ΕΠΙΤΡΟΠΗ ΚΕΦΑΛΑΙΑΓΟΡΑΣ ΚΥΠΡΟΥ
CYPRUS SECURITIES AND EXCHANGE COMMISSION

PRESS RELEASE

CySEC consults on the introduction of investment-based crowdfunding rules

NICOSIA, 15 November 2019 - The Cyprus Securities and Exchange Commission ('CySEC') has today issued a Consultation Paper on adopting rules for investment-based crowdfunding.

Crowdfunding serves as an alternative method to bank financing, through which small and medium enterprises ('SMEs') have access to funding by means of loans or issuance of transferable securities (typically shares or debt instruments). This access point is typically provided by an internet-based electronic information system, or a platform, whereby the crowdfunding service provider matches SMEs seeking financing with the interests of those funding investors – and in return for financing a business interest – a potential economic return is generated.

CySEC's proposal to introduce a Crowdfunding Directive relates solely to investment-based crowdfunding through transferable securities and excludes loan-based, reward-based and donation-based crowdfunding.

The proposal for a Crowdfunding Directive is comprised of a set of secondary rules for investment-based crowdfunding under Cyprus' Investment Services and Activities and Regulated Markets Law (the 'Law'), into which MiFID II is fully transposed. The proposed Crowdfunding Directive prescribed under the Law is therefore complementary to MiFID II's obligations, including but not limited to: conduct of business rules; management of conflict of interests; holding clients' money and financial instruments and product governance.

In offering cross-border transferable securities via investment-based crowdfunding, crowdfunding service providers and their platforms will be subject to prospectus thresholds governing the marketing, sale and distribution of securities across the European Union.

The licensing regime will classify crowdfunding service provides as Cyprus Investment Firms ('CIFs') dealing in Transferable Securities but will be subject to additional provisions as they relate to investor protection for investment-based crowdfunding.

These provisions on CIFs acting as crowdfunding service providers, contained within the proposed Crowdfunding Directive, include:

- **Conflicts of interest:** (i) CIFs will be subject to neural intermediation[1] through licensing and activities restrictions thereby ensuring, amongst other things, fees paid by the project owner to the CIF are not linked to order routing; (ii) CIFs will not be allowed to receive

[1] This means the CIF classified as a Crowdfunding Service Provider does not become party to the transaction and does not participate in the execution of an order on behalf of an investor, but they are merely arranging the relevant transaction by bringing together the investor and project owner who is seeking funding – in a fair, transparent and not misleading manner.

order routing benefits in respect of crowdfunding projects in general, i.e. both on its own or other platforms; and, (iii) CIFs will not be allowed to acquire (equity or debt as the case may be) participation in crowdfunding projects on a platform or allow certain categories of persons (defined herein as "involved persons") to act as project owners;

- **Customer due diligence:** Additional customer and financial due diligence in respect of both the crowdfunding project (including credit risk) as well as the project owner, which must be implemented before a project can be listed on a platform. Identity verification and anti-money laundering checks must be performed on both the end-investor and project owner;
- **Transparency obligations:** Project owners must produce a standardized pre-contractual document (under the responsibility of the project owner), including the natural persons effectively conducting the project owner's business. This must be detailed in a Key Investment Information Sheet ('KIIS') and that certain procedures are in place for ensuring that the content of KIIS is up to date and for rectifying errors or omissions. Marketing communications must be clear, accurate and not misleading, and consistent with the content of marketing communications and that of the KIIS.
- **Safeguarding clients' funds and financial instruments:** All monies raised via the crowdfunding platform must be transferred by the CIF to the project owner only after the successful closing of the relevant offer (i.e. only if it meets or exceeds the funding goal). Financial instruments (i.e. transferable securities) subject to safekeeping must be divided into custodial and non-custodial transferable securities. Specific rules must be introduced for the safe-keeping of those transferable securities that are not subject to custody and specific information requirements are provided for vis-à-vis investors with regards to the safe-keeping.
- **Fair pricing:** Clarifications will be provided on the operation of a bulletin board by the CIF, through which crowdfunding clients of the CIF advertise their interest to buy or sell (as the case may be) transferable securities that had been made available through the CIF's platform, thus providing exit opportunities for the end-investor.

As a key pillar of the European Union's Capital Markets Union, the European Commission's proposal for an EU Bespoke Crowdfunding Framework (the 'Framework') is currently subject to an ongoing legislative process. CySEC's proposed Crowdfunding Directive has taken into consideration the content of the proposal should it come into force at a later date, without prejudice to the overall investor protection offered by the MiFID II regime and to assist with a smooth legislative transition at the appropriate time.

CySEC expects its initiative to alleviate some but not all of the risks involved in investment-based crowdfunding and enhance investor protection therein. To this end, investors should understand the high risks entailed before proceeding with any investment-based crowdfunding investment, even where bespoke rules are in force. From CySEC's market due diligence, these recurrent risks include:

- The high likelihood of investors losing their entire invested amount, primarily because the means of alternative financing is most common in support for start-up businesses where the risk of corporate failure is high;
- Dividend or coupon 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 project owner;
- Startups may proceed with several rounds of share issuance, which in effect may result in diluting the value of the initial investment;
- The exit opportunities (i.e. cashing in) might be severely constrained as a result;
- The possibility of fraud cannot be ruled out.

Consultation process:

Interested parties may submit their comments to the CySEC Policy Department by email at policy@cysec.gov.cy.

The submission of comments should be made **no later than 2 December 2019**.

The subject of the email should have the following form:

"*Consultation Paper (2019 - 03) – [insert the Name of Organisation, Legal or Natural Person submitting the comments or views]*"

ENDS.