

Hainz, Christa; Hornuf, Lars; Nagel, Lisa; Reiter, Sarah; Stenzhorn, Eliza

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Christa Hainz, Lars Hornuf, Lisa Nagel,
Sarah Reiter, and Eliza Stenzhorn

Exemption Provisions of the German Small Investor Protection Act: A Follow-up Study¹

The German Small Investor Protection Act (*Kleinanlegerschutzgesetz*, KASG) from 2015 is designed to create greater transparency for investors on the so-called gray capital market by means of stronger regulation. However, the act also contains provisions exempting companies that finance themselves through a crowdinvesting platform as well as social, charitable, and religious projects from the obligation to provide a prospectus when seeking funding through non-securitized types of investments (henceforth called investments, *Vermögensanlagen*). This report outlines the rules and regulations included in the KASG. In addition, it analyzes the effects of the legal exemptions three years after the introduction of the KASG. The basis for the investigation of these legal exemptions is a comprehensive crowdinvesting database and two survey waves of social and charitable organizations.

Becoming binding on July 10, 2015, the German Small Investor Protection Act (*Kleinanlegerschutzgesetz*, KASG) contains numerous legal amendments concerning the regulation of financial markets. The goal of the KASG is to provide better protection for investors on the so-called gray capital market, which is a market for less-regulated financial products. The KASG amended the German Investment Act (*Vermögensanlagegesetz*, *VermAnlG*) by expanding its regulatory outreach to encompass types of investments that were not previously covered by the *VermAnlG*. Besides requiring all issuers who publicly offer investments above a certain size threshold to publish a prospectus, the KASG also contains a protection mechanism designed to ensure that non-sophisticated investors invest only a certain proportion of their available wealth in such investments. In the course of an evaluation of the KASG in 2016, some of these amendments made by the KASG were partially revised.

When regulating the financial market, the legislator faces a trade-off between the interests of investors and those of the issuers of investments. While investors primarily seek to protect their investments, issuers request easy and affordable access to capital. Since

providing a prospectus comes with high costs for some issuers, the adjustments made by the KASG also include exemptions.² Under certain conditions, crowd-funding initiatives as well as social, charitable, and religious projects are exempted from the *VermAnlG*. In the case of social and charitable projects and religious groups, the goal of such exemptions is to “preserve the diversity of social activities undertaken for the common good in Germany” (Bundestag printed paper 18/4708, p. 60). Crowdinvesting facilitates access to funding and therefore allows companies, especially at an early stage, to overcome barriers to financial access (Carpenter and Petersen 2002; Cassar 2004). By using crowdinvesting platforms, start-ups can promote both their innovative business ideas, as well as the issuing of investments to a wider audience. These offerings are also aimed at non-sophisticated investors since the minimum thresholds are generally low, with some portals offering investments starting at one euro (Hornuf and Schwiendacher 2018). In addition, crowdinvesting can have an advertising effect for the issuing company and may also serve as an indicator of the potential success of the business idea on the market (Colombo and Shafi 2016).

The implementation and the effects of these legal exemptions were already analyzed in 2016 – around one year after the introduction of the KASG (Hainz, Hornuf, and Klöhn 2017; Hainz et al. 2017). Since then, some of the rules and regulations of the KASG were partially revised by the German Bundestag. In this article, we provide an overview of the provisions of the KASG and the amendments and updates that have been made since the act became binding until the end of 2018. We also re-evaluate the effects of the legal exemptions, around three years after the introduction of the KASG. For our investigation of the exemptions for crowdfunding, we have drawn on a comprehensive crowdinvesting database that has been maintained since August 1, 2011. Our investigation of the exemptions for social and charitable projects and religious groups is based on two surveys of the relevant actors, which were carried out in the summers of 2016 and 2018 respectively.

THE GERMAN SMALL INVESTOR PROTECTION ACT AS OF 2015

Exemption Provisions

The statutory amendments of the KASG in 2015 mainly applied to the *VermAnlG*, which regulates the public offering of investments.³ The act’s scope of application was extended to profit-participating loans and subordinated loans; however, the extension of the *VermAnlG*



Christa Hainz
ifo Institute.



Lars Hornuf
University of Bremen,
Max Planck Institute for
Innovation and Competition
and CESifo.



Lisa Nagel
University of Bremen.



Sarah Reiter
ifo Institute.



Eliza Stenzhorn
University of Bremen.

¹ This article summarizes the main findings of the 2018 evaluation report on the KASG commissioned by the German Federal Ministry of Finance. The full report is published as ifo Research Report (Hainz and Hornuf 2019); a short version appeared in the ifo Schnelldienst (Hainz et al., 2019). Significant parts, in particular on the presentation of the KASG, are taken from Hainz et al. (2017).

² The DICE database contains an international comparison of the regulation of crowdinvesting from Hornuf and Schwiendacher (2017) (available at: <http://www.dice.ifo.de>), which is explained in Hainz and Hornuf (2016).

³ Further amendments concern subjects such as investor protection in the German Securities Trading Act (WpHG) and the German Act Establishing a Federal Financial Supervisory Authority (FinDAG); see Buck-Heeb (2015) for example.

Table 1

Types of Investments and Their Regulation under the German Investment Act (VermAnlG)

| Investments (cf. § 1 Para. 2 VermAnlG) | Duties and liability requirements of the VermAnlG |
|--|--|
| <ul style="list-style-type: none"> • Shares that grant a participation in the company's earnings^a • Shares of trust assets • Profit-participating loans • Subordinated loans • Profit-participating subordinated loans • Participation rights • Registered bonds • Other assets | <ul style="list-style-type: none"> • Minimum term and termination of investments (§ 5a VermAnlG) • Prospectus requirement (§§ 6 ff. VermAnlG) • Liability concerning information contained in the prospectus (§§ 20 ff. VermAnlG) • Financial accounting (§§ 23–25 VermAnlG) |

^a Cooperative shares, silent partnerships, shares in business partnerships (GbR, OHG, KG), GmbH shares, and shares in foreign businesses with different legal forms.

Source: German Investment Act (VermAnlG); authors' illustration.

only applies if investments (see Table 1) are offered publicly within Germany (§ 1 VermAnlG). An offering is *public* if it is not restricted to a certain group of people. In the case of an existing personal relationship between the investor and the issuer, an offer cannot be considered public (Zwissler 2013).

To the obligations and liability requirements of the VermAnlG, which are presented in Table 1, exceptions are granted. Figure 1 summarizes the exceptions and exemption provisions. Prior to the introduction of the KASG, § 2 VermAnlG already featured several exceptions. Investments that are covered by § 2 VermAnlG are exempt from the requirements of §§ 5a to 26 VermAnlG,⁴ and in particular from the obligation to publish a prospectus (§ 6 VermAnlG). In practice, exemptions for public offering are particularly important. Such exemptions exist for the public offering of cooperative shares without performance-based compensation for distribution (No. 1), for cooperatives offering profit-participating loans, subordinated loans, or other investments without performance-based compensation for distribution (No. 1a),⁵ for private placements offering a maximum amount of 20 shares (No. 3a) and for investments

with an aggregate value not exceeding EUR 100,000 within twelve months (No. 3b). In addition, the exemptions apply to investments if the price per investor is at least EUR 200,000 (No. 3c), or if they are only offered to a restricted group of people (No. 6). However, the latter exemption has little practical relevance.

New elements introduced in the KASG were the exemption provisions for (i) crowdfunding initiatives (§ 2a VermAnlG), (ii) social projects (§ 2b VermAnlG), and (iii) charitable projects and religious groups (§ 2c VermAnlG). Similar to § 2 VermAnlG, these exceptions to the provisions of the VermAnlG are set out for certain kinds of funding projects. While the catalogue of exemptions is not as comprehensive as in § 2 VermAnlG, it does include important regulations such as the prospectus requirement.

§ 2a VermAnlG privileges projects that are financed via crowdinvesting platforms. Its main privilege is the exemption from prospectus requirements according to § 6 VermAnlG; the issuer only has to provide an investment information sheet (*Vermögensanlagen-Informationsblatt*, VIB) in accordance with § 13 VermAnlG. In addition to the exemption from the prospectus requirement, § 2a VermAnlG also reduces requirements regarding the minimum duration of investments

(§ 5a VermAnlG) and financial accounting and reporting (§§ 23–25 VermAnlG). Nonetheless, the application of § 2a VermAnlG is tied to several conditions: Firstly, the aggregate value of the investments offered by the same issuer must not exceed EUR 2.5 million (on this condition, see also the “Amendments and Updates” section below). Secondly, in order to be eligible for the privileges, the issuer must only offer profit-participating loans, subordinated loans, or other investments as stipulated in § 1 Para. 2 No. 7 VermAnlG. Silent partnerships, which were commonly used in the initial days of crowdinvesting, are not covered by the

Figure 1

Important Exemptions According to §§ 2-2c VermAnlG

| Exclusions § 2 (1) | Exemptions (if investment = profit-participating loan or subordinated loan) | | | |
|---|--|--|--|---|
| | § 2a Crowdinvesting ^b | § 2b Social projects | § 2c Charitable projects / religious communities | |
| No. 1 Cooperative shares ^a | (1) Aggregate value ≤ 2.5 million € | (1) If no performance-based reimbursement for distribution has been paid | (1) | (1) If no performance-based reimbursement for distribution has been paid |
| No. 1a Investment products of cooperatives under certain conditions ^a | (3) Investment counseling or mediation via online platform | (1) Aggregate value ≤ 2.5 million € | (1) | (1) Aggregate value ≤ 2.5 million € |
| No. 3a Shares of the same investment product ≤ 20 | (3) Maximal investment volume (not for capital companies) • 1,000 € • 1,000 €–10,000 € with self-disclosure • Freely available wealth > 100,000 € or • Investment < 2x average monthly net income | (1) Debit interest rate < max. {1.5; issue yield mortgage bond} | (1) | (1) Debit interest < max. {1.5; issue yield mortgage bond} |
| No. 3b Total sales price of investment ≤ 100,000 € | | (2) Statutory social objective and total assets, turnover ≤ 10 million € | (2) | (2) Corporate body who is recognized as non-profit or Domestic church or religious group with the legal form of a public body |
| No. 6 Investment that is only offered to certain groups | | | | |
| §§ 5a – 26^c do not apply (especially in terms of minimum duration, prospectus requirement and accounting standards) | | | | |

^a If no performance-based compensation for distribution is paid. ^b Also for other investments according to § 1 Para. 2 Nr. 7. ^c Regulation on minimum duration and duty to inform.

Source: German Investment Act (VermAnlG), authors' illustration.

exemptions. Instead, unless they fulfill one or more of the circumstances specified in § 2 VermAnlG, they are subject to the prospectus requirement. Thirdly, in accordance with § 2a Para. 3 VermAnlG, investors must submit a self-disclosure about their income and wealth to the platform, if the overall value of one investment exceeds EUR 1,000. Upon reaching defined wealth or income thresholds, the maximum sum that investors are permitted to invest is EUR 10,000. However, these restrictions do not apply to corporate entities (*Kapitalgesellschaften*).

An important restriction concerns the distribution channel. In accordance with § 2a Para. 3 VermAnlG, investments must only be sold through Internet service platforms in the context of investment brokerage or investment consultancy. Only service providers that are obliged by law or decree to verify the formal observance of the just mentioned investment limits, with the help of investor self-declarations, come into consideration to broker investments. The platform obligation is linked to the gatekeeper function that is ascribed to the crowdinvesting platforms as repeat players.

§ 2b VermAnlG also largely exempts the issuer from VermAnlG regulations. Most importantly, issuers are not required to publish a prospectus. Privileges are only applicable to projects whose constitution entails a social objective (§ 2b Para. 2 p. 1 VermAnlG); however, in the law it is not further defined what is meant by the term “social.” In the original draft of the legislation from the Federal Government, it is stated that the rule was designed for “projects in order to create affordable living space and space for micro-businesses or to create and operate nurseries at affordable rates” (Bundesrat printed paper 638/14, p. 46). Throughout the subsequent debates in the Bundestag, it was “emphasized that these regulations should be broadened to encompass social projects with all legal forms” (Bundestag printed paper 18/4708, p. 57). It was also mentioned that the implementation of such legal changes supports many relevant projects and initiatives and thus maintains and further promotes the diversity of these projects in Germany.

§ 2b VermAnlG only covers profit-participating loans and subordinated loans. In contrast to § 2a VermAnlG, other investments as defined in § 1 Para. 2 No. 7 VermAnlG are not covered by the provision. Furthermore, in accordance with § 2b Para. 1 p. 1 VermAnlG, no performance-related compensation must be paid for the distribution of the investment. The aggregate value of the investment must not exceed EUR 2.5 million, and the annual interest rate (§ 489 Para. 5 German Civil Code) is limited to the higher value of either (1) 1.5% or (2) the normal market issue yield for investments of the same duration in the capital market in the form of mortgage bonds. Additionally, the issuer has to comply with certain turnover and balance sheet requirements (§ 2b Para. 2 p. 1 VermAnlG).

§ 2c VermAnlG completes the exemption provisions. Like § 2a and § 2b VermAnlG, it sets out excep-

tions from the regulations of the VermAnlG and is aimed at charitable projects and religious communities. The legislator was guided by the following consideration: “Regarding charitable organizations, it is important to release their honorary activities from bureaucratic and often costly constraints. By doing so, the leap of faith for the millions of citizens in Germany doing honorary work of public utility is strengthened” (Bundestag printed paper 18/4708, p. 57).

The issuer must be either a corporation that is recognized as charitable as defined in § 52 Para. 2 p. 1 German Fiscal Code (AO), or a domestic church or religious community that is constituted in the legal form of a public corporation. § 52 AO considers a corporation to be pursuing charitable purposes if its activities focus on advancing the general public in a material, intellectual, or moral way (§ 52 Para. 1 p. 1 AO). Support of the public is not prevalent if the group of persons benefiting from the support is limited, for example, through family, workforce, or company affiliations (§ 52 Para. 1 p. 2 AO). Corporations are legal subjects according to § 52 AO if they are captured by the German Corporation Tax Act (*Körperschaftsteuergesetz*); that includes corporate entities, cooperatives, associations, institutions, and foundations. Non-Christian religious groups can also make use of § 2c Para. 2 No. 2 VermAnlG. Some Muslim communities, for example, have changed their legal form to that of a public corporation in recent years.

In contrast to § 2a and § 2b VermAnlG, there is no obligation to issue an investment information sheet in § 2c VermAnlG. Furthermore, even more extensive exemptions from the accounting regulations are granted if the aggregate value of the investment does not exceed EUR 250,000 (§ 2c Para. 1 p. 3 VermAnlG). Apart from that, requirements are similar to those set out in § 2b VermAnlG: No performance-related compensation must be paid for the distribution, and the aggregate value of the investment must not exceed EUR 2.5 million. Moreover, the restrictions described in § 2b VermAnlG regarding the annual interest rate apply. However, there are no turnover or balance sheet requirements in § 2c VermAnlG.

In accordance with § 2d VermAnlG, investors who invest in projects covered by §§ 2a to 2c VermAnlG obtain a right of withdrawal, which was also introduced by the KASG.

Amendments and Updates

On the recommendation of the German Bundestag’s Finance Committee, some of the provisions of the KASG were selectively amended as part of the German Act for the Implementation of the Second Payment Services Directive (*Umsetzungsgesetz zur Zweiten Zahlungsdiensterichtlinie*). All these amendments were based on the recommendations made in the 2016 evaluation report on the KASG by the German Federal Government. The following amendments were made:

- Regarding the threshold of EUR 2.5 million stipulated in § 2a VermAnlG, the reference to the provider was removed. This means that the threshold of EUR 2.5 million is not calculated separately for each crowdinvesting platform, but cumulatively for the issuer irrespective of the number of platforms through which an investment is financed.
- In order to ensure the gatekeeper function of the crowdinvesting platforms and as recommended by the 2016 evaluation report on the KASG, exemption provisions do not apply to issuers who are in a position to exercise significant direct or indirect influence over the company that runs the Internet service platform. For example, a personal link or a connection in the sense of the German stock corporation law are not hard-and-fast conditions for this possible influence.
- The provisions concerning the investment information sheet were fundamentally revised. Pursuant to § 13 Para. 2 VermAnlG, the German Federal Financial Supervisory Authority (*Bundesanstalt für Finanzdienstleistungsaufsicht*, BaFin) now undertakes a formal assessment of the investment information sheet. Only if BaFin has given its approval, the investment information sheet can be published (§ 13 Para. 2 p. 1 VermAnlG) and the offering begins (§ 13 Para. 1 VermAnlG). In addition, the investment information sheet was further standardized – information has to be provided in a certain order now – and must contain some new compulsory details about the risk of total loss and about the fees charged by crowdinvesting platforms. Finally, in accordance with § 13a VermAnlG, crowdinvesting platforms must make the investment information sheets publicly available on their websites without access restrictions to prevent situations in which investors get access to the investment information sheet only after concluding a contract (Klöhn 2017).

Due to the lack of practical experiences, the report of the German Federal Government did not propose any changes as regards the exemption provisions in §§ 2b,

2c VermAnlG for social and charitable projects and religious groups.

EXEMPTIONS FOR CROWDINVESTMENTS: § 2A VERMANLG

Database

The basis for the evaluation of § 2a VermAnlG is the crowdinvesting database that Lars Hornuf has maintained and kept updated since August 1, 2011.⁶ The database contains information about funding initiatives on 56 German crowdinvesting platforms. Of these 56 platforms, 24 portals were still active in 2017, that is, they had offered at least one crowdfunding investment over the previous twelve months. The current evaluation almost completely covers the market for crowdinvesting that comes under the exemption provisions of § 2a VermAnlG. As the study takes into account the observation period from August 1, 2011 to April 1, 2018, it investigates all crowdfunding initiatives since the start of this new funding form.

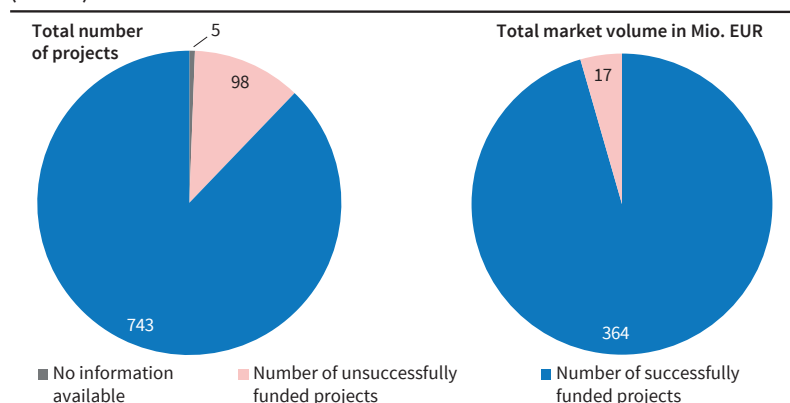
Development of the Crowdinvesting Market Between 2011 and 2018

Up to April 1, 2018, German crowdinvesting portals such as Companisto, Exporo, Kapilendo, or Seedmatch offered a total of 846 funding projects, of which 743 were successfully brokered (see Figure 2). The rate of successfully brokered funding projects thus remains high at 88%. In the domain of company funding, a total of 425 successful crowdfunding projects were recorded, followed by 193 projects in the domain of real estate funding, and 124 projects in the social and environmental sphere. In addition, one movie funding project was recorded. Overall, the issue volume actually achieved was EUR 364 million (see Figure 2). Of this, EUR 220 million went on real estate funding; EUR 114 million on the funding of companies; EUR 29 million on the funding of social and environmental projects; and EUR 400,000 on funding a movie. In the 30 months following the date the KASG became binding, the crowdinvesting portals brokered a total of EUR 279 million. In the 30 months prior to the date the KASG became binding, the platforms were only able to broker EUR 70 million.

Although numerous new crowdinvesting portals were

Figure 2

Successful and Unsuccessful Funding via Crowdinvesting Portals
as well as the Realized Volume of Issues between August 1, 2011, and April 1, 2018
(N = 846)



Source: Crowdinvesting database (see inter alia Klöhn and Hornuf 2012; Hornuf, Schmitt, and Stenzhorn 2018); authors' calculation.

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⁶ Initial publications based on this crowdinvesting database have already appeared in relevant field journals (Klöhn and Hornuf 2012; Klöhn and Hornuf 2015; Klöhn, Hornuf, and Schilling 2016a; 2016b; Hornuf and Neuenkirch 2017; Hornuf, Klöhn, and Schilling 2018).

founded since 2011 and also after the entry into force of the KASG, successfully financed and high-volume projects were concentrated on few portals only. Companisto alone managed to broker over EUR 44 million up to April 2018. For Seedmatch, the figure was EUR 36 million. Founded in 2015, the credit marketplace Kapilendo managed to broker funding of EUR 23 million up to the end of the observation period. Currently, the market leader is the real estate funder Exporo, which has brokered funding of EUR 137 million since 2014.

The crowdfunding platforms that operate in Germany are engaged exclusively in investment brokerage (§ 2 Para. 8 No. 4 German Securities Trading Act (WpHG)). Investment advice (§ 2 Para. 8 No. 10 WpHG) is not practiced by the crowdfunding platforms operating in Germany.

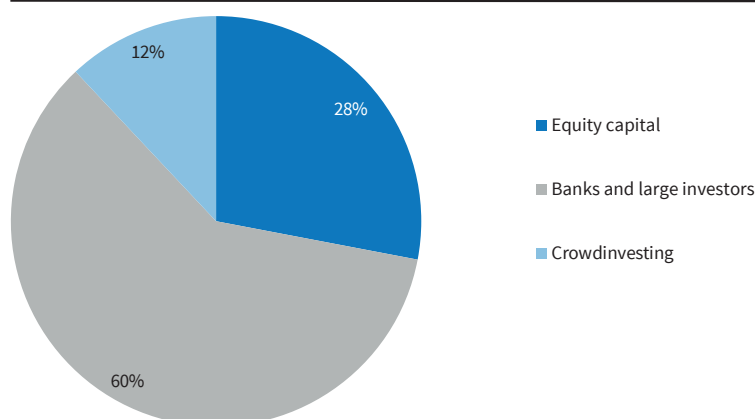
In the years from 2011 to 2017, the German crowdfunding market grew at an average annual rate of 197%. For successful issuers, a funding phase lasted 66 days on average. Drivers of growth continued to be the increasing use of profit-participating loans (Klöhn, Hornuf, and Schilling 2016b), which enabled issuers to achieve higher investment volumes (Hornuf and Schwenbacher 2017), and the extension of funding from companies to include real estate projects. If one were to take out real estate funding, then the market would have had an average annual growth rate from 2011 to 2017 of 141%. The funding of real estate projects contributed to the growth of the overall market, especially since 2016. Young companies make up the majority of the issuers: out of 811 issuers for which it was possible to determine the start of the funding phase and the founding date, 615 were founded after 2009. Half of the issuers were under three years old at the start of funding.

Crowdfunding initiatives were undertaken particularly often in the domains of real estate and housing, information and communication, and trade and manufacturing industry. A majority of the funded companies continue to pursue an Internet-based business model whereby existing offline distribution channels are supplemented by an online distribution channel. In addition, crowdfunding projects have increased particularly in the areas of energy supply as well as health and social services.

Since many crowdfunding initiatives concern real estate and housing projects, we will discuss whether the funds attracted via crowdfunding are being used in some cases as an equity substitute for bank loans. To this end, we analyzed the funding offers recorded on the platform websites and the investment information

Figure 3

Project Volume for Real Estate Projects (Total Funding Volume EUR 1.3 billion, N = 134)



Source: Crowdfunding database (see inter alia Klöhn and Hornuf 2012; Hornuf, Schmitt, and Stenzhorn 2018); authors' calculation.

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sheets deposited with the BaFin. We investigated what share of the overall financing was contributed by banks and other large institutional investors, by crowdfunding, and by equity capital respectively. The analysis revealed that information about the share of the total funding contributed by other lenders and investors is contained only rarely in the investment information sheets. Quite often this information could be found on the websites of the corresponding crowdfunding portals. Figure 3 gives an overview of the shares contributed by different funding sources to the overall financing of 134 real estate projects for which this information was available. More than half of the total funding volume was put up by banks or other large investors. Alongside an equity ratio of 28%, which includes, for example, reinvestments from housing sales, crowdfunding played a comparatively small role with 12%.

On account of the subordinated loans frequently used, a crowdfunding project generally represents economic and balance sheet equity for the issuer (Werner 2004). In many cases, the issues are realized via a financing vehicle specially set up for the funding. The fact that the terms of the investments are comparatively short for real estate crowdfunding indicates that these projects are often a relatively risky equity substitute for bridge financing. While company funding initiatives have an average minimum term of 56 months (n = 266), for real estate it is only 20 months (n = 183). For social or environmental funding projects, the average minimum term is 75 months (n = 127).

Crowdfunding Insolvencies and Multiple Investments

In the observation period, insolvencies occurred after 73 of the 743 successful funding rounds. In real estate crowdfunding projects, only one insolvency has been recorded to date. If we assume that the recovery rate is virtually zero in such cases because of the almost non-existent net asset values of a start-up company

and the subordination specified in many funding contracts, then the investors have incurred losses amounting to EUR 12.1 million to date. Additionally, an analysis of the investment information sheets of real estate crowdinvesting campaigns shows that only in very few cases a first-priority collateralization was agreed to secure the investment risk. An explicit reference to a first-priority collateralization for the crowdinvesting investors was found in 5% of the investment information sheets.

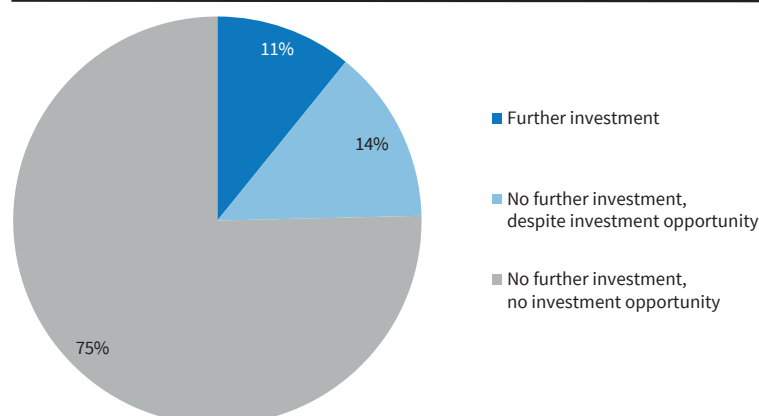
Of the issuers that concluded their financing in the 30 months prior to the date the KASG became binding, 49 out of 226 had reported insolvency or were liquidated. In the period thereafter, 13 out of 437 issuers went into insolvency or were liquidated. The low number of insolvencies after the KASG became binding can be attributed to three factors: First, compared to the issuers that were financed before the date the KASG became binding, the risk of insolvency for recently funded issuers has existed for a much shorter period. Second, in the 30 months after the date the KASG became binding, there was a substantial increase in the funding of real estate and housing projects, which tend to have a lower failure rate than companies. Third, investors have been increasingly reticent to fund start-up companies in recent years, which may have increased the quality of the financing projects offered as a result of better selection.

For the six platforms Bettervest, Companisto, Conda, Green Rocket, Home Rocket, and Innvestment, information was available on whether investors continued to invest in crowdinvesting campaigns after an issuer they had funded went into insolvency or was liquidated. Of the 204 projects analyzed, 17 insolvencies were recorded.⁷ On average, each investor made three investments. Overall, 93.5% investors did not experience an insolvency. 6.5% of 8,215 investors (that is, 536 investors) experienced at least one insolvency. Of these 536 investors, 93.5% were affected by exactly one insolvency. Furthermore, 5.4% of the investors saw two projects they had invested in go into insolvency. One investor endured seven insolvencies.

Figure 4 shows that 11% of the 536 investors who experienced one or more insolvencies later continued to invest in crowdinvesting campaigns. Accordingly, 89% of these investors did not make any further investments. In 75% of cases, however, the investors affected by an insolvency had no opportunity to invest further, as no investment project was offered on the respective

Figure 4

Percentage of Investors Who Continued to Invest After Experiencing Their First Insolvency (N = 536)



Source: Crowdinvesting database (see inter alia Klöhn and Hornuf 2012; Hornuf, Schmitt, and Stenzhorn 2018); authors' calculation.

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platform during the observation period. In spite of having new investment opportunities, 14% of these investors decided against further participation in crowdinvesting campaigns. Of the investors who further invested despite experiencing an insolvency, 37% made only a single further investment. By contrast, around 32% made more than five further investments. On the basis of the descriptive statistics, it is not possible to establish whether having experienced an insolvency generally prompts investors to re-evaluate the risks associated with crowdinvesting and completely withdraw from the market, which, for example, has been observed in crowdlending (Dorfleitner, Hornuf, and Weber 2018).

Size and Type of Investment Product

An evaluation by total sales price showed that 497 of 743 issuers raised less than EUR 500,000. Overall, these issuers comprised just 22% of the total market volume. The remaining 245 issuers, each of which raised EUR 500,000 or more, accounted for 78% of the total market volume. Four issuers issued more than EUR 2.5 million.

Figure 5 shows that during the period prior to July 10, 2015, a total of three issuers issued more than EUR 2.5 million. After the KASG became binding, only one issuer issued more than EUR 2.5 million. Meanwhile, the number of issues increased strongly after the entry into force of the KASG, particularly in the range between EUR 1 million and EUR 2.5 million. As there was a significantly greater number of issuers after the entry into force of the KASG who at least came close to the threshold value of EUR 2.5 million in their crowdinvesting project, this could be a sign of the effectiveness of the EUR 2.5 million threshold, which frees issuers from the obligation to produce a prospectus.

Over the past few years, investors in crowdfunding projects have continued to turn away from silent partnerships in favor of profit-participating loans and subordinated loans. In 2017, particularly corporate

⁷ The analysis is based on 204 projects, with 8,215 investors making a total of 21,579 investments.

financing continued to be used almost exclusively for participation loans, which generally also included subordination (Klöhn, Hornuf, and Schilling 2016b). Figure 6 shows the investments and the issue volume of the successful offerings. With around EUR 231 million and EUR 100 million respectively, most of the capital was brokered via subordinated loans and profit-participating loans. Subordinated loans and profit-participating loans thus make up 91% of the issue volume in the overall market. Initially issuers mostly used silent partnerships, but they frequently came up against the EUR 100,000 limit beneath which silent partnerships are exempt from the production of a prospectus as per § 2 Para. 1 No. 3b VermAnlG. Consequently, many issuers fell back on profit-participating loans, which at the time were not yet regulated in the VermAnlG and therefore could be issued to an unlimited amount without a prospectus. Accordingly, the frequent use of profit-participating loans today can be attributed to path

dependencies and the exclusion from the prospectus requirement as per § 2a Para. 1 VermAnlG for investments of up to EUR 2.5 million (defined in § 1 Para. 2 No. 3, 4, and 7 VermAnlG) for profit-participating loans, subordinated loans, and other investment products, which does not apply to silent partnerships or participation rights. The same is true for the use of subordinated loans in the domain of real estate crowdfunding. Real estate issuers also usually offer subordinated loans: only five out of a total of 193 real estate issuers use another form, such as profit-participating loans, silent partnerships, or securities.

Characteristics of Investors and Investment Amounts

For 456 of the 743 successful issues, the number of investments is known. In these cases, an average of 307 investments were made per issuer. The investors on the

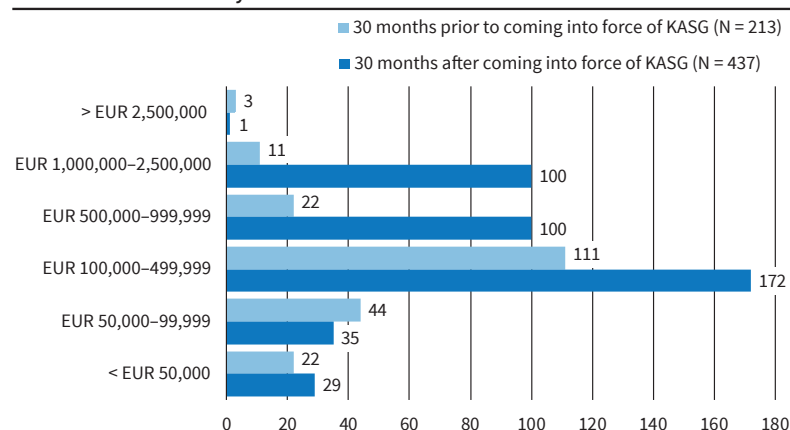
crowdfunding portals are 43 years old on average. The overwhelming majority of investors on all portals are male, with men making up 88% of investors on average.

For investment amounts in excess of EUR 1,000, the KASG stipulates a requirement for investors to self-disclose their income and assets. If investors were to try to get round the disclosure requirement, the solution would be to frequently invest exactly EUR 1,000. In addition, the KASG limits the amount an individual investor can put into an investment product to EUR 10,000. If this upper limit has an effect, then one would expect a spike in investments at precisely this threshold.

Figure 7 outlines the investment amounts 30 months before and 30 months after the KASG became binding.⁸ Around 14% of investors invested more than EUR 1,000 (13.9% before vs. 13.5% after the KASG). The number of investors who invested exactly EUR 1,000 increased from 9.1% to 12.8% after the entry into force of the KASG. This fact suggests that some investors limited themselves to exactly EUR 1,000 due

Figure 5

Number of Successful Investment Issuances via Crowdfunding Portals Before and After the Entry into Force of the KASG

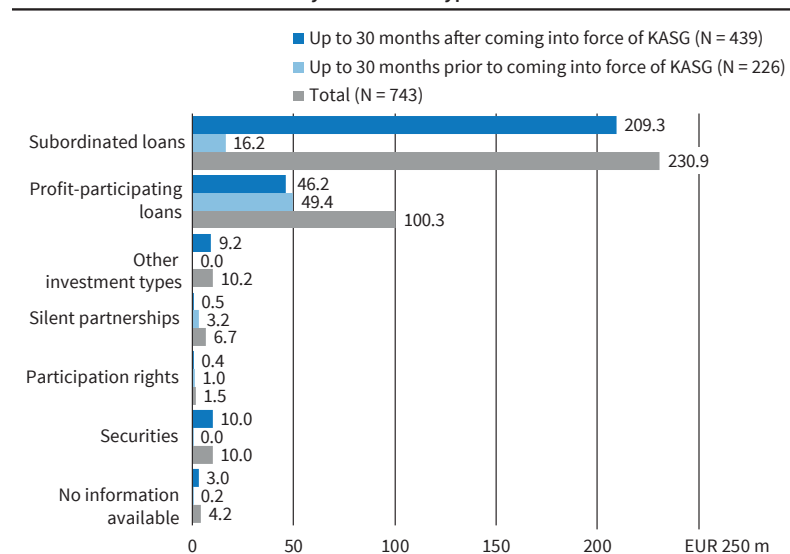


Source: Crowdfunding database (see inter alia Klöhn and Hornuf 2012; Hornuf, Schmitt, and Stenzhorn 2018); authors' calculation.

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Figure 6

Volume of Successful Issuances by Investment Types and Securities

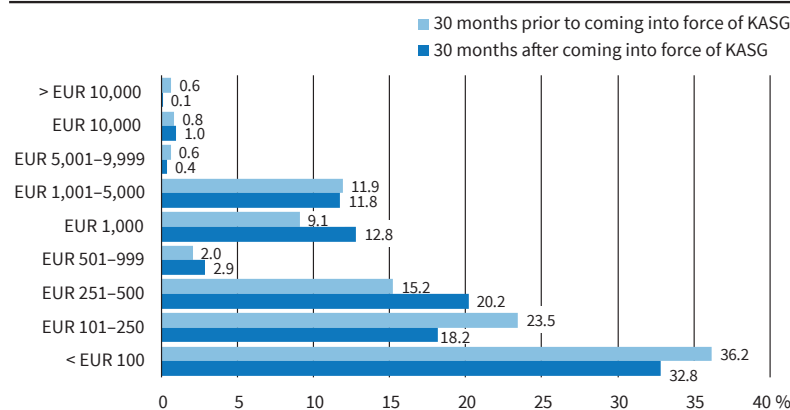


Source: Crowdfunding database (see inter alia Klöhn and Hornuf 2012; Hornuf, Schmitt, and Stenzhorn 2018); authors' calculation.

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⁸ The analysis takes a total of 98,516 investments in 232 issues on nine different crowdfunding platforms into account.

Figure 7

Breakdown of Amounts Invested in Crowdfunding Market^a

^a Up to 30 months prior to coming into force of KASG: N = 48,018 investments, N = 126 issues.

Up to 30 months after coming into force of KASG: N = 50,498 investments, N = 106 issues.

Platforms taken into consideration are Bettermvest, Companisto, Conda, Green Rocket, Home Rocket, Innvestment, Kickrs.net, Seedmatch, and United Equity.

Source: Crowdfunding database (see inter alia Klöhn and Hornuf 2012; Hornuf, Schmitt, and Stenzhorn 2018); authors' calculation.

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to the self-disclosure required for investments in excess of EUR 1,000.

The number of investors who invested over EUR 10,000 decreased after the entry into force of the KASG, falling from 0.6% to 0.1%. Meanwhile, the number of investors who invested exactly EUR 10,000 increased from 0.8% to 1%. This could be an indication that the second threshold value of EUR 10,000 has a limiting effect on crowdfunding.

EXEMPTIONS FOR SOCIAL AND CHARITABLE PROJECTS AND RELIGIOUS GROUPS: §§ 2b, 2c VERMANLG

Methodological Approach and Data Collection

Unlike the market for crowdfunding, the market for financing social and charitable projects is substantially less transparent. We therefore employed a different methodical approach to determine and characterize issuers who could potentially be covered by the exemptions in § 2b and § 2c VerAnlG. In the first phase, we identified the relevant sectors drawing on expert interviews with associations and practitioners. Through comprehensive online research, we identified the individual issuers from the sectors previously defined as relevant. In the second phase, we collected survey data on the projects carried out and investments issued by the previously identified issuers.

how many of the 68 projects recorded in total were carried out before and after the KASG became binding. Of the 50 (18) projects recorded in the social (charity) sector, 40 (16) come from a period before the KASG became binding, while ten (two) come from the period after.

When interpreting the results, it is important to bear in mind the potential limitations related to data collection. Since there is no comprehensive database for organizations that may be affected by §§ 2b and 2c VerAnlG as there is for crowdfunding, we were unable to resort to a total population. Instead, we attempted to learn about the population through an intense and comprehensive investigation. Furthermore, there may be selection problems due to voluntary participation in the survey, since there may be reasons influencing

⁹ As we did not receive any responses from religious groups, references to exemptions as per § 2c VerAnlG will apply only to charitable projects hereinafter.

Table 2

Number of Recorded Projects Before and After the Introduction of the KASG

| | Start of project | | Total |
|--|---------------------------------|--------------------------------|-----------|
| | Before entry into force of KASG | After entry into force of KASG | |
| § 2b VerAnlG | 40 | 10 | 50 |
| Energy projects | 13 | 5 | 18 |
| Housing projects | 8 | 3 | 11 |
| Village shops | 13 | 1 | 14 |
| Community and work partnerships (especially community-supported agriculture) | 5 | 1 | 6 |
| Others (e.g., leisure associations, interest groups) | 1 | 0 | 1 |
| § 2c VerAnlG | 16 | 2 | 18 |
| Churches and religious groups | 0 | 0 | 0 |
| Community-run schools (e.g. Waldorf and Montessori schools, etc.) | 9 | 0 | 9 |
| Foundations | 4 | 1 | 5 |
| Others (e.g., care facilities, aid organizations, sports clubs, friends and supporters associations) | 3 | 1 | 4 |
| Total | 56 | 12 | 68 |

Source: Survey on practical experiences with the German Small Investor Protection Act; authors' calculations.

the willingness to participate that are also related to the financing of a project or the investments. Furthermore, the sample size is relatively small with 68 observations. Due to the small number of observations – especially after the introduction of the KASG – we are not able to provide a meaningful comparison between the projects that were initiated before and after the introduction of the KASG. Even though the collected dataset may not be considered representative, this analysis offers some useful insights into the investment behavior of social and charitable projects by investigating their funding patterns and investment structure.

Compliance with the Exemption Rules

§ 2b Para. 2 VermAnlG and § 2c Para. 2 VermAnlG stipulate certain requirements that issuers must fulfill if they are to utilize the exemption for social and charitable projects for their investment offering (see Figure 1). In total, 45 out of the 50 social projects comply with the turnover and balance sheet requirements as defined in § 2b Para. 2 VermAnlG.¹⁰ Charitable projects were classified as such when it was indicated in the survey that they were charitable in accordance with § 52 Para. 2 p. 1 AO. All 18 charitable issuers included in our analysis stated that this definition applies to them.

Whether the exemptions as per §§ 2b, 2c VermAnlG can actually be used, depends on the features of the investment. For 48 of the 50 social projects and for all 18 charitable projects, we have all the information we need to evaluate the applicability of the exceptions and exemption rules of the VermAnlG.

Overall, 38 of the 48 social projects were carried out before the KASG became binding and ten afterwards. Of the projects that were carried out before the introduction of the KASG, a total of five would have been subject to all duties and liabilities of the VermAnlG if they had been issued after the KASG became binding. In contrast, considering the projects that were carried out after the introduction of the KASG, not a single one was subject to the regulations of the VermAnlG. For these projects, the exception and exemption provisions would apply. Table 3 gives an overview of the

Table 3

Social Projects and Compliance with the Exemption Rules

| | Before entry into force of KASG | After entry into force of KASG | Total |
|--|---------------------------------|--------------------------------|----------|
| Number of projects | 38 | 10 | 48 |
| Application of VermAnlG ^a | | | |
| Yes | 5 (+ 1) | 0 | 5 (+ 1) |
| No | 33 (- 1) | 10 | 43 (- 1) |
| Reasons for non-application of VermAnlG ^b | | | |
| No investment ^c | 2 | 0 | 2 |
| § 2 Para. 1 No. 1 | 11 | 6 | 17 |
| § 2 Para. 1 No. 1a | 11 | 5 | 16 |
| § 2 Para. 1 No. 3a | 9 | 2 | 11 |
| § 2 Para. 1 No. 3b | 10 | 5 | 15 |
| § 2b | 1 (- 1) | 1 | 2 (- 1) |

^a + 1/- 1: There is one social project that could make use of the exemption according to § 2b VermAnlG if the interest rate was low enough. As for this project only an interest margin was specified in the questionnaire, no definitive evaluation can be made. ^b A project can fulfill multiple exception conditions. ^c See Table 1. Source: Survey on practical experiences with the German Small Investor Protection Act; authors' calculations.

Table 4

Charitable Projects and Compliance with the Exemption Rules

| | Before entry into force of KASG | After entry into force of KASG | Total |
|--|---------------------------------|--------------------------------|----------|
| Number of projects | 16 | 2 | 18 |
| Application of VermAnlG ^a | | | |
| Yes | 0 (+ 3) | 0 | 0 (+ 3) |
| No | 16 (- 3) | 2 | 18 (- 3) |
| Reasons for non-application of VermAnlG ^b | | | |
| No investment ^c | 9 | 0 | 9 |
| § 2 Para. 1 No. 1 | 0 | 0 | 0 |
| § 2 Para. 1 No. 1a | 0 | 0 | 0 |
| § 2 Para. 1 No. 3a | 1 | 2 | 3 |
| § 2 Para. 1 No. 3b | 2 | 1 | 3 |
| § 2c | 4 (- 3) | 0 | 4 (- 3) |

^a +1/-1: There are three charitable projects that could make use of the exemption according to § 2c VermAnlG if the interest was low enough. ^b A project can fulfill multiple exception conditions. ^c See Table 1.

Source: Survey on practical experiences with the German Small Investor Protection Act; authors' calculations.

exceptions and exemptions used with respect to social projects.

We recorded one social project carried out after the introduction of the KASG that fulfills all conditions necessary to make use of the exemption according to § 2b VermAnlG. The same holds true for one project carried out before the introduction of the KASG; however, for this specific project, it is not fully clear whether it would fulfill § 2b Abs. 3 VermAnlG with regard to the interest rate. This is because the respondent specified only an interest margin for the project and different durations.

All other projects are exempt from §§ 5–26 VermAnlG because they can make use of the exceptions specified in § 2 VermAnlG. First, given that many issuers operate under the legal form of cooperative, they can make use of the exceptions in § 2 Para. 1 No. 1 VermAnlG and § 2 Para. 1 No. 1a VermAnlG. Second, the number of investors and the return on sales often lie within the range of the exception provisions of § 2 Para. 1 No. 3a VermAnlG and § 2 Para. 1 No. 3b VermAnlG.

Overall, 16 of the 18 charitable projects were carried out before the KASG became binding and two after the introduction. For three of the 16 charitable projects that were carried out before the KASG became binding, it is unclear whether the obligations of the VermAnlG would have applied. The remaining projects

¹⁰ In the case only one of the two values were available, we tried to extrapolate the scale of the missing value from the available one.

were exempt from the requirements of the VermAnlG.

Table 4 gives an overview of the exceptions and exemptions used with respect to charitable projects. One project that was carried out before KASG became binding would clearly fulfill the exemption requirements of § 2c VermAnlG, as it refers to a non-interest-bearing subordinated loan not exceeding the threshold of EUR 2.5 million. Another three projects would possibly have been subject to § 2c VermAnlG. Again, applicability depends on how high the interest rate was set and in one case on the size of the investment.

Nine investments would not have been classified as investments according to § 1 Para. 2 VermAnlG. This relates to (i) loans that were issued by foundations and covered by bank guarantees and (ii) non-interest-bearing loans (which were designated as *loans* and not as *subordinated loans*) that are used by schools. Other exceptions that were frequently used relate to § 2 Para. 1 No. 3a and b VermAnlG.

With regard to the exemption provisions, one should also note that no performance-related compensation was paid for the distribution for any of the investments. Often, the investments were offered only to individuals within the organization. In such cases, the offering was targeted at the members of an association or the parents of students at a school.

CONCLUSION

Before the introduction of the KASG, there were fears that the new act could hamper the growth potential for crowdinvesting in Germany and greatly restrict the funding opportunities for social and charitable projects. Although the market growth rate declined slightly over the past few years, the overall market continued to grow strongly and now reports an accumulated volume of EUR 364 million. On average, the market had an annual growth rate of 197% between 2011 and 2017. Over the past few years, the biggest driver of this growth was the expansion in real estate funding. The use of securities and prospectuses is still extremely rare. An insolvency occurred in around 10% of the issues. If anything, the number of insolvencies decreased slightly over time, which could well be attributable to the brokering of real estate funding, for which there is only one insolvency to report to date.

An evaluation by *total sales price* shows that in particular issues between EUR 1 million and EUR 2.5 million have strongly increased their share of the total market volume. The fact that more issuers came close to the threshold value of EUR 2.5 million could be interpreted as a sign of the effectiveness of the EUR 2.5 million threshold, which exempts issuers from the prospectus requirement. Over the past few years, investors in crowdfunding projects have continued to turn away from silent partnerships in favor of profit-participating loans and above all subordinated loans, which are privileged by the KASG. After the KASG became binding, the

number of investors who invested exactly EUR 1,000 increased from 9.1% to 12.8%. The number of investors who invested more than EUR 10,000 decreased after the KASG became binding, falling from 0.6% to 0.1%. This suggests that the threshold values are influencing the behavior of investors.

To evaluate the practical experiences with the exemptions in §§ 2b, 2c VermAnlG, we had information for 68 social and charitable projects from two survey waves, of which 12 projects stemmed from the time after the KASG became binding. None of the recorded projects that were carried out after the introduction of the KASG were subject to the full list of duties and liabilities of the VermAnlG: One project could make use of the exemption in § 2b VermAnlG. All other projects were not subject to the VermAnlG because they could make use of the exceptions in § 2 VermAnlG. These results show that the new exemption provisions introduced in §§ 2b, 2c VermAnlG are hardly relevant in practice. However, the comments made in the questionnaires reveal a great deal of uncertainty about the rules introduced via the KASG. Furthermore, the decision-makers in social and charitable projects are not always sufficiently informed about the exceptions and exemption rules.

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