

POLICY STATEMENT

(PS-01-2020)



SUBJECT: POLICY STATEMENT ON THE INVESTMENT-BASED CROWDFUNDING RULES

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PURPOSE OF THE PUBLICATION

The Cyprus Securities and Exchange Commission, publishes this Policy Statement in order to notify its decision on the Investment-Based Crowdfunding Rules.

Queries in relation to the content of this Policy Statement may be addressed to the Policy Department of the Cyprus Securities and Exchange Commission at policy@cysec.gov.cy.

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1. INTRODUCTION

PURPOSE OF THIS POLICY STATEMENT

- 1.1. The Cyprus Securities and Exchange Commission ("**CySEC**") has published a [Consultation Paper](#) on 15 November 2019, regarding the introduction of specific rules on investment-based crowdfunding ("**CP-03-2019**") by means of a CySEC Directive. CySEC received feedback from interested parties, comprised of legal practitioners and market participants.
- 1.2. This Policy Statement summarises the feedback received in response to CP-03-2019 and contains CySEC's final position on the subject matter.
- 1.3. The said specific rules on investment-based crowdfunding have been carved into [substantiate existing provisions of] the Investment Services and Activities and Regulated Markets Law (the "**Law**"), transposing MiFID II, by means of Directive DI 87-10 (the "**Crowdfunding Directive**").
- 1.4. CySEC's regulatory initiative is designed to allow crowdfunding investors to make informed investment decisions based on standardised, concise and clear information; and to invest through authorised intermediaries that will have to abide by MiFID II rules, *inter alia*, those on the code of conduct, management of conflict of interests, the holding of clients' money and financial instruments as well as product governance rules, in a proportionate manner. The Crowdfunding Directive has been designed with the aim to enhance investor protection.
- 1.5. Chapter 2 of this Policy Statement provides an overview of the Crowdfunding activities to be regulated by the Crowdfunding Directive, whilst Chapter 3 summarises the responses per each question included in CP-03-2019 and provides the relevant CySEC position and clarifications where needed.

WHO THIS CONCERNS

- 1.6. This Policy Statement concerns the entities established in Cyprus that intend to act as investment-based Crowdfunding Service Providers, by matching the business funding interest of investors and Project Owners. Such entities have to be authorised as Cypriot Investment Firms, in order to act as Crowdfunding Service Providers ("**CIFs**").
- 1.7. The owners of the projects that are seeking funding through the Platform operated by the CIF ("**Project Owners**") will be indirectly impacted. Project Owners should

prepare and make available to the CIF a pre-contractual document named “*Key Investment Information Sheet*”¹ and to ensure the accuracy completeness and clarity of its content. Furthermore, the Project Owner is under the responsibility to notify the CIF acting as (investment-based) Crowdfunding Services Provider in case of any changes affecting the project under financing and the relevant terms of the offering.

2. OVERVIEW OF THE CROWDFUNDING BUSINESS

WHAT IS CROWDFUNDING?

2.1. Fundraising from the Crowd, through online means, in the context of which those who are willing to provide an amount of money are brought together with those who are seeking financing, may constitute a type of what is known as Crowdfunding.

2.2. The most common types of Crowdfunding are the following:

- Investment-based Crowdfunding: It entails fundraising, in exchange for Transferable Securities (commonly equity or debt instruments), within the meaning of the Law (“**TSS**”);
- Loan-Based Crowdfunding (i.e. non-securitised debt): The activity in the context of which funds are raised from the crowd in the form of a loan agreement that entails interest payments and principal repayment over time;
- Reward-Based Crowdfunding: It entails fund raising, in return for a reward, a service or a product;
- Donation-Based Crowdfunding: it entails fund raising in the form of donations.

2.3. Only investment-based and loan-based Crowdfunding currently fall under the remit of financial regulators. Some types of offerings may also fall under the scope of other specific pieces of financial regulation.

2.4. In such cases Crowdfunding² serves as an alternative method to bank financing, through which small and medium enterprises (“**SMEs**”) can have access to funding

¹ A template of which is provided in the Annex of the Proposed Directive.

² The Crowdfunding Directive is the regulation of the crowdfunding business, excluding non-entrepreneurial funding activities, known as ‘*reward-based crowdfunding*’.

by means of, in principle, small contributions from many investors; in its economic function, this is a tripartite relationship consisting of:

- The business, being principally an SME, seeking financing by investors either through borrowings by means of loans or through the issuance of TSs;
- The Crowdfunding Service Provider, that provides a publicly accessible internet-based electronic information system (**the “Platform”**) through which the interest of the businesses seeking financing are matched with those of the funding investors; and
- The investors, seeking to finance a business in exchange for a potential return through the said platform (**“the Economic Function”**).

SCOPE

2.5. Having regard to the Economic Function as described directly above, the regulatory aspects of crowdfunding that will fall within the ambit of CySEC’s competence and, subsequently, within the scope of application of the Law pursuant to which the Crowdfunding Directive will be issued, relate to crowdfunding through TSs only.

2.6. Therefore no other form of crowdfunding is covered under the Crowdfunding Directive.

THE PURPOSE OF INVESTMENT-BASED CROWDFUNDING

2.7. CySEC is committed to creating a regulated environment in which investors wishing to invest in new, innovative businesses or projects are protected by the law.

Crowdfunding investments may generate higher returns than traditional investment opportunities. However, investors should be aware that there are usually significantly higher risks associated.

2.8. Investment-based crowdfunding may also provide alternative financing opportunities to SMEs and start-ups, helping finance the real economy in Cyprus.

THE RISKS OF INVESTMENT-BASED CROWDFUNDING

2.9. Crowdfunding, including investment-based crowdfunding, is primarily used by start-ups as a means of alternative financing and it is considered as a high-risk

investment, since it may result in losing the entire invested amount, in the event the crowdfunded business or project fails.

2.10. The following non-exhaustive list of risks is relevant to the form of investment based crowdfunding, which is known as equity crowdfunding:

- It is possible to result in losing the entire invested amount.
- Dividend payments are not only subject to a successful trajectory of the project in question, but also to a decision to pay such dividends, by the decision making body of the entity in question.
- Startups may proceed with several rounds of shares issuing, which in effect may result in diluting the value of the initial investment.
- The exit opportunities (i.e. cashing in) might be severely constrained.
- The possibility of fraud cannot be ruled out.

2.11. The following non-exhaustive list of risks is relevant to the form of investment based crowdfunding, which is known as securitized debt crowdfunding:

- It is possible to result in losing the entire invested amount and to not receive any coupons, as a result of the funded entity's default.
- The exit opportunities (i.e. cashing in) might be severely constrained.
- The possibility of fraud cannot be ruled out.

3. PROPOSED RULES AND FEEDBACK RECEIVED ON THE PROPOSED RULES

3.1. SUBJECT MATTER AND SCOPE OF APPLICATION (PARAGRAPHS 1 AND 3 OF THE CROWDFUNDING DIRECTIVE)

3.1.1. The Crowdfunding Directive regulates the organization, operations, transparency and marketing obligations as well as the supervision of CIFs offering Crowdfunding Services in and/or from the Republic.

3.1.2. However, the Crowdfunding Directive being a set of secondary rules substantiating provisions of the CIF Law in the context of crowdfunding services, applies without prejudice to any other requirements provided for under the CIF Law. This includes national or EU rules issued in its implementation, or any other applicable rules.

- 3.1.3. To this end interested parties were requested in the context of CP-03-2019 to provide their views on the following question:

Question 1: Do you have any comments on the complementary application of the Directive?

SUMMARY OF COMMENTS IN RELATION TO QUESTION 1

- 3.1.4. The majority of the respondents agreed with the complementary application of the Crowdfunding Directive.
- 3.1.5. Two of the respondents enquire on the practical application and requested prescriptive rules governing the case of conflicting rules.
- 3.1.6. One respondent stated that if CySEC's intention is to develop a category of CIFs which provide crowdfunding services as their main activity, the legislation should also be amended to lower the initial capital of investment firms which provide the service of placing of financial instruments without firm commitment to EUR 125,000. The respondent stated that in their understanding this is allowed by Directive 2013/36/EU and Regulation (EU) No. 575/2013. However they did not provide the legal basis underpinning their understanding.

CySEC'S POSITION

- 3.1.7. In relation to the queries received on the practical implementation, we would like to reiterate that the provisions of the Crowdfunding Directive apply **in addition and without prejudice to** any other obligations provided for under the Law or the Markets in Financial Instruments Regulation and the Delegated Acts and Directives issued pursuant thereto or any other applicable rules (e.g. the AML rules or the Prospectus Regulation - Regulation (EU) 2017/1129 or the Capital Requirements Directive -Directive (EU) 2013/36 or the rules on distant marketing of financial services, where applicable etc.) or Guidelines (e.g. the ESMA Guidelines on MiFID II Product Governance).

- 3.1.8. Therefore the Crowdfunding Directive shall be understood as a non-exhaustive set of specific secondary rules that need to be followed. At the same time, CIFs should meet the rest of their obligations stemming from the applicable regulatory national and EU framework when engaging in the provision of crowdfunding services. The Crowdfunding Directive is complementary to, and not a replacement of, the existing EU and national rules governing CIFs' licensing, supervision and ultimately, enforcement. Even in case where a conflict might potentially arise, it can be solved in accordance with the long-established principles of hierarchy of legal rules, including the supremacy of European Union Law.
- 3.1.9. As to the cross-border offerings of TSs, due consideration shall also be given on whether there are in the host Member State any national rules on the public offering of TSs below the prospectus thresholds. [ESMA has published a list](#) of the current situation and thresholds per Member State. Interested parties should check for any updates and should perform their own review before distributing and/or offering TSs in the territory of the respective Member State.
- 3.1.10. It is stressed that in view of the fact that both the investor and the project owner will be clients of the CIF which will be acting as a Crowdfunding Service Provider, the identity verification and the AML checks should be performed for both parties and the conflicts of interest policy of the CIF will need, *inter alia*, to be amended accordingly.
- 3.1.11. In relation to any potential conflict of rules, we would like to note that we are not aware of the existence of such conflict between the secondary rules on Crowdfunding and any other applicable national or EU rules. The only area where we have identified that potentially clarifications might be required is the interaction of the Crowdfunding Directive with the Prospectus Regulation. For such cases Paragraph 3(b) of the Crowdfunding Directive explicitly provides that the Directive applies without prejudice to any obligations applicable under the Prospectus Regulation, **the provisions of which prevail (i.e. of the Prospectus Regulation)** in case where a crowdfunding offer falls within the latter's scope. However in the event that such conflict between the secondary rules on Crowdfunding and any other legislative piece arise, we would like to reiterate that it can be resolved in accordance with the long-established principles of hierarchy of legal rules, including the supremacy of European Union Law³.

³ Interested parties shall consult their Legal advisors on Law Hierarchy. They may also want to be informed on the Precedence of the European Law (relevant information could be found [here](#)).

3.1.12. In relation to the views expressed by one respondent that the legislation should also be amended to lower the initial capital of investment firms which provide the service of placing of financial instruments without firm commitment to €125.000, as in their understanding this is allowed by Directive 2013/36/EU and Regulation (EU) No. 575/2013, we would like to note that the applicable initial capital requirement corresponding to the specific activity is €730.000.

3.1.13. Further details on the initial capital requirement in relation to the activity of placing of financial instruments without firm commitment, are provided in page 19 of the [Report on Investment Firms Response to the Commission's Call for Advice of December 2014](#), issued jointly by ESMA and EBA, stating the following:

“Regarding the activity of placing financial instruments without a firm commitment basis, this category of investment firm is only implicitly included in the current CRD IV framework because the activity of placing financial instruments without a firm commitment basis (MiFID A7) is not explicitly mentioned. An investment firm performing this activity for another entity actually performs only a ‘sales’ function in that the investment firm agrees to sell the financial instruments of a third party to the public, without the investment firm having an obligation to buy any of the financial instruments that could not be sold to the public. The prudential risk faced by the investment firm itself while performing this activity is therefore limited (although this is not necessarily the case for the firm’s clients). Given the more limited prudential risk profile of this activity, one would expect that it deserves a less than full CRR prudential treatment as operated under Article 29 of the CRD for this particular type of investment firm. This is, however, not the case. By default, such an investment firm is subject to the highest initial capital requirement of EUR 730 000 under Article 28 of the CRD, which seems irrelevant given the absence of risk to the firm and its customers. Level playing field issues arise too, since only minor differences actually distinguish placement agents from firms transmitting (or executing) orders, in that their service is connected to the issuance of financial instruments as opposed to the secondary market sales of these instruments”

3.1.14. Even though the above is recognized as an inadequacy of risk sensitivity in the current framework, until the current EU framework is amended, the initial capital requirement for the activity of placing of financial instruments without firm commitment remains €730.000.

3.1.15. We would also like to note that Paragraph 2.3 of CP-03-2019 states that in respect of the businesses seeking funding by placing their TSs through the CIF’s crowdfunding platform, these will be receiving the investment service of placement of financial instrument **with or** without a firm commitment, within the meaning of

the Law. We would like to clarify that the activity of underwriting and placement **with** firm commitment was incorporated by mistake into Paragraph 2.3 of CP-03-2019. In view of the fact that our approach aims at ensuring that the Crowdfunding Service Provider acts as neutral intermediary, such Crowdfunding Service Providers may perform the activity of placement without firm commitment but not the activity of underwriting and placement with firm commitment. This is in line with the content of the Crowdfunding Directive, as consulted.

3.1.16. On the basis of the above, CySEC proceeded with the clarifications on the complementary application of the Crowdfunding Directive, as consulted under CP-03-2019.

3.2. ORGANISATIONAL REQUIREMENTS (PARAGRAPH 4 OF THE CROWDFUNDING DIRECTIVE)

3.2.1. Paragraph 4 of the Crowdfunding Directive lays down the specific procedures and arrangements that need to be additionally submitted to CySEC by a CIF (including an applicant CIF), in order for it to act as a Crowdfunding Services Provider.

3.2.2. In view of the risks entailed, a CIF that wishes to provide crowdfunding services, will not be able to commence its crowdfunding activities, irrespective of the scope of its licence, unless CySEC has established that the said CIF has in place appropriate arrangements to ensure compliance with the regulatory framework in question and for the management of the risks emanating specifically from crowdfunding and from the provision of relevant services. In CySEC's view this is a proportionate measure for ensuring investors' protection in the context of Crowdfunding Services, since the investment and/or ancillary services covered by a CIF's license, may cater for various business models.

3.2.3. With regard to the Platform, it has to be operated via a wholly-owned and exclusively operated website of the CIF, which will be dedicated to the provision of crowdfunding services only, without any other person having any rights of use thereupon.

3.2.4. In line of the above, interested parties were requested in the context of CP-03-2019 to provide their views on the following question:

Question 2: Do you agree that a CIF who wishes to provide crowdfunding services, should not be able to commence its crowdfunding activities, irrespective of whether its licence includes the respective investment and ancillary services, unless CySEC is convinced that the said CIF has in place appropriate arrangements, specifically in relation to crowdfunding?

SUMMARY OF COMMENTS IN RELATION TO QUESTION 2

- 3.2.5. The majority of respondents agreed or did not disagree with CySEC's approach.
- 3.2.6. However a number of respondents raised concerns in relation to the period provided for in the Crowdfunding Directive in order for CySEC to evaluate the specific Crowdfunding Services application and grant its consent to an applicant to commence its Crowdfunding Services operations, particularly where a CIF is already authorised and its authorisation includes the relevant investment and ancillary services.

CySEC'S POSITION

- 3.2.7. We would like to clarify that the six month period envisaged in the Crowdfunding Directive in order for CySEC to evaluate the application and grant its consent to an applicant to commence its operations, is a maximum timeframe. If all necessary checks are completed in a timely manner, and CySEC is fully satisfied that the applicant meets all the necessary requirements, this period may be considerably less than six months.
- 3.2.8. CP-03-2019 did not include the applicable fees for the said evaluation. Where such an application entails an authorisation extension, applicants will pay the respective fee provided for in Directive DI 87-03. Where the respective services and/or activities are already included in the CIF's authorization, applicants will pay a fee of €3.500. The reason for an additional regulatory fee for the provision of Crowdfunding Services in case of already duly licensed CIFs is that CySEC will need to devote resources to reviewing the additional information, documentation and arrangements submitted pursuant to Paragraph 4 of the Crowdfunding Directive. However, where an application entails an authorisation extension for the purposes

of providing Crowdfunding Services, such review will have to be in any case performed and therefore we believe that it is proportionate to not charge the said additional fee in such cases. The Crowdfunding Directive has been amended in order to provide for the payment of such fee.

- 3.2.9. Other than the addition of the previous paragraph, we have not amended our approach on the procedural part regarding the commencement of provision of Crowdfunding Services.

3.3. CONDUCT OF BUSINESS RULES (PARAGRAPHS 5-7 OF THE CROWDFUNDING DIRECTIVE)

3.3.1. PARAGRAPH 5 OF THE CROWDFUNDING DIRECTIVE

- 3.3.1.1. The provisions of this paragraph of the Crowdfunding Directive aim at ensuring that the CIF retains the role of a neutral intermediary when providing Crowdfunding Services.

- 3.3.1.2. For this reason, a CIF is not allowed to offer the investment services of portfolio management, including through the use of SPVs⁴, and of investment advice in respect of crowdfunding projects on its platform. A CIF which is a Crowdfunding Service Provider **is also not allowed to become, in the context of providing Crowdfunding Services, party to the relevant transaction and/or to participate in the execution of an order on behalf of an investor.** The role of a CIF acting as a Crowdfunding Service Provider is restricted to the arrangement of the relevant transaction by bringing together the investor and project owner seeking funding (this is why the definition of Crowdfunding Services in the Crowdfunding Directive does not include the investment service of execution of orders or the investment activity of Dealing on Own Account).

- 3.3.1.3. The key concept of neutral intermediation envisaged by the Crowdfunding Directive is also achieved by prohibiting a CIF acting as a Crowdfunding Service Provider to receive order routing benefits in respect of crowdfunding projects in general, i.e. either on its own or other platforms. The prohibition of linking the fees and/or benefits paid by the project owner to the CIF acting as a Crowdfunding Service Provider to order routing (including a prohibition of linking the successful completion of the Crowdfunding offer to the payment of extra fees) is also aimed at addressing the conflicts of interests that arise.

⁴ This is the reason why the use of SPV is subject to restrictions, in order to avoid evasion of the prohibition through a pooling at SPV level.

- 3.3.1.4. In CySEC's view the above restrictions are already provided for under the CIF Law, thus being an existing requirement, and are also necessary and proportionate in order to ensure neutrality and prudent management of conflicts of interests, which in effect will enhance investors' protection and investors' confidence.
- 3.3.1.5. Furthermore, this Paragraph lays down certain due diligence obligations in respect of both the Crowdfunding Project⁵ as well as in respect of the Project Owner. In CySEC's view, it is reasonable and proportionate that a regulated entity under MiFID such as a CIF which also acts as a Crowdfunding Service Provider, performs customer due diligence before accepting a crowdfunding project on its platform.
- 3.3.1.6. It is reminded and stressed that the crowdfunding rules are complementary to the existing ones regulating the activities of CIFs. Therefore a CIF acting as Crowdfunding Services Provider should also meet the rest of its obligations under the EU and National rules, including its obligation on product governance, as a distributor of financial instruments.
- 3.3.1.7. Compliance with the provisions of this Paragraph has to be ensured also by means of relevant record-keeping obligations.
- 3.3.1.8. In line with the above, interested parties were requested to provide their views on the following questions:

Question 3: Do you agree that a CIF who wishes to provide Crowdfunding Services, should retain the role of a neutral intermediary when providing crowdfunding services?

Question 4: Do you agree that a CIF which is a Crowdfunding Service Provider to perform a due diligence as the one provided for in the Crowdfunding Directive before accepting a crowdfunding project on its platform?

⁵ Referring to the credit risk associated therewith, where applicable.

SUMMARY OF COMMENTS IN RELATION TO QUESTION 3

- 3.3.1.9. The majority of the respondents agreed or did not disagree with our view that a CIF who wishes to provide Crowdfunding Services, should retain the role of a neutral intermediary when providing crowdfunding services.
- 3.3.1.10. One respondent enquired on the practical application in view of the fact that CIFs will not be allowed to take part in the execution of investors' orders and another respondent enquired on whether fees and charges should be visible on the website of the CIF.
- 3.3.1.11. There were also calls for clarity on the permissible fees and charges.

CySEC'S POSITION

- 3.3.1.12. We consider that a CIF does not participate in the execution of the orders where it is merely arranging the relevant transaction by bringing together the investor and project owner who is seeking funding and does not become party to the transaction (i.e. where the execution takes place in the name of the end investor and not in the name of the CIF acting to conclude the relevant transaction on behalf of the investor).
- 3.3.1.13. Fees and charges should always be communicated to the investors in line with the currently applicable requirements of the Law. We expect interested parties to be fully aware and compliant with their obligations under the Law. It is reminded at this point that the Crowdfunding Directive applies without prejudice and in a complementary manner to any other obligations provided for under the Law.
- 3.3.1.14. Fees and charges should be in line with the provisions of the Law, as may be further substantiated by the Crowdfunding Directive, and shall not result in incentivising CIFs providing Crowdfunding Services to route investors orders to a specific project instead of another. Charging a project owner on the basis of the amount raised (i.e. a percentage on the respective amount) would not be considered to fall under the aforementioned order-routing prohibition, as long as there is no incentivisation to route investors' orders to a specific project instead of another. This would be the case where a success fee (i.e. bonus) is offered by a specific Project Owner to the CIF incentivising it to prioritise towards the projects of the specific Project Owner.
- 3.3.1.15. In view of the above, we have not amended our approach on CIFs retaining the role of neutral intermediary when acting as Crowdfunding Service Providers.

SUMMARY OF COMMENTS IN RELATION TO QUESTION 4

- 3.3.1.16. The majority of the respondents agreed or did not disagree with our view that a CIF which is a Crowdfunding Service Provider should perform a due diligence as the one provided for in the Crowdfunding Directive before accepting a crowdfunding project on its platform.
- 3.3.1.17. One respondent argued that the extent of a CIF's liability should be limited to the extent to which the CIF is able to acquire knowledge on the Project Owners' project for which funding is required. The specific respondent also argued that under the Crowdfunding Directive, CIFs are under an obligation to ensure the completeness and clarity of the Key Investment Information Sheet ("**KIIS**") prepared by the Project Owner. However, according to the respondent's view such obligation fails to recognize that in certain cases this may require knowledge of specific know-how and trade-secrets, or even methodologies of calculation and research performed by the Project Owner, which the CIF may not be able to have access to.
- 3.3.1.18. Contrary to the above view, there were also calls for enhancing the CIFs responsibility by ensuring that the CIF is also responsible for ensuring the accuracy of the KIIS (not only clarity and completeness). They argued that prudent CIFs will perform independent verification checks in any case, either on their own (if they have the expertise) or by contracting experts to perform such checks on their behalf, in order to shield themselves against lawsuits and reputational damages.
- 3.3.1.19. One respondent proposed that the language of paragraph 5(7)(a) of the Crowdfunding Directive is rephrased to require a clean criminal record and non-bankruptcy certificate to include, to the extent possible checks on the specific areas of law described in sub-paragraphs 7(a)(i) – 7(a)(vi) and mentioned that that as part of the due diligence requirements, the CIF should also check, to the extent possible, whether:
- i. The same project was previously offered through a Crowdfunding platform and failed; and
 - ii. The project is listed in a different Crowdfunding platform

CySEC'S POSITION

- 3.3.1.20. We agree that CIFs should remain responsible for ensuring the accuracy of the KIIS before allowing an offer to take place through their platform. To this end we amended the wording of the respective Paragraph in order to ensure that this is

clear in the Crowdfunding Directive. We also believe that this is in line with their obligations under the Law and particularly with their obligation to act in a fair and professional manner, in accordance with the best interests of their clients.

3.3.1.21. We have also rephrased paragraph 5(7)(a) of the Crowdfunding Directive to require a clean criminal record and non-bankruptcy certificate to include, to the extent possible checks on the specific areas of Law described in sub-paragraphs 7(a)(i) – 7(a)(vi) and we have added that as part of the due diligence requirements, the CIF should also check, to the extent possible, whether:

- i. The same project was previously offered through a Crowdfunding platform and failed; and
- ii. The project is also listed in a different Crowdfunding platform.

3.3.2. PARAGRAPH 6 OF THE CROWDFUNDING DIRECTIVE

3.3.2.1. The provisions of this Paragraph of the Crowdfunding Directive aim at ensuring that the CIF which is a Crowdfunding Service Provider prudently manages and/or avoids conflicts of interests that might occur in the course of providing the relevant services.

3.3.2.2. To this end, the provisions of the CIF Law on conflicts of interest have been adapted to the specific Crowdfunding Services context, corroborated by additional specific safeguards: it is prohibited for a CIF to acquire (equity or debt as the case may be) participation in crowdfunding projects on its platform or allow certain categories of persons⁶ to act as project owners on it. The said persons are only allowed to act as investors on the relevant CIF's platform, subject to the observance of certain conditions.

3.3.2.3. In CySEC's view such restrictions emanate from the provisions of the Law, whereas the provisions of the Crowdfunding Directive further specify them, and are also necessary and proportionate in order to ensure neutrality and prudent management of conflicts of interests, which in effect will enhance investors' protection and investors' confidence.

3.3.2.4. In line with the above, interested parties were requested in the context of CP-03-2019 to provide their views on the following question:

⁶ Defined in the Crowdfunding Directive as 'involved persons'.

Question 5: Do you agree with the restrictions provided for in the Crowdfunding Directive, aiming at managing and/or avoiding conflicts of interests where a CIF wishes to provide crowdfunding services?

SUMMARY OF COMMENTS IN RELATION TO QUESTION 5

- 3.3.2.5. The majority of respondents agreed or did not disagree with the restrictions provided for in the Crowdfunding Directive, aiming at managing and/or avoiding conflicts of interests where a CIF wishes to provide crowdfunding services.

CySEC'S POSITION

- 3.3.2.6. We have not altered our approach on the restrictions, aiming at managing and/or avoiding conflicts of interests where a CIF wishes to provide crowdfunding services

3.3.3. PARAGRAPH 7 OF THE CROWDFUNDING DIRECTIVE

- 3.3.3.1. The provisions of this Paragraph of the Crowdfunding Directive aim at ensuring that there are uniform requirements in place for the safe-keeping by CIFs of TSs belonging to investors, when providing Crowdfunding Services.
- 3.3.3.2. To this end, the provisions of the present paragraph firstly divide the TSs so safe-kept, into custodial and non-custodial TSs. Secondly specific rules are introduced for the safe-keeping of those TSs that are not subject to custody. Thirdly, specific information requirements are provided for *vis-à-vis* investors with regards to the safe-keeping of their TSs.
- 3.3.3.3. CySEC considers the safekeeping of such financial instruments to be of utmost importance for ensuring investors' protection and for preserving the investors' rights over the TSs in question. Therefore the elaboration of the safekeeping rules is in CySEC's view necessary and proportionate in the case of crowdfunding.
- 3.3.3.4. It is reminded and stressed that the Crowdfunding Service Provider shall maintain the role of neutral intermediary. Therefore, the TSs in question shall be registered

in the name of the respective investors in the official register in relation to the Project Owner, in line with the applicable legislation in the jurisdiction of its incorporation.

3.3.3.5. It is stressed that the rules on holding clients' funds and as a prudential rule of general applicability monies raised during the offering on the crowdfunding platform, shall be transferred by the CIF to the project owner only after the successful closing of the relevant offer (i.e. only if they meet or exceed the funding goal). In the meantime the clients' funds should be kept by the CIF which is a Crowdfunding Service Provider and in case where the funding goal is not reached the funds should be returned to the investors. This is to ensure that investors will not be locked into a project which is likely to fail.

3.3.3.6. In line with the above, Interested parties were requested in the context of CP-03-2019 to provide their views on the following question:

Question 6: Do you agree with the safekeeping rules, where a CIF wishes to provide Crowdfunding Services?

Question 7: Do you agree with our view on clients' money?

SUMMARY OF COMMENTS IN RELATION TO QUESTION 6

3.3.3.7. The majority of respondents agreed or did not disagree with the safekeeping rules as consulted under CP-03-2019.

3.3.3.8. A limited number of respondents enquired as to:

- i. Whether the CIF will be able to safeguard the TS in an omnibus account;
- ii. Whether the CIF should maintain a separate account for safeguarding TS;
- iii. Whether information about ownership will be received by the project owner in view of the fact that the CIF will not be able to participate in the execution of the transaction;
- iv. Who will be responsible to ensure the accuracy of information in relation to ownership.

CySEC'S POSITION

- 3.3.3.9. The safekeeping of financial instruments should take place in line with the requirements of the Law and the secondary rules issued pursuant to it, including the provisions of the Crowdfunding Directive.

However it is reminded that the CIF which is a Crowdfunding Service Provider shall retain the role of neutral intermediary. Therefore such CIF which is a Crowdfunding Service Provider **is not allowed to become party to the transaction (neither as an agent) and/or to participate in the execution of an order on behalf of an investor.** Its role is restricted to the arrangement of the relevant transaction by bringing together the investor and project owner who is seeking funding. To this end is unclear how an omnibus account will be in compliance with the above as such account refers to financial instruments registered in the name of the CIF.

- 3.3.3.10. It is clarified that the aforementioned restriction (neutral intermediation), is limited solely to the CIFs activity as Crowdfunding Service Providers and within this context only. Conversely, the said restriction does not apply in the case of e.g. secondary trading, where such instruments are listed on a trading venue operated by the CIF, or by another CIF or by a Market Operator.

- 3.3.3.11. In relation to the practical application and verification procedures, we would like to clarify that we expect CIFs which are acting as a Crowdfunding Service Providers to act in a professional manner in accordance with the best interests of their clients. To this end, CIFs shall collect the respective funds from the investors and hold them as clients' funds during the offering period. Once the offering is successfully completed (i.e. the target amount has been reached), the CIF which is Crowdfunding Service Provider shall inform the Project Owner that the respective amount has been collected, providing the necessary details of the investors and the relevant amounts, requesting the Project Owner to arrange the transfer of ownership of such instruments. TSs offered by means of a crowdfunding platform that can be registered in a financial instruments account in the name of the client and all financial instruments that can be physically delivered to the crowdfunding services provider shall be held in custody. TSs offered by means of a crowdfunding platform that cannot be registered in a financial instruments account opened in the name of the client or cannot be physically delivered to the crowdfunding services provider it shall be subject to ownership verification and record-keeping. The CIF which is Crowdfunding Service Provider shall release the funds to the Project Owner, **only** where the TSs have been physically delivered or where **sufficient evidence** is provided by the Project Owner to the CIF that the ownership has been proportionately transferred to the respective investors, in line with their

contributions. The CIF which is Crowdfunding Service Provider will in effect act as an escrow agent, facilitating a Delivery Versus Payment transaction.

SUMMARY OF COMMENTS IN RELATION TO QUESTION 7

- 3.3.3.12. The majority of respondents agreed with our approach on clients' money. We were also requested to amend the Crowdfunding Directive, in order to explicitly refer to the obligation of CIFs which are Crowdfunding Service Providers to transfer the funds raised during the offering on the crowdfunding platform to the Project Owner only after the successful closing of the relevant offer (i.e. only if they meet or exceed the funding goal) and to their obligation to return such funds to the investors in case where the funding goal is not reached.

CySEC'S POSITION

- 3.3.3.13. We have amended the Crowdfunding Directive in order to explicitly reflect the above. We have also clarified that the CIF which is Crowdfunding Service Provider shall release the funds to the Project Owner, **only** where the TSs have been physically delivered or where **sufficient evidence** is provided by the Project Owner to the CIF that the ownership of the TSs has been proportionately transferred to the respective investors, in line with their contributions.

3.4. TRANSPARENCY OBLIGATIONS (PARAGRAPHS 8-13 OF THE CROWDFUNDING DIRECTIVE)

3.4.1. PARAGRAPH 8 OF THE CROWDFUNDING DIRECTIVE

- 3.4.1.1. The provisions of this Paragraph aim at adapting the general CIF Law provisions on the content and on how information is provided, to the crowdfunding services context.
- 3.4.1.2. It is also clarified that such information should be provided before a transaction takes place.
- 3.4.1.3. Interested parties were requested to provide their views on the following question:

Question 8: Do you agree with the content of Paragraph 8 of the Crowdfunding Directive?

SUMMARY OF COMMENTS IN RELATION TO QUESTION 8⁷

- 3.4.1.4. The majority of respondents agreed with our approach on the information to be provided to clients.

CySEC'S POSITION

- 3.4.1.5. We have proceeded as per CP-03-2019.

3.4.2. PARAGRAPH 9 OF THE CROWDFUNDING DIRECTIVE

- 3.4.2.1. The provisions of this Paragraph aim at adapting the general CIF Law provisions on client appropriateness, to the crowdfunding services context.

- 3.4.2.2. As to those investors that qualify as retail clients, within the meaning of the CIF Law, they have to be granted the possibility to undergo a loss simulation test, such test however not being prohibitive of the intended investment. In our view such simulation test will allow them to better understand the risks entailed and make an informed decision.

- 3.4.2.3. It is reminded that the provisions of this paragraphs are complementary to the content of the appropriateness test performed under the Law. The CIF which is a Crowdfunding Service Provider should meet its obligations in relation to the appropriateness test and to product governance (applicable to the CIF, which is acting as a distributor of financial instruments), under the Law.

- 3.4.2.4. Interested parties were requested to provide their views on the following question:

⁷ The numbering has been corrected from this question onwards, as there was a repetition in the numbering of some questions in CP-03-2019.

Question 9: Do you agree with the content of Paragraph 9 of the Crowdfunding Directive?

SUMMARY OF COMMENTS IN RELATION TO QUESTION 9

- 3.4.2.5. The majority of respondents agreed with our approach as per Paragraph 9 of the Crowdfunding Directive.
- 3.4.2.6. One respondent requested further clarifications on whether the loss simulation test should be part of the knowledge test or if it would suffice to be provided through the CIF's website at any given time. The respondent also expressed the view that it should be clarified that the requirement to perform an assessment every 2 years should be limited solely to the access of an investor to new projects.

CySEC'S POSITION

- 3.4.2.7. The simulation test should be provided through the CIF's website at any given time. However we consider it appropriate that a CIF refers a retail investor to the specific simulation test during the onboarding process. The requirement to perform an assessment every two years, would not be relevant for TSs that have been already purchased.
- 3.4.2.8. In line with the above we have proceeded as per CP-03-2019.

3.4.3. PARAGRAPH 10 OF THE CROWDFUNDING DIRECTIVE

- 3.4.3.1. The provisions of this Paragraph aim at introducing a pre-contractual document produced by and under the responsibility of the project owner, including the natural persons effectively conducting the project owner's business, the so-called KIIS.
- 3.4.3.2. The KIIS has to be made available to potential investors by the CIF. The minimum content of the KIIS is laid down in the Crowdfunding Directive.
- 3.4.3.3. The CIF is obliged to verify that the information contained in the KIIS is complete accurate and clear and establish relevant procedures to this end. Furthermore, the

CIF has to request the project owner to inform it on any changes relating to the content of the KIIS, in order to keep such content up to date throughout the duration of the relevant offer.

- 3.4.3.4. Where the CIF acting as Crowdfunding Services Provider identifies a material error, a material omission or a material inaccuracy regarding the content of the KIIS, it has to suspend the offer to which the default KIIS relates, request the Project Owner to amend its content accordingly and inform (potential) investors thereof. In case where the default KIIS is not amended within a period of 30 days the suspended offer has to be cancelled and the funds should be returned to the investors.
- 3.4.3.5. In relation to cross border offerings of TSs, due consideration shall be given on whether there are national rules in the host Member State in question on the offering of TSs, where such offering falls below the applicable prospectus thresholds. [ESMA has published a list](#) with the current situation per Member State. Interested parties should check for any updates and should perform their own review before distributing and/or offering TSs in the territory of the respective Member State. Where an offering is above the Prospectus Regulation threshold, as has been set in the respective Member State, it will be subject to the provisions of the Prospectus Regulation.
- 3.4.3.6. In line with the above, interested parties were requested to provide their views on the following question:

Question 10: Do you agree with the content of Paragraph 10 of the Crowdfunding Directive and with the content of the KIIS (Annex to the Crowdfunding Directive)?

SUMMARY OF COMMENTS IN RELATION TO QUESTION 10

- 3.4.3.7. The majority of respondents agreed with our approach on the information to be provided to clients.

CySEC'S POSITION

- 3.4.3.8. We have proceeded as per CP-03-2019.

3.4.4. PARAGRAPH 11 OF THE CROWDFUNDING DIRECTIVE

- 3.4.4.1. The provisions of this Paragraph aim at clarifying issues relating to the operation of a bulletin board by the CIF, via which crowdfunding clients of the CIF advertise their interest to buy or sell (as the case may be) TSs that had been made available through the CIF's Platform, thus providing for an additional exit opportunity.
- 3.4.4.2. The provisions of the present Paragraph clarify that such bulletin board shall not consist of a matching system which executes client orders on a multilateral basis and shall only be understood and operated as a bulletin board where buying and selling interests are advertised, whereas the relevant transaction is concluded between the parties (transferor and transferee) concerned.
- 3.4.4.3. As to the investors advertising their buying or selling interest (as the case may be), the CIF shall require from such investors that they inform it on any changes in ownership of the said TSs, in order for it to carry out its safe-keeping tasks of ownership verification and record-keeping.
- 3.4.4.4. Where a CIF operates a system for the execution of such client orders, shall be authorised either as an MTF or as an OTF.
- 3.4.4.5. In the context of CP-03-2019, interested parties were requested to provide their views on the following question:

Question 11 Do you agree with the content of Paragraph 11 of the Crowdfunding Directive?

SUMMARY OF COMMENTS IN RELATION TO QUESTION 11

- 3.4.4.6. The majority of respondents agreed with our approach.
- 3.4.4.7. One respondent mentioned that the bulletin board will in their understanding serve as a secondary market for the assets. Another respondent mentioned that it can be operated without a system, without elaborating on their remark.

CySEC'S POSITION

- 3.4.4.8. We would like to once again stress that whilst the bulletin board may be designed to allow investors to advertise their interest and contact with each other, with a view to transact, it should not be designed in a way rendering it as a trading system.
- 3.4.4.9. Therefore the bulletin board should be understood as a place where investors are allowed to merely exchange information about buying and selling interests. However, it should in no way facilitate matching of orders and/or concluding of contracts on it.
- 3.4.4.10. Where such a bulletin board allows the publication of binding prices on it, it would in effect operate as a trading venue, rather than merely as a point of information exchange about buying and selling interests. Where a bulletin board does not function as a place where investors are allowed to merely exchange information about buying and selling interest, but also brings together buying and selling interests in a way that results in a contract and/or a transaction, such bulletin board would meet the essential elements of the Law for functioning as a trading venue and the CIF should be properly authorised for the operation of a Trading Venue.
- 3.4.4.11. Such qualification as a trading venue will also exist, where the prices posted on the bulletin board are binding for the seller/buyer, resulting in the execution of a transaction between the counterparties by simply accepting the offer.
- 3.4.4.12. We acknowledge that in practice the operation of a bulletin board might not be that efficient and might not provide adequate liquidity. However such TSs may be listed on a trading venue operated either by the CIF in question, another CIF or a Market Operator, allowing thus for further liquidity.
- 3.4.4.13. In line with the above we have proceeded as per CP-03-2019. Interested parties should always bear in mind the above.

3.4.5. PARAGRAPH 12 OF THE CROWDFUNDING DIRECTIVE

- 3.4.5.1. The provisions of this Paragraph aim at adapting the CIF Law provisions on record-keeping in the context of crowdfunding services.
- 3.4.5.2. Such records shall be kept for a period of five years following the termination of the relationship with the relevant clients (either the investor or the project owner).

- 3.4.5.3. In the context of CP-03-2019, interested parties were requested to provide their view on the following question:

Question 12: Do you agree with the content of Paragraph 12 of the Crowdfunding Directive?

SUMMARY OF COMMENTS IN RELATION TO QUESTION 12

- 3.4.5.4. The majority of respondents agreed with our approach on record keeping.

CySEC'S POSITION

- 3.4.5.5. We have proceeded as per CP-03-2019.

3.4.6. PARAGRAPH 13 OF THE CROWDFUNDING DIRECTIVE

- 3.4.6.1. The provisions of this Paragraph aim at ensuring that marketing communications are clear, accurate and not misleading as well as their consistency between the content of marketing communications and that of the KIIS.
- 3.4.6.2. Furthermore, the provisions of the present paragraph also clarify the language, in which such communications have to be produced.
- 3.4.6.3. In line with the above, interested parties were requested in the context of CP-03-2019 to provide their views on the following question:

Question 13: Do you agree with the content of Paragraph 13 of the Crowdfunding Directive?

SUMMARY OF COMMENTS IN RELATION TO QUESTION 13

- 3.4.6.4.** The majority of respondents agreed with our approach. One respondent mentioned that it should be noted that in certain cases, the Project Owner may also conduct certain marketing on its own without the involvement of the CIF and on which the CIF may have no control.

CySEC'S POSITION

- 3.4.6.5.** In our view CIFs which are Crowdfunding Service Providers, should in the context of complying with their obligation to act in a professional manner in accordance with the best interests of their clients, under the Law, ensure that they remain contractually able to interrupt and withdraw an offer from their platform and return the funds to the investors, where it comes to their attention that a Project Owner conducts certain marketing on its own that is misleading or inaccurate or in any case is not in line with the marketing standards of the CIF as these standards are formed by the Law.

- 3.4.6.6.** In line with the above, we have proceeded as per CP-03-2019.

3.5. MISCELLANEOUS

- 3.5.1.** In the context of CP-03-2019, interested parties were requested to answer the following question:

Question 14: Do you have any other comments?

SUMMARY OF COMMENTS IN RELATION TO QUESTION 14

3.5.2. A limited number of respondents raised the following:

- i Whether dual listing of the same project in two different Crowdfunding platforms offered by different IFs in different EU Member States, will be permitted or not and in case that dual listing will be permitted how can consistency of information be determined? E.g. in cases where the different country applies different rules particularly regarding:
 - 1. The service provider remaining neutral
 - 2. The KIIS requirements
- ii Requested additional guidance regarding the remuneration of CIFs, with respect to both remuneration received by the Project Owner and the clients/investors.
- iii That according to their understanding where an SPV interposes between an investor and the project owner, it is possible that investment-type crypto assets may be issued to the investors representing the relevant TSs offered which is still in the safekeeping of the crowdfunding provider.
- iv That according to their understanding the businesses which have no commercial activity other than investment fall within the scope of other regulatory frameworks (AIFs Law & UCITS Law) and are excluded from the Crowdfunding Directive.
- v That according to their understanding the investment-type crowdfunding projects can only be done through an investment firm.

CySEC'S POSITION

- 3.5.3. Where a CIF decides to accept a project which is or will be dually listed should ensure that this is explicitly disclosed in the KIIS under Section D(A) - Total amount and type of transferable securities to be offered, providing the relevant break down per IF. It might also be subject to a tripartite agreement between the Project Owner and the Investment Firms involved, to ensure the consistency of information amongst other investor protections.
- 3.5.4. In relation to the remuneration we reiterate that such remuneration should be in line with the provisions of the Law, as may be further substantiated by the Crowdfunding Directive, and shall not result in incentivising CIFs providing Crowdfunding Services to route investors orders to a specific project instead of another, such as the case would be with a success fee (i.e. bonus) offered by a specific Project Owner to the CIF incentivising it to prioritise towards the projects of the specific Project Owner.
- 3.5.5. The rules in relation to the (restricted) use of SPVs aim at ensuring that no evasion of the prohibition of (individual or collective) portfolio management through a pooling at SPV level may take place; this is also in order to ensure that the CIF acting as a Crowdfunding Services provider remains at all times a neutral intermediary. In any case as per CP-03-2019 we would like to reiterate that In line with CySEC announcement dated 15 November 2017, products utilizing Distributed Ledger Technology (“DLT”) depending on their characteristics may fall under the existing regulatory framework. Therefore entities engaging in such activities should be very cautious and comply with the Legislation.
- 3.5.6. The Crowdfunding Directive is primarily drafted having in mind the offering of TSs by SMEs. We have not considered the case of offering of financial instruments issued by Collective Investment Undertakings in the context of our proposal. Interested parties must bear in mind that in such cases the provisions of the sectorial legislation are also triggered and marketing might be subject to national rules. It might also be challenging to fit into the Crowdfunding framework (including into the relevant definitions of the Crowdfunding Directive).
- 3.5.7. TSs may still be offered directly by the Project Owners, in compliance with the applicable framework. However where the offering is performed through an intermediary acting in the capacity described herein and in the Crowdfunding Directive, such intermediary must be authorised as a CIF.