also frame, these activities. This also applies to Austria, which enacted changes in July 2013 and, more recently, in August 2015 through a regulation that specifically targets securities-based crowdfunding — namely, the 'Alternativfinanzierungsgesetz'.

Austria, with its under-developed business angels and venture capital market, stands to benefit greatly from promoting its securities-based crowdfunding market, as it could help fill the gap in early equity financing (Hornuf and Schwienbacher 2015). Currently, the Austrian securities-based crowdfunding market remains relatively small compared with other European countries. Wardrop et al. (2015) provide statistics on annual market volumes of alternative finance transactions done by country in 2014. These statistics indicate that the total volume of transactions in Austria amounted to EUR 3.6 million in 2014. In per capita terms, this figure amounts to EUR 0.40 in Austria, versus EUR 36.00 in the United Kingdom, EUR 10.90 in Sweden, and EUR 1.70 in Germany. Austria ranked 16th in Europe in terms of the volume of alternative finance transactions per capita in 2014. Although these statistics still suggest that the market is poorly-developed in Austria compared with other European countries, several securities-based crowdfunding platforms are now active in Austria. The first to enter the market was *1000x1000.at*[2] on which the crowd can start investing with as little as EUR 100 per project in the form of profit-sharing certificates (*Genussrechte*) in a financial vehicle that invests in the selected start-up. Other active platforms include *Conda*, *Crowd Capital*, *Green Rocket* and *Regional Funding*[3].

Facilitating the development of a larger securities-based crowdfunding market must go hand in hand with the development of proper regulation that enables platforms to grow, start-ups to raise the funds that they need and investors to obtain a minimum level of investor protection. Finding the right balance between these conditions is a difficult task, especially in the fast-evolving environment in which crowdfunding is developing and the large range of business models currently in use. In addition, securities-based crowdfunding transactions resemble deals done by business angels in many respects, although there are also obvious differences (Hornuf and Schwienbacher 2016). This means that professional investors typically deal with many types of risk through monitoring and contracting, both of which are difficult to implement with a large crowd. At the same time, given the significant costs involved in issuing securities under existing regulation, offering the same level of investor protection as provided by large-scale issuance by established companies is probably unfeasible. Most securities-based crowdfunding campaigns can only run under a lighter regulation that involves lower costs.

From a broad perspective, Austria's approach was similar to that of many other European countries, in that the initial regulation did not allow much securities-based crowdfunding to develop. Offers were limited to EUR 100,000 in Austria, unless a formal prospectus was prepared and validated by the national regulator. However, regulation was gradually changed to broaden the scope

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[2] See: https://1000x1000.at.

[3] See: https://www.conda.at, https://www.crowdcapital.at, https://www.greenrocket.com and https://www.regionalfunding.at.

of funding and thereby allow this market to develop. This approach contrasts with that seen in Germany and the Netherlands, where this type of crowdfunding has developed quickly, but is subject to far less regulation. Start-ups in Germany, for example, could raise several millions of euros using some form of participating notes (*partiarische Nachrangdarlehen*), a type of security that may not be the most appropriate for many innovative, high-growth start-ups. These notes largely replicate equity-type payoffs, but offer no voting rights. Notes also have a maturity date, which requires repayment or refinancing at maturity. In the Netherlands, up to EUR 2.5 million can be raised without a formal prospect. These countries have, however, recently put in place more specific rules with regard to securities-based crowdfunding.

This article reviews the new regulation 'Alternativfinanzierungsgesetz' implemented in Austria in 2015. While the regulation features many more details than can be discussed in this article, I would like to focus on the most important parts from the perspective of investors and entrepreneurs. The next section presents the new regulation while the last section offers some conclusions.

The new regulation

Companies that wish to issue securities to the general public are required to comply with capital market regulation, whose main objectives are to protect investors and ensure proper information disclosure, including during the securities issuance phase. The main regulatory framework for securities issuances is the Prospectus Directive (the EU Directive 2003/71/EC of 4 November 2003, later amended by the EU Directive 2010/73/EU of 24 November 2010), which harmonises prospectus requirements for offers larger than EUR 5 million at the European Union level that are offered to the general public (i.e., 'non-qualified' investors). Before any offer, the prospectus must be validated by the national regulator in the country where the offer is made. The Directive further specifies the required content of the prospectus and managerial responsibilities in the case of misreporting. However, the Directive states several exemptions from the prospectus requirement (Hornuf and Schwienbacher 2015): if the offer is made to qualified investors only, or to fewer than 150 non-qualified investors per member state (in addition to qualified investors); if investors are required to invest at least EUR 100,000 (because either the price of a unit of security or the minimum investment required to participate in the issuance is at least EUR 100,000); or if the total amount of the offer over a 12-month period does not exceed EUR 100,000. The last exemption is often referred to as the 'small offer exemption'. If the offer fits into one of these exemptions, no prospectus is required to solicit the general public.

The Prospectus Directive is deliberately silent on the topic of funding ranging between EUR 100,000 and EUR five million. Thus, national regulators have some freedom to set their own rules within this range. While some member states impose a prospectus for any offer in that range (which was the case with Austria in the past), others use this freedom to increase the prospectus exemption on 'small offers' (e.g., the Netherlands to EUR 2.5 million and the United Kingdom to EUR five million).

As a first step to promote securities-based crowdfunding, in July 2013, the Austrian legislator increased the small offer exemption threshold from EUR 100,000 initially to EUR 250,000, such that no prospectus is required for an issuance below that value. This change in the national securities law (*Kapitalmarktgesetz*) enabled platforms and start-ups to raise somewhat larger amounts without a costly prospectus that would otherwise make crowdfunding unattractive for issuers[4]. It further enabled start-ups at a more developed stage of development to use securities-based crowdfunding as a viable means of financing.

More importantly, however, Austria has recently adopted a new regulation on 'alternative financing', the so-called *Alternativfinanzierungsgesetz* (AltFG 114, of 14 August 2015), which offers more opportunities for securities-based crowdfunding initiatives in Austria to take place. The new law regulates how and which alternative finance instruments can be used. Other forms of crowdfunding are not considered. The first article deals with the use of alternative financing instruments, and the second article deals with changes in capital market regulations due to the first article of the AltFG Decree (*Verordnung*) 242, called *Alternativfinanzierungs-Informationsverordnung* (AltFG-InfoV), which complements the AltFG by specifying the type of information that issuers need to provide to potential investors and in which form.

[4] The Austrian Chamber of Commerce estimates the costs of drafting and seeking approval of the prospectus from the national regulator as ranging between EUR 30,000 and EUR 50,000 for the type of start-ups that use securities-based crowdfunding. Larger companies are likely to incur much higher costs due to their increased complexity (Wirtschaftskammer Österreich 2015).

Different conditions must be met cumulatively for the applicability of the AltFG (Art. 1, § 2), to ensure that only specific issuances benefit from this regulation. One important condition is that the issuer needs to be a small or medium-sized enterprise, which is primarily defined as fewer than 250 employees (following the EU definition in the Commission Recommendation 2003/361/EC of 6 May 2003 'concerning the definition of micro, small and medium-sized enterprises'). Another condition involves the type of securities. However, this list is rather comprehensive, so most securities are included, including shares, bonds and other securities commonly used by existing platforms. Other important conditions pertain to the absence of unconditional redemption rights (*unbedingter Rückzahlungsanspruch*) and the fact that the investor must be a natural or legal person. Finally, further conditions relate to the internet platform and its operator, and the proper use of a permanent, electronic data support (*dauerhafter Datenträger*). Unsurprisingly, these conditions of applicability are primarily meant to offer solutions and frame crowdfunding campaigns on internet platforms, though the regulation uses the term 'alternative finance'.

Art. 1, § 4 of the AltFG specifies the type of documentation that issuers need to provide, depending on the issuance offer amount made in the European Union (i.e., not just in Austria). For offers below EUR 100,000, there is no requirement, in line with the Prospectus EU Directive 2010/73/EU[5]. For offers between EUR 100,000 and below EUR 1.5 million, issuers need to provide light documentation (Information Sheet) in line with the AltF-InfoV (see subsequently). From EUR 1.5 million to below EUR five million, a simplified prospectus is required (so-called *Schema F* under the *Kapitalmarktgesetz*). For shares and bonds, a simplified prospectus is already required for an offer of EUR 250,000, so the Information Sheet only applies to shares and bonds that range between EUR 100,000 and EUR 250,000. Finally, for any securities offer of EUR 5 million or more, a formal capital market prospectus must be provided. In this case, issuers must comply with Prospectus EU Directive 2010/73/EU.

Following Art. 1, § 4 of the AltFG, the AltF-InfoV of 31 August 2015 offers more details on the necessary content and structure of the documentation to be prepared and distributed to potential investors in the event of issuance of financial instruments (securities). A template is proposed and must be fully completed before any solicitation. While this Information Sheet does not need to be validated by the financial market regulator, it needs to be reviewed (in German: *geprüft*) by a lawyer, a trustee, a notary, or a specific business or finance adviser (see Art. 1, § 4(9) of the AltFG). These individuals should not have any conflict of interest with the proposed issue, and reference to potential investment risks must be clearly made (see Art. 1, § 4(4) of the AltFG).

The AltFG further restricts the amount that investors can invest (Art. 1, § 3(3)). Investors are limited in how much they can invest within a 12-month period on securities-based crowdfunding platforms. The baseline limit is EUR 5,000 per issuance. However, wealthy investors may invest more, up to 10 percent of their investable wealth or twice their average monthly net income (this average is calculated on a yearly basis). These limits are meant to protect unqualified investors (the crowd) by limiting their potential losses, as they may be less protected under the AltFG as a result of no formal prospectus being issued. Whether investors are sufficiently 'wealthy' to meet one of these last two conditions depends on self-reporting by investors themselves.

Another mechanism protecting investors is the right of withdrawal (*Rücktrittsrecht*). Art. 1, § 4(7) of the AltFG grants investors the right to revoke the signed investment contract within two weeks of being informed of their right of withdrawal (which is generally at the time the offer was made to the investors, unless the investors were subsequently informed about their right of withdrawal). This mechanism is consistent with the need for consumer protection, which allows consumers (here, consumers of financial products) to revoke earlier decisions within a reasonable amount of time. An open question, however, is the ultimate impact on closing campaigns. Most campaigns operate according to an 'all-or-nothing' mechanism in which the issuer receives the fund only if a minimum threshold is achieved. In this case, the right of withdrawal generates some uncertainty beyond the campaign about its success, should the withdrawal of committed funds be massive and compromise the fundraising campaign once the campaign is closed. Moreover, it may deter the use of some securities allocation mechanisms such as auctions, in which the impact of the right of withdrawal may lead to significant difficulties in implementation.

Securities-based crowdfunding platforms operating in Austria are partially regulated by Art. 1, § 5 of the AltFG. However, many aspects are regulated by the

[5] Cooperatives issuing ownership certificates are not required to issue any documentation up to EUR 750,000.

Kapitalmarktgesetz[6]. In general, platform operators are required to check the offers made, ensure that required information is provided by issuers and recommend that investors spread risk through diversification (*Risikostreuung*). Moreover, the operator of the platform needs to disclose information on the platform itself, including the names of all owners with an ownership stake of at least 25 percent and annual financial statements of the firm operating the platform.

Concluding remarks

The "Alternativfinanzierungsgesetz" is an important step towards promoting securities-based crowdfunding in Austria, but it will probably not be the last. Recent market trends will challenge regulation in the future, and may call for new changes to ensure a sound and sufficiently well-functioning crowdfunding market in Austria, and in the European Union more generally. One of these trends is the emergence of pan-European platforms that will eventually result in a market consolidation in Europe and more globally (similar to the consolidation trend in reward-based crowdfunding, with large, global platforms such as *Kickstarter* and *Indiegogo*). Some securities-based platforms already operate cross-border. Given that platforms are regulated and supervised very differently across countries, national regulators concerned with the lack of supervision and license requirements in other countries may raise concerns about these emerging cross-border activities, and European Union-level regulatory harmonisation may be necessary. Another trend is the increase in cross-border offers of a same issuer and even issuances being entirely done in a different jurisdiction. Start-ups may choose whether to run their campaigns on a domestic or foreign platform, and some start-ups have already chosen the latter. This choice may be motivated by regulatory arbitrage incentives when regulation in the foreign jurisdiction is more appealing to issuers than that in the home jurisdiction. Taken together, these two trends indicate the need for a European Union-wide regulatory harmonisation as a way of creating a level playing field in Europe.

[6] For a more detailed presentation, see Wirtschaftskammer Österreich (2015, 9–12).

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