

Crowdfunding in the context of securities offerings in the US and Europe: an overview of the regulatory framework

Marjukka Sippola

Krogerus, Helsinki
marjukka.sippola@krogerus.com

Leif Laitinen

Krogerus, Helsinki
leif.laitinen@krogerus.com

Some smart-thinking people have figured out that rather than go to financial institutions or corporate sponsors to ask for project funding, they can use the power of the internet to raise money. This phenomenon is called crowdfunding and, like the name suggests, the basic idea is that you get lots of people to give you cash. What you get in return varies from shares in the company, an actual product, or something else.

This article addresses crowdfunding in the context of the selling of debt and equity securities in small amounts to large numbers of people over the internet. While the concept seems simple enough, the offering of securities in return for cash inevitably raises a number of legal and regulatory issues. What follows is a discussion of the regulatory environment in the US and Europe. Particular emphasis is placed on the applicable regulations in Finland.

US crowdfunding exemption

On 5 April 2012, President Barack Obama signed the Jumpstart Our Business Start-ups (JOBS) Act into law. Part of the JOBS Act seeks to liberalise the applicable securities offering regulations to encourage the funding of small businesses through a wider pool of investors. More specifically, Title III of the JOBS Act amends Section 4 of the US Securities Act of 1933 (the 'Securities Act'). It exempts issuers from the requirements of Section 5 of the Securities Act when they offer and sell up to US\$1m in securities during any 12-month period.

The amount an issuer can sell to an individual investor during any 12-month period is limited to the maximum of: (i) the greater of US\$2,000 or five per cent of the annual income or net worth of an investor, if either the investor's annual income or the net worth is less than US\$100,000; and (ii)

ten per cent of the investor's annual income or net worth, not to exceed a maximum aggregate amount sold of US\$100,000, if either the investor's annual income or net worth is equal to or more than US\$100,000. In addition, an issuer must sell the securities in a crowdfunding offering through a broker or a 'funding portal', which is required to register with the US Securities and Exchange Commission (SEC). The issuer must also comply with new Section 4A(b) of the Securities Act regarding solicitation limitations, disclosure obligations, and other requirements and prohibitions.

The SEC has not yet issued final rulings to implement the JOBS Act (the JOBS Act directs the SEC to adopt rules to implement Title III within 270 days of enactment of the JOBS Act), which means that any offer to sell securities in reliance of the crowdfunding exemption is currently unlawful. As the investment community waits for the final rules, the general sentiment is that the new exemption is only partly a welcome change. Some commentators have hailed it as a way to revolutionise the funding of start-ups, while others are concerned the new regulation will increase the likelihood of investor fraud.

EU approach to crowdfunding

While there has been lots of discussion around this subject in Europe, no similar act is on the immediate horizon in the EU. Rather, the legal framework is laid out in various directives, such as the Directive 2003/71/EC (as amended, the 'Prospectus Directive'). Pursuant to the Prospectus Directive, a prospectus must be published when securities are offered to the public or admitted to trading, unless an applicable exemption from the prospectus obligation exists. Among other things, the obligation to publish a prospectus does not apply to a securities offering with a total consideration

of less than €100,000 (calculated over a period of 12 months). A prospectus must be published with regard to securities included in an offer where the total consideration for the offer is more than €5,000,000 (calculated over a period of 12 months).

This means that when securities are offered to the public or admitted to trading for amounts of less than €100,000, EU member states may not impose their own prospectus regimes. In contrast, with regard to amounts between the €100,000 and €5m range, EU member states may impose their own prospectus regimes. For example, in Finland, a prospectus must be published when the aggregate amount of the offering during a 12-month period is €1.5m or more.

Besides the euro-limit exemptions described above, other applicable exemptions from the prospectus obligation also exist. The most commonly used ones are the so-called private placement exemptions, which allow an offer of securities addressed solely to qualified investors or to fewer than 150 natural or legal persons per EU member state (other than qualified investors) without the obligation to publish a prospectus.

Sufficient information requirements

Once a prospectus exemption is found, issuers must also comply with the information requirements found in EU member state securities laws. For example, pursuant to Chapter 1, Section 4 of the Finnish Securities Markets Act,¹ an issuer is obligated to keep sufficient information on factors that may have a material effect on the value of the security equally available to investors. In October 2012, despite taking benefit from the exemptions from the obligation to publish a prospectus, the Finnish Financial Supervisory Authority (FFSA) prohibited a newly established Finnish wind power company from continuing the marketing of its share issue on the internet because, in the view of the FFSA, the company had not given sufficient information on factors that may have a material effect on the value the security. Also, the FFSA stated the issuer had marketed the share issue in a misleading manner. The conclusion by the FFSA was that the procedure undertaken by the company in its marketing was in violation of the Finnish Securities Markets Act.

Regulations impacting crowdfunding platforms

The crowdfunding platforms are also subject to their own unique set of regulations. Some activities that are regulated by the Markets in Financial Instruments Directive 2004/39/EC (MiFID), a regulation in the EU that aims to make it easier for investors to buy financial instruments or investment services across the EU, may face different national interpretations as to whether the platform performs a regulated activity or not. This would be true, in particular, for the placing of financial instruments, executions of orders on behalf of clients, reception and transmission of orders in relation to one or more financial instruments, services related to underwriting and operating a multilateral trading facility.

The current interpretation is that crowdfunding platforms do not provide ‘investment services and activities’ as defined in MiFID (Section A of Annex 1). The end result is that crowdfunding platforms may not need to be licensed under MiFID and are not subject to supervision by the relevant national authorities. It should be noted, however, that MiFID is currently under review. The current proposal for an amending directive, generally known as MiFID II, introduces a new regulated trading venue, a so-called organised trading facility (OTF). The current view is that it is likely that crowdfunding platforms will fall into the OTF category.

Is crowdfunding picking up speed?

While it is likely that larger corporations will never use crowdfunding for their financing needs, the growth of this concept speaks to how smaller businesses are using new avenues for their funding needs. Whether crowdfunding will impact the business models of private equity or venture capital firms – the traditional places where companies go to ask for private investor funding – remains to be seen. Crowdfunding can benefit companies that are too small to interest institutional investors and lack assets to raise debt. It also gives retail investors a new target for their asset diversification. For now, an investment via a crowdfunded platform is not likely to generate significant returns. But it is interesting to see how this new fundraising model will develop over time and how it will impact traditional financiers.

Once the SEC finalises its rulemaking to adopt the JOBS Act, the new rules are likely to have a ripple effect in Europe. Before the JOBS Act was signed, Europe had a competitive advantage in the sense that crowdfunding was virtually impossible in the US. Once the JOBS Act is implemented, this will level out the competitive edge Europe used to have. At some point, European laws

may have to catch up to the market need to specifically address crowdfunding in certain instances and still regulate it sufficiently to protect investors.

Note

- 1 This law came into force on 1 January 2013. It replaces the Finnish Securities Market Act (495/1989, as amended).

Terrorism and International Law: Accountability, Remedies and Reform

A Report of the IBA Task Force on Terrorism

The IBA's Task Force on International Terrorism was convened to examine the developments in international law and practice in this dynamic and often controversial area. The Task Force comprises world famous jurists and is chaired by Justice Richard Goldstone.* This book provides a global overview of counter-terrorism, including but not restricted to the US-led 'war on terror', by considering case law and examples of state practice from all continents.

*Other members: Professor Judge Eugene Cotran, Mr Gijs de Vries, Ms Julia A Hall, Mr Juan E Méndez and Professor Javaid Rehman, Elizabeth Stubbins Bates (author).

Issues covered include:

- the framework of international conventions against terrorism
- international humanitarian law
- international human rights law
- the investigation and prosecution of terrorist crimes and of international crimes committed in the course of counter-terrorism
- reform in counter-terrorism
- victims' right to a remedy and reparations

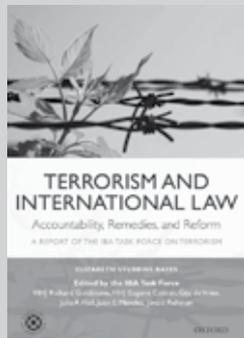
The book closes with Conclusions and Recommendations from the Task Force focusing on how the international community can ensure respect for human rights and the rule of law when responding to the threat of terrorism.

International Bar Association

4th Floor, 10 St Bride Street, London EC4A 4AD, United Kingdom

Tel: +44 (0)20 7842 0090 Fax: +44 (0)20 7842 0091 E-mail: publications@int-bar.org Website: www.ibanet.org

Please include your mailing address on all e-mails.



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