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New EU Crowdfunding Rules and the Bulgarian Crowdfunding Landscape

A new EU crowdfunding regulation¹, which was adopted at the end of 2020, introduced common requirements for crowdfunding service providers in all Member States and will begin to apply as of 10 November this year. In the meantime, Member States were supposed to undertake legislative steps to exclude crowdfunding service providers from the scope of their internal laws transposing the MiFID II requirements and thus avoid a situation where the same activity would be subject to multiple authorizations within the Union².

What is a crowdfunding service and a crowdfunding service provider as per the new EU regulation and what are the main related requirements?

A crowdfunding service means the matching of business funding interests of investors and project owners through the use of a crowdfunding platform and which consists of any of the following activities:

- the facilitation of granting of loans;
- the placing without a firm commitment basis, as referred to in the MiFID II Directive, of transferable securities³ and admitted instruments for crowdfunding purposes⁴ issued by project owners or a special purpose vehicle, and the reception and transmission of client orders in relation to such securities/instruments.

A crowdfunding service provider in turn is a legal entity providing crowdfunding services as an operator and manager of the crowdfunding platform which is a publicly accessible internet-based information system. In other words, the crowdfunding service provider as per the new EU regulation should act as a key matching component between investors and projects and link them via its online platform⁵. Such providers shall not invest in projects and respectively shall not be credited by investors.

However, crowdfunding service providers may offer individual portfolio management of loans. An individual portfolio management of loans is the allocation by the crowdfunding service provider of certain funds of an investor to projects on its crowdfunding platform on the basis of an individual mandate given by the investor. Each individual mandate shall specify the parameters for providing the service, which shall include certain mandatory criteria that every loan in the portfolio will have to

¹ Regulation (EU) 2020/1503 of the European Parliament and of the Council of 7 October 2020 on European crowdfunding service providers for business, and amending Regulation (EU) 2017/1129 and Directive (EU) 2019/1937.

² The process is still ongoing despite the fact that the time limit for such legislative steps by Member States expired on 10 May 2021 – by early June only Ireland, Cyprus and Hungary have completed the necessary changes.

³ Such as (a) shares in companies and other equivalent securities; (b) bonds or other forms of securitised debt; (c) other securities giving the right to acquire or sell any such transferable securities or giving rise to a cash settlement determined by reference to transferable securities, currencies, interest rates or yields, commodities or other indices or measures.

⁴ Admitted instruments for crowdfunding purposes means, in respect of each Member State, shares of a private limited liability company that are not subject to restrictions that would effectively prevent them from being transferred, including restrictions to the way in which those shares are offered or advertised to the public.

⁵ The new EU regulation does not apply to crowdfunding offers exceeding EUR 5,000,000, over a period of 12 months by a particular project owner.

PETERKA PARTNERS

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comply with, e.g., the minimum and maximum interest rate payable or the minimum and maximum maturity date of any loan facilitated for the investor.

In terms of authorization, crowdfunding services shall only be provided by EU-established legal entities which have been duly authorized by the competent authority of the Member State where they are established. Crowdfunding service providers authorized by one Member State will be able to operate in other Member States without the need for additional authorization. Such providers will though have to comply with a notification procedure under the new regulation. Moreover, companies which provide cross-border crowdfunding services will not be obliged to be physically present on the territory of the other Member States where they also operate. The competent authorities will notify, for all granted authorizations, the European Securities and Markets Authority (ESMA) which, in turn, shall keep a public register of all crowdfunding service providers within the Union.

Once authorized to provide crowdfunding services, companies will have to comply with the many requirements laid down in the new regulation. These include the obligation to implement internal rules and policies against conflicts of interest (crowdfunding service providers shall not have any participation in any crowdfunding offer on their crowdfunding platforms; crowdfunding service providers shall not accept as project owners in relation to the crowdfunding services offered their shareholders holding 20%, or more, of share capital or voting rights, their managers or employees or any natural person or legal entity linked to those shareholders, managers or employees). Depending on the type of the crowdfunding services provided, other EU or national mandatory requirements might apply, for example, anti-money laundering rules.

Crowdfunding providers shall also annually disclose information on a confidential basis regarding all funded projects to the national authorities, including information regarding project owners, investors and amounts raised. The information disclosed shall be reported in anonymized format to the ESMA which will then prepare and publish annual statistics relating to the crowdfunding market in the Union.

It is worth mentioning that crowdfunding service providers will also be entitled to engage in activities other than those covered by the crowdfunding authorization in accordance with the relevant applicable Union or national law. In this regard, crowdfunding may also be performed, for example, by credit institutions or companies providing payment services.

Protection of investors

Another important aspect covered by the new regulation concerns the protection of investors.

To this end, the regulation contains various requirements protecting investors such as rules concerning the projects and risk information which must be provided to investors always in clear, fair and non-misleading manner, e.g., crowdfunding providers should inform investors that their investments are not covered by a deposit guarantee or investor compensation schemes. Certain mandatory rules related to the marketing communications through which crowdfunding services are promoted should be further followed by crowdfunding providers.

Crowdfunding providers will also have to determine whether investors using their platforms are sophisticated or non-sophisticated investors and respectively apply different rules to the different types of investors. For instance, non-sophisticated investors will be entitled to benefit from a pre-contractual reflection period and will be subject to entry tests and assessments before being granted full access to invest in crowdfunding projects.

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What is more, crowdfunding providers will have to implement effective and transparent procedures for the prompt handling of complaints received from investors who should be able to file complaints against them free of charge. All complaints should be investigated in a timely and fair manner.

In the light of protection rules, it is worth mentioning that most of the rules shall protect all crowdfunding providers' clients, meaning project owners along with investors.

How about the Bulgarian market?

Crowdfunding platforms, in the broadest terms, both established in Bulgaria and abroad, have already been operating on the local market for years.

Some of them provide credits to project owners and then assign parts of their receivables to third parties through their platforms.

Other platforms match the players involved. Project owners use the platforms to apply for loans from certain financial institutions working with the crowdfunding service providers. Third parties may use the platform to purchase parts of the financial institutions' receivables from the approved project owners. Such platforms actually link project owners to financial institutions and then financial institutions to third parties who may purchase receivables from the financial institutions.

Another type seen on the market provides the opportunity to invest in real estate which is subsequently renovated and then sold or leased. Most recently, the investments are received by the crowdfunding service provider or another related company which purchases, manages and finally sells or leases the real estate properties on its own or through its subsidiaries.

There are also platforms providing the opportunity to investors to finance the purchase of certain equipment or machinery which then secures the granted loans.

Overall, the Bulgarian market already offers diverse crowdfunding options, and with the new EU regulation it is likely that cross-border crowdfunding will be stimulated and more persons/entities will consider investing through crowdfunding platforms. The new rules set better protection of investors' and project owners' interests while various crowdfunding providers will have to consider carefully how their businesses are affected by the new EU regulation and take the relevant steps in view of compliance.

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