Crowdfunding – Towards a sustainable sector

A review of (supervision of) the crowdfunding sector

December 2014

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Introduction

Management summary

The crowdfunding sector is developing rapidly and is therefore receiving appropriate attention in the public debate (both nationally and internationally). It is a sector that has emerged from its start-up and pioneering phases and will now be entering a phase of growth. The Netherlands Authority for the Financial Markets (AFM) has been involved with the crowdfunding sector for some time already as a result of its supervisory duty. Since 2012, the AFM has been granting licences and exemptions for crowdfunding platforms on the basis of existing legislation and regulation. Against this background we have, also at the request of the Minister of Finance, carried out a study of the crowdfunding sector and the supervision thereof. We have discussed the design and progress of the study with the Ministry of Finance, the Ministry of Economic Affairs and De Nederlandsche Bank. The study presents an opportunity for us to look more closely at the supervisory regime in a growing market and to identify and address potential issues.

Crowdfunding meets a social need

The AFM welcomes the development of new initiatives such as crowdfunding, which meet social needs such as the funding of small and medium-sized enterprises and have the potential to play a useful part in the financial markets. We consider it important that the crowdfunding sector is given the opportunity to grow in a sustainable and responsible manner. Sustainable and responsible means that it meets a number of preconditions, such as professional platforms, a minimum level of transparency, a certain degree of protection for lenders and borrowers and cooperation between platforms. If these preconditions are met, the risks associated with crowdfunding (such as fraud, unsuitable funding or investment and dysfunction of platforms) will also be addressed in an adequate way.

The law and the supervision of crowdfunding

The current legislation and regulation does not set adequate requirements for the sector to reflect these preconditions in the long term. Certain aspects of the statutory framework are also experienced as restrictive by the sector, and there are a number of legal problems preventing the AFM from fulfilling its duty optimally.

For this reason, we recommend that legislation and regulation and the intensity thereof be allowed to grow along with the development of the market. This offers the opportunity to create appropriate regulation that takes into account the uncertainties inherent to a rapidly developing market and will encourage the market to increase gradually into a sustainable and mature sector. In this report, the AFM for this reason distinguishes between three phases of market growth: the start-up market phase, the growth market phase and the mature market phase. The expected future market developments are elaborated on for each phase, and it is also indicated how the statutory framework and the AFM's supervision can be applied proportionally so that a situation in which the market's development is stifled by regulation can be avoided.

Recommendations for the short term and the medium to long

We make a number of specific recommendations for the short and the medium to long terms in a situation where there is a growth market. The AFM wishes to continue to use the present regulatory framework in this phase; however, it also wants to see the solution of a number of issues in the current four supervisory regimes. We view the current exemption regime applying to platforms that provide funding for SMEs in the form of loans as too lenient. We advise that this regime be intensified with a number of ongoing regulatory provisions. The AFM will moreover no longer apply the mediation regime, since this involves too many legal issues and is not appropriate to the crowdfunding sector. Instead of this, platforms providing loans to consumers will only be able to continue to do so with a licence to offer credit. We also recommend that a number of provisions be adjusted. This concerns firstly the adjustment of provisions experienced as restrictive by regulated platforms, and secondly the introduction of a number of additional provisions with which regulated platforms must comply in order to achieve sustainable and responsible growth.

Recommendations for the longer term

We also put forward a number of suggestions for the longer term, in the case that crowdfunding becomes a mature market. We recommend that a new statutory framework be created, consisting of two statutory regimes: a loan-based regime and an equity-based regime. Within these regimes, statutory rules would apply that are specifically designed for crowdfunding and more stringent and more specific requirements would be set for the operation of a platform. Prudential rules would also apply. Moreover, we recommend that the provisions applying be given a legal basis and made to form part of the statutory requirements applying to the operation of a platform. The AFM will carry out its supervisory duties on the basis of the legislation and regulations that apply.
The recommendations for the long term are less detailed than those for the short and medium to longer terms, since it is not yet clear whether and if so how the market will develop into a mature

market. The AFM recommends that the market be monitored on the basis of certain indicators in order to be able to determine at an early stage whether the sector is growing into a subsequent market phase. The report lists a number of possible indicators.

Recommendations to the sector

Lastly we put forward a number of recommendations to the sector, in which we request that it gives attention to matters including among others education, standardisation of information and cooperation between platforms.

Invitation for response from stakeholders

We welcome the reactions of the various stakeholders to our recommendations by completing our online questionnaire by 23 January. The results will be presented to the ministries for consideration.

Methodology and guide to this report

The review (and the resulting report) consists of the following:

Section 1 gives a brief description of crowdfunding

Section 2 gives a brief description of the market in its start-up phase, expectations with respect to the growth phase and expectations with respect to the mature phase of the market.

Section 3 states our views with respect to crowdfunding and the supervision of the crowdfunding sector.

Section 4 identifies and describes the risks associated with crowdfunding and points out the risks that should be prioritised by and receive attention from the supervisor.

Section 5 identifies the key preconditions that are important for the adequate addressing of risks.

Section 6 compares the current situation to the desired situation of the mature market. This section also answers the question as to what extent the current statutory framework enables the supervisor and the sector to bridge the differences.

Section 7 lists the AFM's recommendations to the legislator with regard to the statutory framework and notes a number of items of attention for the sector.

Basis for the study

We used various sources for this review, including published research, discussions with various crowdfunding platforms and fellow supervisors in Europe (including the European Securities Markets Authority (ESMA), the European Banking Authority (EBA) and the European Commission (EC)), the AFM *Consument&Panel*, the websites of the platforms and the experience gained by the AFM in its capacity as conduct supervisor.

The report is mainly based on qualitative research, partly because there is little substantial data currently available.

Further details of the sources are given in Appendix 2 of the report.

1. Description of crowdfunding

Crowdfunding is the investment or lending of relatively small amounts of money by a large group of investors (hereinafter: ‘the lenders’) to private citizens or companies (hereinafter: ‘the borrowers’) usually via an online platform (hereinafter: ‘the crowdfunding platform’). Crowdfunding platforms bring borrowers and lenders together. There are various manifestations, with loan-based crowdfunding (credit provision) and equity-based crowdfunding (investment in companies) falling under supervision. This report deals with these two kinds of crowdfunding.

Crowdfunding is based on small amounts of money that collectively form a large amount. Crowdfunding is a form of funding whereby finance (or funding) is obtained from the public (the ‘crowd’).

1.1. Manifestations of crowdfunding

Crowdfunding manifests in various forms, depending on the borrower’s objective. From the point of view of the lender, there are essentially four different forms of crowdfunding:

- Donations:
  Giving money to a good cause. The lenders part with their money, but can see directly what it will be used for.
- Sponsoring and reward-based:
  Supporting a project, in return for a (non-financial) consideration. The financial aspect is subordinate here and the lenders are primarily concerned with the objective the applicant is striving to achieve.
- Loan-based:
  Lending money to a business or private person with interest as compensation for the loan. A financial return is important for this form of crowdfunding.
- Equity-based:
  Investing in a business, with dividend and value appreciation of shares as compensation. Here too, the significant factor is the return on the investment.

The supervision by the AFM, and this review study focusses on the two last-mentioned forms of crowdfunding, loan-based and equity-based. This does not, however, mean that all platforms facilitating these forms of crowdfunding have or need to have a licence or exemption from the AFM. There are currently four supervisory regimes applying to the above-mentioned types of crowdfunding:

- Exemption for intermediation in callable funds:
  This type relates to the funding of SMEs (both existing and start-up) in the form of loans funded by private lenders (consumers);
- Licence to intermediate in loans:
  This type concerns the provision of finance to consumers in the form of loans funded by private lenders (consumers), whereby the platform acts as intermediary;
- Licence for the offering of loans:
  This type concerns the provision of finance to consumers in the form of loans funded by private lenders (consumers), whereby the platform acts as the credit provider;
- Licence to operate an investment firm:
  This type relates to the funding of start-up SMEs in the form of shares or bonds issued to private lenders (consumers).

1.2. The crowdfunding process

The crowdfunding process generally involves the following steps:

Matching

Crowdfunding platforms bring borrowers and lenders together. The borrower attempts to raise finance by pitching a project to the public through a platform. A platform sets certain requirements for a project pitch. The borrower must for example clearly state historical results, a forecast and its qualities. After the platform has screened these items, the pitch is put online.

Lenders can then support the project by investing. The platform assesses whether the desired amount has been raised and maintains the administration. The money flows are usually managed by a third party trust account (*Stichting Derdengelden*). The funding can go ahead once a minimum sum has been raised, for instance ninety per cent of the intended investment. The lenders transfer their loan or investment to the trust account and after successful subscription to a project, the funds are transferred to the borrower. If the starting minimum is not reached and the investment does not go ahead, the funds are returned to the lenders.

The operator of the platform receives a commission from either the borrowers or the lenders, or both, for bringing the lenders and borrowers together. This may be a fixed amount per participant and/or a percentage of the project funding. The amounts involved vary.

Ongoing service

As an ongoing service, the platform can also facilitate the interest and repayment of a loan or distribution of dividends and repayment of sums invested. The payment of funds is usually via a trust account. The platform operator generally charges a fee for these activities. The collection of funds can also be outsourced by the platform. In such cases platforms often do still maintain records of the rights and obligations of the lenders and borrowers.

1.3. Motivation for lenders and borrowers

Crowdfunding can answer various needs of borrowers and lenders. The following points emerged from the AFM's discussions with crowdfunding platforms and the results of its *Consument&Panel*[1]:

Borrowers

The borrowers seeking to fund their activities through crowdfunding are usually starting or established SME business operators and private persons. There are various reasons why these parties may choose to use crowdfunding rather than other forms of funding:

- Crowdfunding seems to be a relatively easy, low-cost and quick method of raising funding;
- Crowdfunding is an alternative for businesses and private persons that are not eligible for more traditional finance, such as bank loans;
- Crowdfunding and the specific platform are suitable for the particular business concept. For example, the business is innovative or the platform focuses specifically on sustainability;
- Crowdfunding can give access to a new target group. Investors are themselves directly involved with the business or the private borrower.

[1] The AFM *Consument&Panel* is a consumer panel operated by the AFM. Through our online consumer panel, we approached 128 consumers who invest or lend money through crowdfunding or intend to do so in the future. The AFM *Consument&Panel* is not representative of the average Dutch citizen, but the results do provide indications regarding the attitude of consumers to crowdfunding.

Lenders

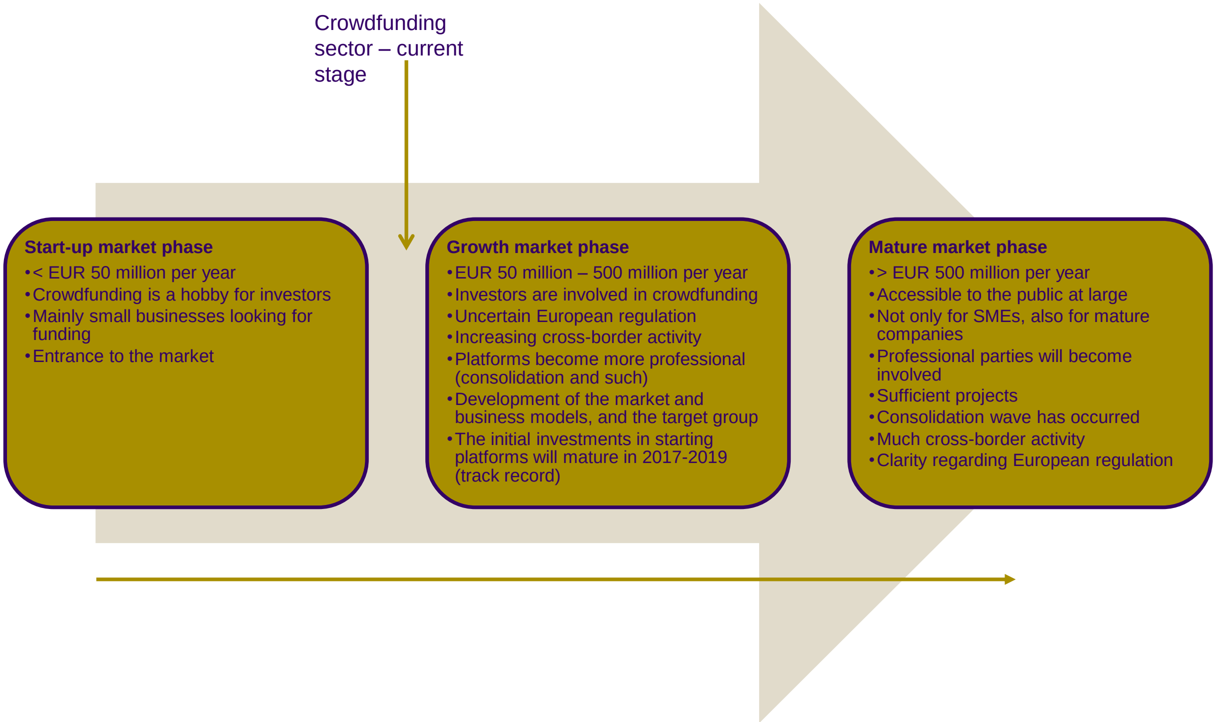
Crowdfunding lenders are usually private investors who may have various reasons for choosing this type of investment, including:

- They find it entertaining, attractive or educational to invest through crowdfunding;
- Crowdfunding offers simple and direct access to financing start-ups and existing SMEs;
- They find the return attractive;
- They have a special involvement with the aim of the borrower and/or they see their investment to some extent as a gift.

From the AFM *Consument&Panel* it appears that the average lender is male, relatively well educated and has above-average wealth. We should note that the panel is not a representative sample, and that the total group of lenders will prove to be varied.

2. Development of the crowdfunding market

The crowdfunding market is currently still limited in size, but it is showing strong growth. The AFM's estimate is that the crowdfunding market is currently nearing the end of the start-up phase. We expect a strong growth in the coming years, potentially (but not definitely) towards a mature market. The phases determine the development of the risks and preconditions needed to address these risks, and also they form a basis for the AFM's view with respect to supervision of this growing sector. The growth phases and our expectations for the crowdfunding sector are shown below.



2.1. Observations regarding the start-up market phase

The crowdfunding market in the Netherlands is growing rapidly, in terms of the number of platforms, the number of projects and the amounts of funds raised through crowdfunding.

Sector

Many new platforms (19) joined the market in 2014. There are currently 24 crowdfunding platforms regulated by the AFM[2] and there are approximately 5 applications pending with the AFM. There are 2

[2] http://www.afm.nl/nl/professionals/registers/alle-huidige-registers.aspx?type=%7B3AB49ED8-34AB-404D-B94B-BFD742D11E99%7D

equity-based platforms, 17 loan-based company platforms and 5 loan-based retail platforms active in the market. One of the Dutch loan-based platforms is also active in Germany. The largest loan-based platform in the Netherlands has recently been acquired by a Swedish party.

Based on the information received from regulated platforms by the AFM or derived from the websites of regulated platforms, the state of the market is as shown below[3].

Category	Total funds provided (EUR)	Funds Provided in 2013 (EUR x million)	Funds Provided in 2014 (to end Oct) (EUR x million)	Total cumulative number of projects	Total cumulative individual loans[4]	Average size of individual loan (EUR)	Average project size (EUR)
Consumers	**4.0M**	1.6M	1.9M	89	3,671	1,093	45,088
SME	**42.8M**	15.7M	22.6M	466	48,479	883	91,831
Start-up	**2.7M**	0.5M	2.2M	55	5,950	455	49,244
Total	**49.5M**	**17.8 M**	**26.7M**	**610**	**58,100**	**852**	**81,175**

We expect to see around EUR 37 million of funds raised through crowdfunding over the whole of 2014. This corresponds to a growth of more than 100% in 2014 compared to 2013.

Platforms

We have looked at the financial statements and interim financial information of a number of active crowdfunding platforms, to the extent of which these are available. It is notable that the revenue of most platforms is rising rapidly, but that it is not yet sufficient to cover all the expenses. A number of

[3] The table includes only platforms regulated by the AFM. There are currently 24 platforms with an exemption or licence, 11 of which currently are offering live projects. The available data on the platforms regulated by the AFM are limited since most platforms only started operation in 2014.

[4] An individual loan is one investment from one lender. Example: a crowdfunding project of a total of EUR 100,000 has 100 lenders, all of whom invested EUR 1,000. This project therefore has 100 individual loans and the average size of an individual loan is EUR 1,000.

platforms has now become profitable, but most platforms are expected to need another few years to become profitable.

Borrowers and lenders

Crowdfunding is still relatively unknown among borrowers. Platforms have difficulty in attracting good quality projects. The largest group of borrowers consists of relatively small businesses. Lenders are frequently not fully aware of the risks associated with crowdfunding.

International

Some crowdfunding platforms are cautiously starting commencing with exploratory cross-border activities. There are a few European crowdfunding platforms that focus (or intend to focus) on the Dutch market, and vice versa. The approach taken by the Member States to crowdfunding and its supervision varies. There is a lack of clarity with respect to the consistent application of regulations.

2.2. Expectations for the growth market phase[5]

Expectations for the sector

The AFM expects that in the first instance the number of platforms wishing to enter the crowdfunding market will increase and that platforms will appear that provide a secondary market in which loans and/or shares could be traded. One cannot rule out the possibility that even more foreign crowdfunding platforms will enter the Dutch market. In the growth phase, the annual funding provided will amount to between EUR 50 and EUR 500 million.

Competition between the platforms is expected to intensify as more crowdfunding platforms enter the Dutch market. After some time the number of new parties entering the market will flatten out as the market becomes saturated.

Expectations for the platforms

In the growth phase of the market, platforms will continue to vary in size and also in their degree of professionalism. Survival will require differentiation and keeping up with the wave of professionalisation that will occur in the sector. The outcome of this wave of professionalisation will

[5] There is no substantial amount of data available at the moment on the basis of which clear trends could be established. The expectations are based on written sources and various discussions with international supervisors, market participants and advisers.

largely depend on market forces and regulation. Successful active platforms will become profitable and loss-making platforms will gradually disappear from the market.
The first (exploratory) steps regarding cooperation between platforms and traditional financiers such as banks will be made.

Expectations for lenders and borrowers

In the growth phase, the AFM expects that investors with above-average wealth will form the largest group of lenders. They will not depend on the financial results of the crowdfunding activities. The first exploratory steps will be taken towards expanding the group of lenders to include professional investors at one end of the spectrum, and less experienced retail investors at the other. Less experienced investors are not yet fully aware of the risks associated with crowdfunding. The focus is on the positive aspects, such as innovation.

Given the fact that most platforms started operation in 2014 and the investments have an average term to maturity of 5 years, the extent to which crowdfunding has been successful in realising returns for the lenders will become clear around 2020. Once there is better clarity regarding matters such as default risk at the various platforms, more professional parties may get involved and invest.

Expectations for international developments

European institutions (EC, ESMA, EBA) have conducted a number of exploratory studies on crowdfunding and the statutory framework. The line currently being followed is that the existing legislation and regulation must be consistently applied by the Member States, and that monitoring of the market is important, but that no new regulation will be developed, at least for the time being. We expect to see additional activity with respect to European regulation for crowdfunding.

2.3. Expectations for the mature phase[6]

Expectations for the sector

A wave of consolidation will have taken place by the time the market matures. A smaller number of larger platforms will be operating, including several foreign ones. The platforms will have all gone

[6] There is no substantial amount of data available at the moment on the basis of which clear trends could be established. The expectations are based on written sources and various discussions with international supervisors, market participants and advisers.

through a process of professionalisation. With the increase in knowledge and experience with respect to crowdfunding, the number of projects and the size of individual projects will increase.

Expectations for lenders and borrowers

In the mature market, the active target group of crowdfunding platforms will expand to include the whole spectrum of investors, from inexperienced retail investors to professional investors. In addition to small companies, medium-sized and large businesses will also be looking to raise funding through crowdfunding.

Expectations for international developments

Cross-border activities by crowdfunding platforms will continue to be visible. It is not clear whether a large international crowdfunding sector will emerge, or a collection of national crowdfunding sectors. The AFM expects that once the market matures, it will be clear whether European regulations will be developed specifically for the crowdfunding market and, if so, what form it will take.

2.4. Summary – indicators for the growth and mature market phases

Based on the above description of how the market will develop, the AFM has formulated potential market indicators as shown in the table below. These indicators can assist the AFM to determine which phase the market is in, or where it will be within the foreseeable future. The list is neither definitive nor exhaustive. The AFM cannot foresee how the growth will actually occur since there are other factors that may affect the outcome that we have not foreseen. The methods the AFM can use to measure the variables listed below and monitor the market are described in Section 7.

Indicator	Growth market phase	Mature market phase
Market volume	Annual funding provided to borrowers is EUR 50 million to 500 million.	Annual funding provided to borrowers is > EUR 50 million to 500 million.
Profile of projects	Annual number of projects 700 to 7,000.	Annual number of projects > 7,000. The largest projects will approach the level of the prospectus requirement of EUR 2,500,000.
Profile of platforms	Most platforms are independent and the market is fragmented. The platforms operate mainly on a national basis.	A consolidation phase has taken place and a number of large platforms have concluded joint ventures with other financial institutions. The platforms operate internationally.
Profile of lenders	Most lenders are consumers and invest in crowdfunding as a hobby. They have some experience of investing.	Most lenders will invest in crowdfunding in order to realise an attractive return. Professional parties are also active lenders.
Profile of borrowers	Mostly consumers, start-ups and small businesses that use crowdfunding as an alternative to traditional finance.	Medium-sized and large companies view crowdfunding as a valuable alternative for meeting their funding requirements.

3. View of the AFM with regard to crowdfunding and its supervision

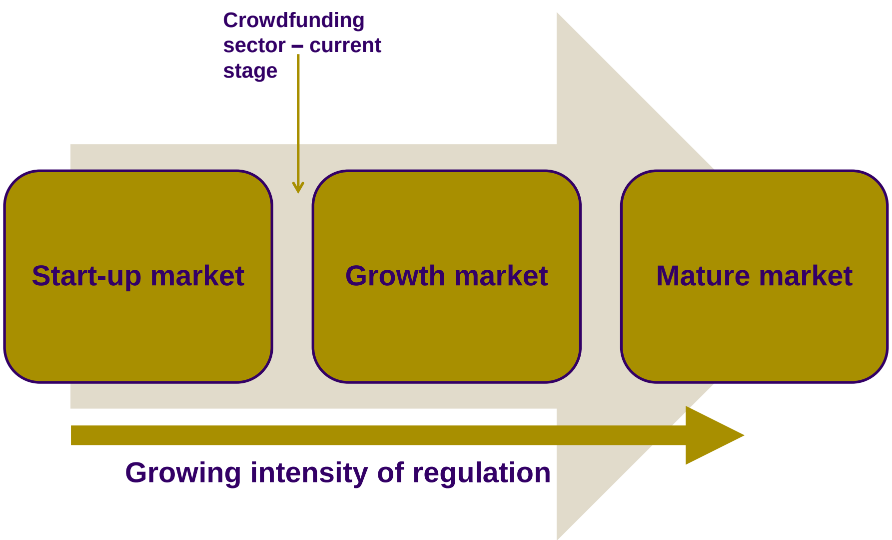
3.1. View of the AFM with regard to crowdfunding

The AFM welcomes the development of new initiatives such as crowdfunding, which meet social needs such as the funding of small and medium-sized enterprises and have the potential to play a very useful part in the financial markets.
We consider it important that the crowdfunding sector is given the opportunity to grow in a sustainable and responsible manner. This means that it meets a number of preconditions, such as professionalism of platforms, a minimum level of transparency, a certain degree of protection for lenders and borrowers and cooperation between platforms. If these preconditions are met, the risks associated with crowdfunding can also be addressed appropriately. The sector has an important role in this.

3.2. View with regard to the supervision of crowdfunding

The sector is developing, and we expect crowdfunding to attract a greater variety of users as the sector grows. The market will grow and the players will become more professional. The AFM also expects to see further development in international regulation in the coming years.
For this reason, we recommend that legislation and regulation and the intensity thereof be allowed to grow along with the development of the market. This will give us the opportunity to develop appropriate regulation that takes into account the uncertainties arising from the fact that this is a market undergoing rapid development. It will moreover encourage the market to grow in phases into a sustainable and mature sector. The AFM accordingly distinguishes between three scenarios for market growth: the start-up market phase, the growth market phase and the mature market phase.

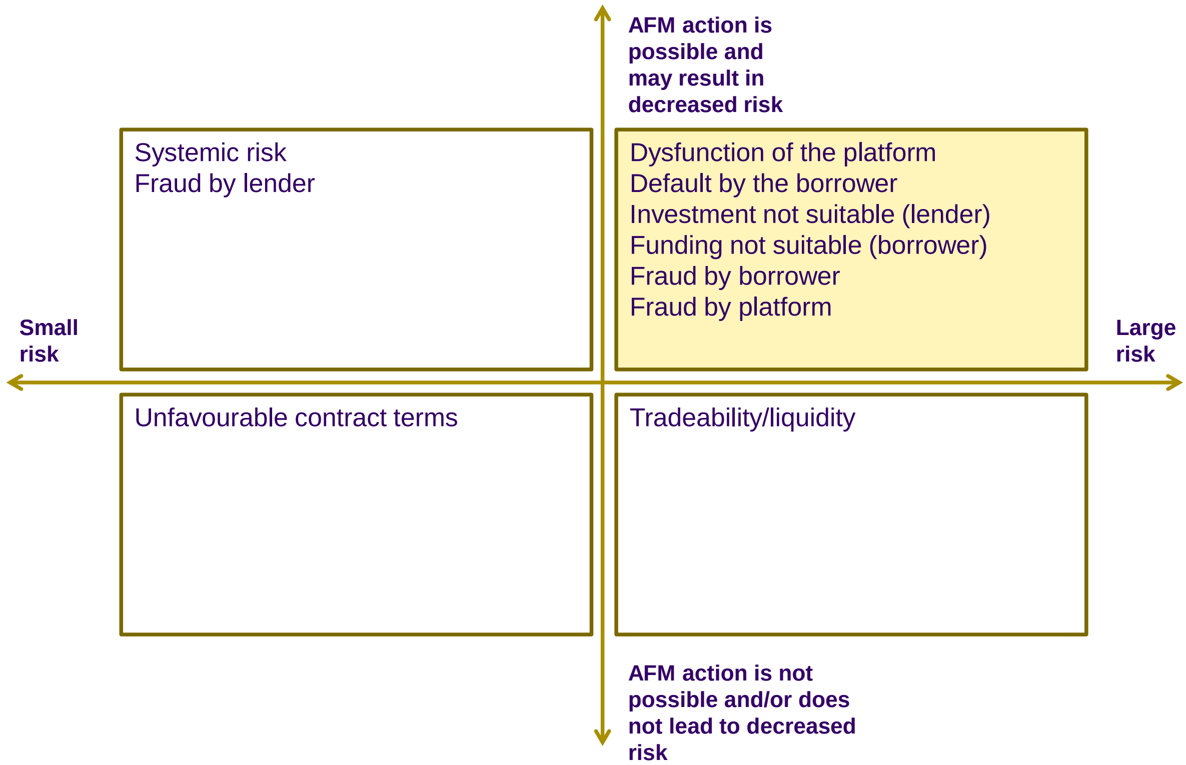
In each phase, it is important that the statutory framework and the AFM's supervision be proportionate. This will avoid a situation in which the market's development is suffocated by regulation.



4. Identifying and prioritising risks

Like any investment or type of funding, crowdfunding involves risk. The AFM is a risk-based supervisor and for us, risk forms the starting point for determining a suitable supervisory strategy and regulatory framework for crowdfunding. Based on various reports, signals from the market and discussions with the platforms, the AFM has identified a total of 10 risks that can occur at or affect the various crowdfunding actors.

We have prioritised 6 of these risks in this report, firstly on the basis of the likelihood that they will materialise and their potential impact. This is shown in the table below as 'high risk' or 'low risk'. Secondly, we note those risks that could entail action by the AFM that could lead to decrease of the risk in question (likelihood and/or impact). The diagram below shows the AFM's prioritisation of these 10 risks.



4.1. High risk, AFM action is possible and may lead to decreased risk

The 6 risks we have prioritised are explained below. We consider these risks to be substantial, and that for these risks AFM action is possible and can lead to mitigation.

Dysfunction of the platform

This refers to the risk of the platform not functioning properly due to temporary or permanent operational failure or bankruptcy.

Operational failure

Since crowdfunding happens more or less exclusively online and most platforms depend on a robust ICT structure for their administration, the risk of ICT problems is realistic and can affect both lenders and borrowers. Since many small sums of money will be invested, the administration of the cash flows is automated and complex. Problems with ICT may endanger ongoing project funding either temporarily or permanently and could for instance temporarily interrupt the repayment of funds. Both borrowers and lenders could suffer losses as a result and the continuity of the platform itself could be threatened.

Bankruptcy

Bankruptcy could seriously affect either the platform or the borrowers and lenders, or both. The cash flows between borrowers and lenders may be through a trust account or via the platform itself. The administration of the rights and obligations with respect to crowdfunding is carried out by the platforms themselves. Since investment is virtually anonymous, the borrowers do not know who their creditors are. There is a risk that in the event of bankruptcy the records will no longer be available, and this affects the flow of funds between the borrowers and the lenders. The AFM considers the risk of platforms going bankrupt to be realistic, given the fact that in the growth phase there are relatively many new platforms and competition is intense, and in view of the earnings model of the platforms, which is mainly based on one-off initial revenues (success fees).

Default by the borrower

Like any other form of investing, investment through crowdfunding entails the risk that the expected proceeds are not received with the consequence that the lender does not realise a return or actually loses his entire investment or amount lent. Crowdfunding, however, has specific features that increase the likelihood that this risk will occur.

Crowdfunding projects are usually initiated by start-up businesses with no track record, meaning that the chance of bankruptcy or default is greater. Most platforms currently also have no track record on the basis of which the AFM or the lender can establish how well the screening works, what the net return is and whether the platform is able to keep the percentage of payment obligations not met under control. If a platform admits projects that are not creditworthy, this will ultimately lead to default on payment obligations. In the long term, this may also damage the reputation of the platform.

Investment is not suitable (for the lender)

There is a relatively high chance that the lender will lend money to or invest in a project with a risk profile that is not sufficiently appropriate to their financial situation and/or risk appetite. An unsuitable investment may lead to a situation in which the lender (unexpectedly) loses more money than he wishes to or can afford in the event that the project fails, either entirely or partially.

The AFM believes that especially retail investors are not sufficiently aware of the risks associated with crowdfunding investments. The investment threshold for crowdfunding is relatively low, also due to its accessibility online. Since there is an information asymmetry between the borrower and the lender, lenders may base their decisions solely on the screening carried out by the platforms themselves, which currently is not an adequate basis for taking a suitable investment decision in all cases.

Funding is not suitable (for the borrower)

With crowdfunding the borrower decides the amount of funding that is required. It is difficult for start-up companies to estimate how much funding they will need to start their business in advance. The funding may not be suitable for the borrower in terms of type, since it may entail a repayment obligation that is too large for a start-up project with limited cash flow at an early stage.

The effect of overfunding and unsuitable funding for the borrower is significant for the lenders, the borrowers and the platform. The borrower may soon encounter difficulty in making payments or even become bankrupt. The lenders will be the victims in such cases, since they will receive less or even no return. Repetition of this problem may also damage the reputation of a platform.

The AFM considers the risk that business operators will obtain funding that is unsuitable (in terms of either size or type) as realistic, because funding can be obtained through crowdfunding relatively easily in some cases. There are no rules to prevent small businesses from asking for too much credit. Such borrowers are moreover usually not assisted by an adviser who could assess the suitability of the funding.

Fraud by the borrower

When a borrower raises money, he has an information advantage over the platform and the lenders. Knowing that the platform itself does not take any credit risk, the borrower can attempt to circumvent the platform's screening. He may withhold relevant information or provide incorrect or misleading information and thereby convince lenders to invest on incorrect grounds. As a result, the lenders' money could be used for purposes other than intended and/or projects could perform less successfully than the lender could have expected on the basis of the information provided.

The AFM considers that there is a realistic possibility that borrowers acting in bad faith will use crowdfunding to raise money and then misappropriate the money after receipt, also in view of the relatively limited screening process compared to that of the banking system. If borrowers misappropriate the funds, the investors will lose all or part of their investment. The platforms do not currently exchange information on fraud cases and are not linked to a system that registers those who commit fraud.

Fraud by the platform

The platform could also act fraudulently itself. It could fail to pass funds from lenders to borrowers or vice versa, or place fictitious projects on the platform in order to fraudulently raise money from lenders. The result of fraud by a platform is that the borrowers do not receive the money they need and the lenders potentially lose their money and/or not receive their return.

A growing market, which has fewer safeguards than a mature market, is more accessible for fraudulent platforms. The online nature makes it more likely that fictitious projects will be posted. The consequences for the reputation of and confidence in the crowdfunding market would be serious.

4.2. High risk, AFM action is not possible and/or does not lead to decreased risk

Tradability/liquidity (no secondary market)

Investments in equity-based crowdfunding are in principle tradable. Loan-based crowdfunding involves finance, usually in the form of annuity loans, and tradability is not in itself an objective. Since the market presently involves a relatively small number of investors, there are also no parties maintaining a secondary market. This means that the lenders have to hold their financial instruments or loans until maturity. This may cause problems if at some time the lender's financial situation changes.

The AFM expects to see the liquidity of equity-based crowdfunding improve during the growth market phase. We expect that the platforms will facilitate tradability themselves or that trading platforms will appear in the market to meet this need.

4.3. Low risk, AFM action is possible and may lead to decreased risk

Systemic risk

Once the crowdfunding market grows and becomes more interrelated with financial institutions, problems in the crowdfunding market could spill over to financial institutions and even to the real economy, as is already the case for the banks. Issues in the crowdfunding market could in that case lead to a wider crisis of confidence.

This risk will not manifest until the crowdfunding sector has become significantly larger than it is today. The AFM accordingly considers this risk to be low at this time.

Fraud by the lender

Lenders could use crowdfunding platforms for the purpose of money laundering. In practice, the possibility of investing cash money in a crowdfunding platform is limited, since the lender has to have a Dutch bank account and the platforms work exclusively with bank transfers. Regulated banks are obliged to identify their customers. The AFM considers this risk to be low at this time.

4.4. Low risk, AFM action is not possible and/or does not mitigate risk

Unfavourable contract conditions

The conditions of crowdfunding contracts are formulated by the platforms. There is a chance that the conditions are formulated in such a way as to be disadvantageous for lenders and/or borrowers. One example is if a platform imposes unreasonably high charges and does not provide clear information on this in advance. As long as there is adequate transparency with respect to the contract conditions and lenders and borrowers have a choice whether to accept certain conditions or not, this is a low risk.

5. Preconditions for sustainable and responsible crowdfunding

For each risk we have prioritised, we have analysed the preconditions necessary to manage the risk in question and to accommodate a sustainable and responsible crowdfunding sector. This concerns the risks classified as high in Section 4 and for which AFM action is possible and can mitigate the risk. The preconditions are in line with the mission and objectives of the AFM. The sector is primarily responsible for meeting these preconditions and the AFM supervises their implementation.

The section explains the requirements which (the players and) the market must satisfy with regard to each precondition in order to allow crowdfunding to grow into a sustainable and properly functioning market. In the mature market, the service will be offered to a wide public, there will be sufficient projects, and the active platforms will be fully-fledged players in the market. A mature market has platforms that are professional, ethical and focused on continuity, offers a minimum level of transparency and of protection for lenders and borrowers, and involves cooperation and exchange of information between the platforms. These preconditions will ensure that the risks prioritised by the AFM are acceptable or mitigated to a level acceptable to the AFM.

The table below shows how the various preconditions will contribute to mitigating the 6 prioritised risks (high risk, and AFM action is possible and can mitigate the risk).

	Dysfunction of the platform	Default by borrower	Investment unsuitable (for lender)	Funding not unsuitbale (for borrower)	Fraud by platform	Risk of fraud by borrower
Platforms are professional, ethical and focused on continuity	X	X			X	X
There is a minimum level of transparency		X	X	X	X	X
There is a minimum level of protection for lenders			X			X
There is a minimum level of protection for borrowers	X	X		X		
The crowdfunding sector as a whole meets its responsibilities (or there is cooperation and exchange of information between platforms)		X			X	X

Precondition 1: Platforms are professional, ethical and focused on continuity

Addresses the risks: 'dysfunction of the platform', 'borrower defaults', 'fraud by the borrower' and 'fraud by the platform'.

Since the platforms have a pivotal role in the crowdfunding process, they have a central role in the mitigation of the above-mentioned risks and their consequences. Professionalism, ethical conduct and a forward-looking attitude by the platforms are therefore crucial for a sustainable and responsible crowdfunding sector. The following items are important here.

There needs to be sufficient safeguards of the continuity of the platform to address the risk that the platform will fail to function. The platforms need to conduct their business ethically and in a professional manner to address the risks of 'dysfunction of the platform' and 'fraud by the platform'. The ICT systems need to be of high quality and be adequately monitored and secured. The administration of the rights and obligations of the lenders and borrowers needs to be safeguarded in the event of bankruptcy of the platform. We expect the platforms to structure their business so that payments between borrowers and lenders can continue even if the platform itself cannot fulfil its role, either temporarily or permanently.

The business model has to be structured such that the platform continually has adequate cash flow to continue to offer its services (not only initial matching costs, also ongoing administration costs), even when fewer new projects are being offered on the platform. The business model and the conduct of the business also need to be structured such that the platform selects good quality projects and does not have an incentive to accept projects of lesser quality because of the initial income that these will provide.

Lastly, a platform will need to have a good and ongoing screening procedure. The screening procedure needs to focus on detection of fraud, and the risk assessment of the feasibility of projects and the creditworthiness of the borrower both at the outset and during the life of the project. This will reduce the chance of funded projects failing and of borrowers committing fraud, being unable to meet their payment obligations or going bankrupt.

Precondition 2: There is a minimum level of transparency

Addresses the risks: 'borrower defaults', 'investment is unsuitable (for the lender)', 'funding is unsuitable(for the borrower)', 'fraud by the borrower' and 'fraud by the platform'.

Transparency is important because it enables those participating in a financial activity to make suitable choices. In a mature market, borrowers and platforms will provide information that actually leads to understanding by the recipient (borrowers and lenders). This transparency will reduce the risk of inappropriate funding or investment. In addition, the risk of fraud and the risk that the borrower will default will be reduced, since transparency will firstly lead to better thought-out business cases and secondly will have a deterrent effect on parties that intend to act fraudulently. The following items are important here.

The information provided needs to be sufficient, accurate, balanced and comprehensible, so that the recipients can make a well-considered decision. This information needs to be manageable for recipients and the provision of information should not be unreasonably expensive for the borrowers and the platforms. For this reason, the AFM speaks of a *minimum level* of transparency.

A platform provides information on the benefits and disadvantages of crowdfunding. The platform needs to continually make the participants aware of the risks associated with making an investment on its website and in its advertising.

The crowdfunding platform needs to be transparent regarding its services. The platform should provide information on what is included in the service, the conditions that apply to the service and costs of the service, what information is and is not provided and what the screening procedure includes and what it does not.

Information should be provided on the implications of each specific crowdfunding contract. This should make lenders aware of the conditions and risks of investing via crowdfunding in each specific project and the conditions and risks of the crowdfunding contract. This could include a risk profile of the project and the borrower and the repayment obligations, but also for instance the possibilities and/or restrictions that apply with regard to adjustment of the funding during the contract term.

Precondition 3: There is a minimum level of protection for lenders

Addresses the risks: ‘investment is unsuitable (for the lender)’ and ‘fraud by the borrower’.

Transparency can prevent lenders making inappropriate investments by means of crowdfunding. Education of investors focusing on the specific risks of crowdfunding can prevent lenders entering into a contract that is not appropriate. Not all lenders are able to make a good estimation of the consequences of an investment on the basis of information. Transparency alone will therefore not be enough to limit foreseeable disappointments for lenders. The following items are important here.

Since the platforms do not provide advice to lenders, the duty of care that applies to advisory services does not apply to crowdfunding. In the mature market phase, lenders wishing to take advice will be able to engage the services of specific crowdfunding advisers to guide them. The platforms will also make a test available to lenders enabling them to check whether (independently) investing in a specific project through crowdfunding is suitable for them. This will address the risk of lenders making unsuitable investments.

Financial compensation for lenders by the platforms in the event of losses due to fraud on the part of borrowers will be an element of a minimum level of protection for lenders. Surely the risk of fraud by borrowers cannot be adequately mitigated by transparency alone. The platforms bear the primary responsibility for the detection of fraud. Unlike the platforms, the lenders cannot be expected to have the resources or (possibly) the information needed to detect fraud on the part of the borrowers. Compensation would not be appropriate for losses due to other reasons, since such events are inherent in investing. Compensation in such cases could lead to moral hazard: the lender will be less critical in his choice of investment because he knows there is a financial safety net.

Precondition 4: There is a minimum level of protection for borrowers

Addresses the risks: 'funding unsuitable (for the borrower)', 'borrower defaults' and 'dysfunction of the platform'.

The importance of this precondition concerns addressing the risk to which the entire sector is exposed if the funding is unsuitable for the borrower. An example of unsuitable funding would be a start-up that receives an annuity loan at an early stage while its cash flow is limited and thereby has a repayment obligation that is too onerous. If this risk occurs, it has a direct effect on the borrower's creditworthiness and thus an indirect effect on the lender's investment. There may also be a negative effect on the reputation of the platform. The possibility that funding will not be appropriate is substantial, since there is no natural incentive for the platform to ensure otherwise, as it does not incur risk. The crowd, which does incur risk, is not in a position to perform such assessment. The following items are important here.

In the mature market phase the platform will focus attention on borrower protection by screening the borrower's business case and payment capacity and adjust its own acceptance policy accordingly. This does not only concern the amount of the funding, the type of funding is also important. The sector will moreover feature specific crowdfunding advisers that can advise borrowers in the planning of their funding.

The platform will also therefore have a suitability test that will make the borrower aware of what is suitable in view of his individual profile. Here, too, attention will be paid to the amount and type of the funding.

Precondition 5: There is cooperation and exchange of information between platforms

Addresses all the risks: 'borrower defaults', 'fraud by the platform' and 'fraud by the borrower'.

Cooperation and exchange of information between platforms can accelerate and strengthen the perpetuation of the preconditions described above. Platforms can help each other to remain alert, exchange information where necessary and work together in order to achieve and ensure a high level of quality across the sector. The following items are important here.

The platforms will exchange information among themselves regarding potential incidents of fraud by lenders and other platforms in order to prevent borrowers with fraudulent intentions from moving from one platform to another. They will also notify the AFM. An industry association could fulfil a facilitative role in this respect. The platforms will also provide a certain degree of standardisation of information and processes.

6. Analysis of necessary steps

This section compares the present situation in the crowdfunding market against the preconditions for a mature market as described in Section 5. This shows the steps needed for growth towards a properly functioning and sustainable crowdfunding market. These include further professionalisation, screening, information provision, suitability safeguards and information exchange within the sector. Section 6.2 describes the current statutory framework and considers how this could be adjusted to encourage the necessary steps. We also list some of the legal difficulties observable in the current framework, and show that the current regimes still fall short of the desired intensity of supervision.

6.1. Present situation compared to the preconditions

The AFM has not been able to carry out a detailed review of the performance of the platforms and the sector as a whole with respect to the preconditions we have mentioned. One important reason for this is that the data available on the performance of the sector are as yet scanty. The following – general – observations on the daily state of affairs at the platforms are mainly based on the information gained during the granting of licences (since 2012) in recent years and discussions in the context of this review.

The crowdfunding market is growing and has now reached a certain level of professionalism; however, there is still room for improvement, certainly in view of the expected growth of the market. Levels of professionalism vary between the various active platforms.

There is potential for improvement in the following areas, which can be seen as preconditions for a properly functioning market:

Precondition 1: Platforms are professional, ethical and focused on continuity

The earnings models of the platforms currently appear to be insufficiently focused on quality in the long term (for instance, with respect to continuity of administration and the interests of the investors). The screening procedures vary widely, also in terms of intensity. Screening procedures appear to focus only to a limited extent on the borrower's ability to repay.

Precondition 2: There is a minimum level of transparency

The current information provision by the platforms on their websites regarding the risks and the screening procedure varies from one platform to another. This means that comparability is limited. Moreover, it is mostly unknown to lenders what the default percentage is for each platform, meaning that lenders still cannot determine the net return.

Precondition 3: There is a minimum level of protection for lenders

The platforms currently focus more on borrowers than on lenders. This is shown for instance by the fact that the contracts in which the services of the platform are established are mainly drawn up between the platform and the borrower as the counterparty. This is also shown by the design of the earnings model. The platform depends mainly on the borrower for its revenue, who pays a one-off success fee and an ongoing fee to the platform. It is currently not always made clear to the lenders whether and to what extent the investment is really appropriate for them. Crowdfunding in its present form would seem to be suitable mainly for more experienced investors who can estimate and/or cope with potential financial losses.

Precondition 4: There is a minimum level of protection for borrowers

We have seen that the current types of funding are not always appropriate to the borrower's situation. Annuity loans are being provided to start-up companies. More generally, one may question the extent to which a small business is able to assess the suitability of funding properly.

Precondition 5: There is cooperation and exchange of information between platforms

The sector is still rather new, and mutual cooperation has the potential to grow where this is useful. The AFM sees an important role for an industry association with respect to the sharing of information about, for instance, fraudulent borrowers, the standardisation of information and the professionalisation of the sector in general.

6.2. Problem areas in the current statutory framework

In principle, the sector is ready to take the steps towards a situation in which the preconditions stated will be met. Legislation and regulation is an important instrument here, which will encourage the sector to move in the desired direction and establish certain minimum levels. This legislation and regulation is also the means whereby the AFM as the supervisor is able to actively carry out its supervision and take measures where needed. The following paragraph shows the extent to which this is currently possible. The current statutory framework for crowdfunding is based on existing legislation and regulation. There are four possible licensing or exemption regimes under which a platform can fall. In addition, the AFM has attached a number of specific provisions to each licence or exemption of platforms[7] with the aim of protecting private investors, such as:

- The platform should prevent investors investing more than 100 times;
- Maximum total investment of €40,000 per platform for loan-based crowdfunding;
- Maximum total investment of €20,000 per platform for equity-based crowdfunding;
- The platform must continually advise lenders to invest a sensible proportion of their assets;
- The platform must continually advise lenders to spread their investments across different projects;
- The platform must continually make lenders aware of the risks associated with a crowdfunding investment on its website and in its advertising;
- The platform must ensure that communications by the borrower regarding projects on the platform are at all times correct, clear and not misleading;
- The platform must have an established policy as its basis for assessing applications for loans by companies or borrowers;
- The platform must carry out a risk assessment for loans and investments, including an assessment of the borrower's capacity to repay and payment behaviour;
- The platform must ensure that the borrower applies different interest rates that correspond to different risk classifications;
- The platform must ensure that the borrower provides adequate background information on investments on the basis of which the lender can make an informed investment decision; and
- The platform must ensure that all payment flows are conducted through a trust account or a payment service provider.

The AFM has identified a number of statutory problems in the 4 crowdfunding regimes, which are shown in the table below:

[7] Pursuant to § 1:102 (2) to 1:105 (1)(c) Wft.

Problem areas: / Type of regime and description	Potential contravention of § 3:5 Wft by borrower	Potential contravention of § 2:60 Wft by lender	Potential contravention of ban on inducements[8] by	Potential contravention of ban on rewards[9] by the platform	Potential provision of
Exemption for intermediation in callable funds[11] This type relates to the funding of SMEs (both existing and start-up) in the form of loans funded by private lenders (consumers)	X				X
Licence to intermediate in loans[12] This type concerns the provision of finance to consumers in the form of loans funded by private lenders (consumers), whereby the platform acts as intermediary	X	X		X	X
Licence for the offering of loans[13] This type concerns the provision of finance to consumers in the form of loans funded by private lenders (consumers), whereby the platform acts as the credit provider					X
Licence to operate an investment firm[14] This type relates to the funding of start-up SMEs in the form of shares or bonds issued to private lenders (consumers)			X		X

Generally, we take the view that the current statutory framework[15] does not set adequate requirements for the sector with respect to meeting the preconditions. In any case, we also currently

[8] Contravention of § 168a BGfo.
[9] Contravention of § 4:74 Wft.
[10] Contravention of § 2:3 (a) Wft.
[11] This regime is not a licensing regime and has virtually no ongoing statutory requirements. Only the properness of policymakers has to be beyond doubt at all times.
[12] Under this regime, the requirements in relation to properness, suitability and structural requirements for the business conduct appropriate to an intermediary must be met at all times.
[13] Under this regime, the requirements in relation to properness, suitability and structural requirements for the business conduct appropriate to a provider must be met at all times.
[14] Under this regime, the requirements in relation to properness and suitability, the prudential requirements and structural requirements for the business conduct appropriate to an investment firm must be met at all times.
[15] Not all equity-based platforms in the Netherlands are subject to supervision by the AFM. Some platforms are structured as a kind of notice board where the services provided by the platform for the funding of projects is limited to the introduction of clients. This type of activity is exempt from the requirement to obtain a licence to operate an investment firm. There are also platforms where lenders invest collectively in a legal entity that holds shares in the borrower, which is usually a start-up company. This type of funding currently does not within the scope of the Wft, but the AFM intends to review this position in due course and has already been in contact with the parties concerned.

see various legal problems with respect to the above-mentioned regimes that prevent the supervisor from exercising its duties optimally. These actual and legal problems under each regime are listed below (with a further legal explanation in the appendix to this report):

The current exemption regime for intermediation in callable funds is too light

This regime has virtually no ongoing supervisory requirements and does not adequately encourage the platforms to professionalise their services, provide a minimum level of transparency and a minimum level of protection for both lenders and borrowers. While the AFM can attach ongoing provisions to an exemption, supervision of compliance with these provisions is difficult because no statutory requirements are involved.

Other legal problems currently include: borrowers may raise callable funds (a contravention of § 3:5 Wft) since this can occur on a professional or commercial basis and the platform may provide payment services (contravention of § 2:3(a) Wft).

The current licensing regime for intermediation in loans is not appropriate

Although this regime does include ongoing supervisory requirements with respect to matters such as suitability and business conduct, the regime does not set adequate requirements with regard to a minimum level of protection for lenders and borrowers (for instance with respect to dysfunction of the platform, default on payment obligations and the appropriateness of the investment).

In addition, the situation is strictly speaking not one of intermediation, since the lenders are mostly consumers and not professional providers[16]. Lenders may offer loans directly (contravention of § 2:60 Wft), borrower may raise callable funds (contravention of § 3:5 Wft), the ban on rewards applies (§ 4:74 Wft) and the platform may provide payment services (contravention of § 2:3(a) Wft).

The current licensing regime for the provision of loans is appropriate for the protection of the borrower, but does not take account of protection for the lender

[16] The definition of intermediation (in loans) in § 1:1(b) Wft reads as follows: all activities carried out in the pursuit of a profession or business focused on establishing, as a broker, a contract regarding credit between a consumer and a provider, or on assisting in the administration and performance of such a contract.

This regime is concerned with the protection of the borrower, but has no provision for a minimum level of protection for the lender. Although the AFM has set provisions to protect the lender, these have no statutory status.

The regime also entails a legal problem in that the platform may be providing payment services (contravention of § 2:3(a) Wft).

The current licensing regime for the transmission of orders in financial instruments is appropriate, but there is a potential conflict with the ban on inducements for investment firms

This regime focuses on the protection of the lender and under this regime a platform must meet onerous requirements regarding business conduct and solvency. Most of the preconditions are met.[17]

The legal problem here is that the ban on inducements for investment firms may apply (§ 168(a) BGfo). Whether this is the case depends on how the services provided by the platform are seen. The line being followed by ESMA is that this concerns transmission of orders on behalf of the lender. If this interpretation is applied, the ban on inducements would in principle apply and that would mean that the fee paid by the lender to the platform would not be permitted. Another point of view is that the situation concerns the placement of financial instruments on the borrower's behalf (without guarantee). In this case the platform would be exempt from the ban on inducements, and the payment received by the platform from the borrower would be permitted. The AFM is still considering its position on this point.

In addition, it may still be the case that the platform may be providing payment services (contravention of § 2:3(a) Wft).

[17] With the exception of precondition 4.

7. Recommendations

In order to create good preconditions for a sustainable sector, the AFM has a number of recommendations to the legislator and the participants in the sector based on the analysis above. In legal terms, the AFM recommends that over time a transition be made from four separate regimes to two statutory regimes: one for loan-based crowdfunding and one for equity-based crowdfunding. We also have recommendations for the short and the medium to longer term, which will already apply in the first half of 2015. Lastly, we have a number of recommendations to the sector, among others in the areas of education, standardisation, information exchange and cooperation. A branch association has an important part to play in this.

7.1. Recommendations to the legislator: changes to the statutory framework

Our recommendations for the short and the medium to longer terms (the growth phase) and for the long term are listed below. The recommendations for the short and the medium to longer terms are more detailed than those for the long term (the mature market phase), and we recommend that they be implemented in the first half of 2015. The recommendations for the long term can be elaborated further. Implementation will be relevant at such time as the sector is expected to grow into a mature situation on the basis of certain indicators yet to be established. Details of the legal implications of the recommendations listed below are given in Appendix 1.

Short term (the current market)

1. The AFM recommends that the legal problems it has identified in the existing regimes for crowdfunding regimes be resolved in the short term.

Medium to longer term (growth market phase)

2. The AFM recommends for the medium to longer term that a move be made from four to three supervisory regimes, with the intermediation regime no longer seen as appropriate in the context of crowdfunding.

3. The AFM recommends that the exemption regime for intermediation in callable funds be strengthened in the medium to longer term by declaring additional ongoing statutory obligations to be applicable, such as requirements in relation to ethical and controlled business conduct and the appropriateness of directors.

4. The AFM recommends that the provisions in use until now with respect to the admission of platforms to the market be published on its website, thus providing more clarity regarding policy.

5. The AFM recommends that a number of provisions[18] relating to consumer protection and currently experienced as a barrier to growth be changed while retaining a minimum level of protection, such as the withdrawal of the maximum limit of investing 100 times. In addition, we want to make it possible for wealthier consumers to invest more through the introduction of a suitability test for lenders. This test would make it possible to invest more than the current limit per platform per individual of €20,000 for equity-based crowdfunding, €40,000 for loan-based crowdfunding or investing in 100 projects. The test would be conducted by the platform when these limits are reached.

6. In the growth market phase, the AFM will use its powers to set further provisions[19] to further encourage professionalism if this becomes necessary due to developments in the sector. We will consult further with the market on this point.

7. The AFM recommends that the market be monitored using certain growth factors as yet to be established, possibly in line with the indicators described in Section 2.4, in order to determine when the market is reaching the mature phase in a timely manner. When this happens, the AFM can propose to the legislators to further adjust the regimes in line with the long-term recommendation described below. The recommendations for the mature market phase are somewhat more abstract, in view of the uncertainties regarding the direction of future growth.

Long term (mature market phase)

8. The AFM recommends that there be two (new) statutory regimes for the mature market in which the statutory requirements reflect the previously mentioned preconditions. A new regime would enable the AFM to work on requirements designed specifically for loan-based crowdfunding and equity-based crowdfunding. In these regimes, lenders and borrowers enjoy a certain level of protection and prudential requirements apply. It is important to note that the AFM will advise the legislator to provide a statutory basis for the provisions the AFM has set, and will continue to set in future. With the introduction of this regime, the platforms that are

[18] See Appendix 1 for further examples.
[19] See the suggestions for provisions in Appendix 1.

currently operating without a licence or an exemption from the AFM (and who engage in lending and investing) will fall within the scope of the crowdfunding regime.

7.2. Recommendations to the sector

We advise the sector to address the following points of attention that are separate from the statutory framework (and which are therefore not subject to active supervision) but which are nonetheless important for increasing the professionalism and sustainability of the sector. Self-regulation can play an important part.

1. The AFM calls on the sector and its participants to exchange information with each other and seek to cooperate with each other regarding best practices and quality norms.
2. The AFM expects the sector and its participants to play a part in designing initiatives with respect to education to raise awareness amongst both lenders and borrowers.
3. The AFM calls on the sector and its participants to play an active part in creating opportunities for lenders and borrowers to obtain support and advice on investing in the case of the lenders and the financial aspects of crowdfunding campaigns for the borrowers. This need could also be addressed by (consultancy) parties who are not yet active in the sector.
4. The AFM calls on the sector and its participants to play a part in standardising information and processes with respect to screening (designed to detect fraud) and the risk assessment with respect to the feasibility of projects.
5. The AFM calls on the sector and its participants to mutually exchange information on cases of fraud and to continue to report such instances to the supervisor. We also call on the sector and its participants to think about potential ways of providing a collective or individual compensation scheme for instances of fraud.

We see an opportunity for a branch association that will in cooperation with the sector address the items of attention listed above in order to attain and safeguard higher quality standards across the sector. The industry association ‘Nederland Crowdfunding’ has recently been incorporated. The AFM welcomes this development.

Appendices

- Appendix 1: Detailed recommendations regarding the statutory framework
- Appendix 2: Sources of information

Appendix 1: Detailed recommendations regarding the statutory framework

For the growth market phase, the AFM proposes a number of practical changes to the current statutory framework, including the addition of a number of specific provisions. We recommend that the recommendations for the short and the medium to longer terms be adopted in the first half of 2015 and that the recommendations for the long term be further elaborated as soon as it is established that the sector is approaching the mature market phase on the basis of indicators to be established in due course.

Short term (the current market)

1. The AFM recommends in the short term that the legal difficulties in the current crowdfunding regimes be resolved or clarified with respect to the correct interpretation of the Financial Supervision Act (Wft). There are currently four 4 regimes: 1) licence to provide investment services (§2:99 Wft); 2) licence to intermediate in loans (§2:83 Wft), 3) licence to offer credit (§2:63 Wft) and 4) exemption for intermediation in callable funds (§4:3(4) Wft, hereinafter referred to as 'the Exemption Regime').

   The AFM has formulated potential solutions for these difficulties that are in line with the AFM's desire to change the supervisory framework into a framework more specific to crowdfunding in the long term. We see the following as potential solutions to the legal difficulties.

   a) *Potential contravention*[20] *of §2:3(a) Wft (prohibition on the offering of payment services).* This issue affects all the regimes.

      We need clarity regarding the question of whether the PSD[21] does indeed apply, or whether platforms fall within the scope of §2:3(a) Wft and if so, whether all platforms accordingly have to be included as exempt payment services providers by DNB in its register. Depending on the structure of crowdfunding platforms, there may be an overlap with the scope of §2:3(a) (provision of payment services). If this is the case, platforms fall within the scope of

[20] Reference here to 'contravention' is intended to mean that there is the potential for contravention; we have not looked at individual cases to establish whether there has actually been any contravention of legislation and regulation.

[21] Directive on Payment Services (PSD), 2007/64/EC.

§2:3(a) Wft. If the platform in question handles transfers of more than 3 million per month, it has to apply for a separate licence to DNB as a payment services provider.

b) *Potential contravention of §3:5 Wft (prohibition on raising callable funds) by the borrower.* This issue mainly affects the Exemption Regime.

The AFM and DNB recognise the importance of establishing whether the users of crowdfunding platforms over which the AFM exercises supervision pursuant to the Wft, and who in the exercise of their business (may) act in contravention of the prohibition in §3:5 Wft, can be exempted from this prohibition, and if so, to provide for this. Depending on the structure of crowdfunding platforms, there may be an overlap with the scope of §3:5 (raising callable funds). In this case an exemption should be drawn up with reference to §3:5 Wft on the basis of which a start-up or existing SME is permitted (professionally) to raise funds from the public via a regulated platform.

c) *Potential contravention of §2:60 Wft (prohibition on the offering of credit) by lenders*[22] *and contravention of the ban on rewards in §4:74 Wft.*

The latter issue affects intermediaries in loans (§2:80 Wft)

An additional difficulty in the case of intermediaries is that there may be doubts as to whether there is a situation of 'intermediation' now that professional providers do not generally engage in intermediation. Platforms that currently have a licence to intermediate need to extend their licence to include the provision of credit. This would solve the above-mentioned problems at a stroke. For this, the AFM needs to change its previous qualification of the activities concerned. In the legal text of §2:60 Wft the term provision also includes the management of agreements. It may be possible to qualify certain 'intermediaries' as providers. Such providers do have to actually be the counterparty to the borrower (the MvTto §2:60 Wft assumes the civil-law definition of the term 'offering'). Companies that as lenders receive interest and repayments from a borrower can make use of §3 of the Exemption Regulation under the Wft, so that there is no separate licensing obligation as a credit provider. If this interpretation cannot be adopted, there needs to be an amendment to the Wft.

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[22] This will generally be the case if the lender makes more than 100 loans with a total value of more than €40,000.

d) *Potential contravention of the ban on inducements (§168(a) Bgfo) by the platform in the case of transmission of orders in financial instruments.*

The ban on inducements affects the earnings model of the platform, since the borrower is normally asked to pay a success fee and an ongoing fee. A possible solution envisaged by the AFM would be to interpret the service provided by the platform for the borrower as (the investment service named) a placement (of financial instruments)[23]. This in the sense that the platform receives a fee from the issuer of financial instruments (the borrower) for the placement of the financial instruments with the lender at the initiative of the borrower (here: placement without placement guarantee). If this interpretation can be allowed, this would enable an appeal for exemption from the ban on inducements (§168a(1)(c) Bgfo).

Medium to longer term (growth market phase)

2. The AFM proposes that the four supervisory regimes be reduced to three, with the regime applying to intermediation in credit being abolished with respect to crowdfunding activities in view of the legal difficulties and the fact that the regime for the offering of credit is more appropriate to crowdfunding in the form of loans. This would leave the provision of investment services, the offering of credit, and intermediation in callable funds (the Exemption Regime).

3. The AFM proposes that more ongoing statutory obligations be added to the Exemption Regime in the medium to longer term in order to bring this regime more in line with the other regimes, especially with regard to lender protection. The Exemption Regime is clearly too lenient in comparison with the other regimes. We envisage a solution along the following lines. In addition to §2 and §3 Bgfo, certain additional requirements need to be added in the areas of properness, business conduct and (possibly) certain prudential requirements.

4. The AFM proposes that it publish the provisions it has used until now regarding the admission of platforms to the market on its website, thus providing more clarity with respect to its policy. Because the provisions associated with a licence or exemption may in principle not be shown

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[23] §1:1 Wft, investment service mentioned under (f).

in an AFM register, the AFM wishes to request permission from the legislator to publish these as policy.

5. The AFM proposes that a number of provisions regarding consumer protection that are now experienced as an obstacle to growth be amended or withdrawn. We envisage the following potential solutions:
   - The provision of an upper limit of 100 investments for consumers should be removed. It has emerged that this number is too low, and is an obstacle to proper diversification of risk.
   - The provision of an upper limit of €40,000 to be invested by consumers for loan-based platforms should be changed. A consumer may invest more than €40,000 per platform if the platform conducts a suitability test for the lender to establish whether a person has sufficient wealth to invest more.
   - The provision of an upper limit of €20,000 to be invested by consumers for equity-based platforms should be changed. A consumer may invest more than €20,000 per platform if the platform conducts a suitability test for the lender to establish whether a person has sufficient wealth to invest more.

6. The AFM proposes that the market be monitored until it reaches the mature phase so that a clear idea can be obtained regarding the timespan within which the AFM can put forward its proposal for an entirely new statutory regime for crowdfunding. We will establish the information the AFM wishes to receive on a regular basis in close consultation with market parties so that we can monitor the growth of the market properly. To be able to monitor the growth of the sector, firstly good indicators need to be established (for instance in line with Section 2.4) and secondly sufficient information needs to be available in order to establish which phase the market is in. We propose that we obtain information on the development of the crowdfunding sector as follows:
   - The AFM will receive information on the admission of new parties to the crowdfunding market.
   - The AFM will receive information from regulated platforms as part of the ongoing supervision of these institutions.

- The AFM will enter into agreements with the regulated platforms regarding the quantitative data it needs in order to monitor the growth of the market. We refer here to numbers of projects, numbers of lenders, general features of borrowers, amounts raised, project failures and types of funding used by projects. This information will be supplemented with information on the financial situation of the platforms and their related parties.
- The AFM will consult regularly with the crowdfunding industry association to discuss market developments.
- In its regular consultations as part of its ongoing supervision of financial institutions such as banks, pension funds, insurers and industry associations, the AFM will devote attention to the attitude of these financial institutions regarding crowdfunding.
- Through its AFM *Consument&Panel*, the AFM can measure the involvement and opinion of lenders on an annual basis. These annual measurements can then be analysed and compared. This information will be in addition to the information from the platforms themselves (under 1c).

7. In the meantime, the AFM will use its powers to set provisions to reflect changes in the crowdfunding market so that certain risks can be proportionally addressed at platforms subject to regulation by the AFM. The AFM in any case envisages the following provisions:

- The platform must ensure that proper administration and financial settlement of projects is guaranteed in a situation in which the platform ceases to operate (for instance due to bankruptcy).
- The platform may formalise risk diversification by retail investors by making an automatic investment profile possible, as long as this new service meets the requirements for asset management pursuant to the Wft.
- The platform must explicitly state its default percentage on its website and include this in the information overviews of investors.
- The platform must provide transparency regarding its screening methodology on its website.
- The platform must make a (standard) information document available on its website if investments are made in companies.

- The platform must ensure that the type of funding is appropriate in cases involving start-up finance.
- After the funding is provided, the platform must obtain ongoing financial information from the borrower and provide this to the lenders.

First of all, we will of course discuss these provisions with market parties and the industry association so that the requirements correspond to normal business operation.

Long term (mature market phase)

8. In the mature market phase, the AFM proposes that there be a new statutory regime in which the statutory requirements reflect the above-mentioned preconditions. This new regime could consist of two sub-regimes, a loan-based crowdfunding regime and an equity-based crowdfunding regime. These regimes should ensure that lenders and borrowers enjoy a certain level of protection and that prudential requirements apply to the platforms. Such a regime will set stricter requirements for business conduct and will also entail prudential requirements. It is important to note that the provisions that the AFM has set, and to the extent applicable will continue to set in future, should as far as possible be given a legal basis. In the mature phase, the market must be able to achieve the preconditions set by the legislator and the AFM. Further elaboration of these regimes will take place in due course, after we have consulted extensively with the FCA in order to learn from its experience. This will assist us in the development of a new statutory crowdfunding regime. It should be noted that the FCA applies a regime whereby no distinction is made any longer between the customer(s) for the loan. Consumers and SMEs are essentially treated as being the same ('the lender'). In principle, we would prefer to make a certain differentiation regarding the term 'borrower'.

Appendix 2: Basis for the review

The report is mainly based on qualitative research, partly because there is little substantial data currently available.

The AFM used various sources for its review, consisting of:

Public reports/documents (not exhaustive):

- "*OICV-IOSCO "Crowd-funding: An Infant Industry Growing Fast, Staff Working Paper of the IOSCO Research Department*", authors: Eleanor Kirby and Shane Worner, 2014;
- "*Crowd Investing in the Netherlands: Market Analysis Securities Regulation and Policy Options*", author: Armin Schwienbacher, 14 November 2014;
- "*Beantwoording kamervragen crowdfunding*" (Answers to Parliamentary Questions on Crowdfunding), Minister of Finance J.R.V.A. Dijsselbloem, 25 April 2014; and
- "*EC Communication: Unleashing the Potential of Crowdfunding in the European Union*", 27 March 2014.

Unpublished reports/documents (not exhaustive) from institutions including:

- ESMA;
- EBA; and
- AFM

Consultations with:

- 8 crowdfunding platforms;
- ESMA;
- EBA;
- EC; and
- various foreign supervisors

Websites:

The websites of various crowdfunding platforms have been reviewed by the AFM.

Online survey of lenders:

The AFM *Consument&Panel* is a consumer panel operated by the AFM. Through our online consumer panel, we approached 128 consumers who invest or lend money through crowdfunding or intend to do so in future. The AFM *Consument&Panel* is not representative of the average Dutch citizen, but the results do provide indications regarding the attitude of consumers to crowdfunding.