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Short Version (English)

CROWDFUNDING

An analysis of 18 platforms in Germany, Switzerland, United Kingdom and Austria seen from the perspective of consumer

Summary of the findings of AK-survey

The Federal Chamber of Labour carried out a survey and did an analysis of 18 internet-based crowdfunding platforms in Germany, UK, Switzerland and Austria. The sample was aligned with the criterion to draw a qualitative image of various types of crowdfunding. The study is available in a full version in German language. [1]The subject of the study was to get information about the quality of information, seen from consumers' perspective. Therefore, the platforms were examined relating to following points:

- Risk warnings
- Return arguments
- Costs (for consumer or investor)
- Right of withdraw (according to distance selling contracts) and terminate a contract
- Clear Information dedicated to consumers (e.g. FAQ)
- Website Information/Disclaimer (in German: Impressum)
- General Terms and Conditions of Business

1. Definitions

In crowdfunding, project or enterprise financing is obtained from a large number of investors who find out about the projects on Internet platforms. Crowdfunding is a generic term covering many types of activities.
The consultation started by the European Commission describes crowdfunding as follows:

> *"Typically on the two sides of a crowdfunding transaction there is a person with an idea for a project who sets up a crowdfunding campaign on one side (project owner or campaigner), and many people who give money to realise this idea on the other side (contributors).*
>
> *The campaigner can collect funds directly, but often a web-based intermediary (so-called 'crowdfunding platform') will assist in publishing campaigns, reaching contributors and collecting funds. These platforms usually perform certain screening and monitoring functions as well, and they typically charge a fee for these services. In 2012 it was estimated that there were more than 200 crowdfunding platforms in Europe."*[2]

[1] http://media.arbeiterkammer.at/PDF/Crowdfunding_Verbraucherschutz_2014.pdf

[2] http://ec.europa.eu/internal_market/consultations/2013/crowdfunding/docs/consultation-document_en.pdf Page 3.

Proceeding from the definitions of terms in the consultation paper on crowdfunding, one can distinguish various ways in which consumers participate in crowdfunding platforms:

- donations,
- sponsoring (*advertising in exchange for financing*),
- rewards (*a product or service of lower value than the contribution),*
- pre-selling (*collecting funds to develop and deliver a product*),
- lending (*the project borrows money from the crowd with or without interest*) and
- securities-based investments, *where the project issues shares or bonds to contributors to the crowdfunding campaign*. [3]

A typology of crowdfunding platforms:

- **Crowdfunding** based on **donations:** Money is collected to support the project and is not paid back if funding is successful. The contributor receives rewards or goodies as an acknowledgement.
- **Crowd investing** involves the acquisition of project shares. Several platforms offer the acquisition of equity shares/profit-shares (www.bergfürst.de, www.crowdcube.com, www.darwinonline.com)
- **Crowd lending:** In this case, investors (lenders) are brought together with people acquiring loans (borrowers such as private individuals, companies or other organisations).
- **Hybrid forms:** Platforms offering donations, as well as investing and (or) lending (credit facilities, loans).

2. Findings from the analysis of platforms

The 18 platforms examined have the following varying focal points:

Type of crowdfunding	Number of platforms
Support/donations	7
Investing	7
Hybrid forms (lending and/or donations and/or investing):	4

Among the 18 Internet-based platforms examined, there are not only several **hybrid forms** (mix of funding, investing, lending), but also very different thematic emphases (in

[3] http://ec.europa.eu/internal_market/consultations/2013/crowdfunding/docs/consultation-document_en.pdf Page 4 ff.

terms of sectors, size of enterprise, scientific, business, cultural or other NGO financing, hi-tech start-ups, already established SMEs, etc.). The platforms provide website visitors with myriad statistics of (usually) successful and finished projects.

The **product categories** (forms of participation) made available to consumers on the platforms examined can be divided as follows **on a country by country basis**:

- **Germany**: Subordinated loans, equity shares, support (donations), silent partner's holding
- **Switzerland**: Equity shares, donation, loan agreement
- **England**: Stock/participation (shares), support (UK), credit facilities (lending)
- **Austria:** Participation rights, donation or support

Thus the following product forms are on offer:

- **Monetary contribution** (with or without gift of acknowledgement, usually determined by the project beneficiary) or other type of support (e.g. through cooperation, purchase of vouchers, guides, and the like).
- Investing: This category included **financial instruments** such as equities and participating certificates (participation right similar to equity shares).
- Lending: **Credit facilities** extended by a private individual to a private individual (*peer-to-peer lending*), which Austria does not allow (a Swiss example: cashware AG). The German platform seedmatch.de offers subordinated loans with profit participation.

It is no wonder that consumers encounter many **different designations** in this context: Along with investors, there are supporters, sponsors, backers, boosters (e.g. at www.100-days.net) etc.

In investing, (e.g. participating certificates) the usual investment criteria come to the fore:

- **Return**
- **Risks**
- **Commitment** or possibilities to withdraw (after entering into an agreement) and terminability.
- **Costs** are also an investment criterion, especially if returns are not fixed and proceeds stem solely from company profit or value appreciation. Detailed findings on these investment criteria:

Return arguments are not necessarily in the forefront. Platforms rarely held out the prospect of their products delivering higher profits than other investments. For instance, the German platform seedmatch.de presented the following argument: "*You can now benefit from multiple return potential." The* English platform Crowdcube described the return as follows in connection with risks:

> *"Investing in start-ups or early stage businesses isn't risk free, but the returns are potentially great (…)."*

The quality of information varied in the **references to risks**. There were differences in the following respects:

- Visual positioning and layout: Risk was presented on one platform, for example, at the bottom of each article page; more often as a separate link (e.g. *“Risk Warnings*”) in the footer area of the website; often in FAQs or in the terms and conditions of business. Just one website featured a readily visible button with “Loss of capital paid in”).

- Formulations and choice of words: In some cases there were highly explicit and comprehensive notes on risks or risk lists (e.g. for securities); or in others there were also vague formulations such as “ … is not free from risk”)

- Available or not at all available: As a rule, donation platforms contained no reference to a risk such as the loss of the donation. On one investing platform, there was no reference at all made to a possible total loss (www.bergfuerst.de).

- In many cases, information on risks for a website visitor could only be found after a lot of searching.

Rights to withdraw and terminate are especially important for consumers. No standard approach was ascertainable for withdrawal (possible within a certain period after entry into an agreement) or the termination of the agreement or participation:

- Four of 18 platforms contained no information on withdrawal or termination whatsoever,
- Three of the 18 platforms provided information that withdrawal or termination was “not possible.”
- On investing websites offering investors participation agreements, termination provisions varied (from three to ten years).
- Several platforms in Germany, Switzerland, England and Austria did contain information that a consumer could **withdraw** from an agreement within a certain period after entering into it. The periods named were 7 or 14 days.

The **costs** were examined from the perspective of which **expenses were charged to the investor**. There are diverse costs that affect both private investors and the projects being financed. It should be added, however, that (higher) costs are usually incurred by the project beneficiary being financed:

- Platform commissions are (usually) collected only if funding (of an enterprise) is successful. These commissions range from 5% to 10% of the total collected (“total funded”). Various fixed fees (for service or administrative expenses) can also apply (e.g. 1,750 British pounds at BankToTheFuture for “*company secretarial service*”).

- Transaction expenses can also be incurred for private investors or contributors: The amount depends on the transaction operator (Paypal, credit card, direct debit from account, GoCardless, SecuPay, Fido Bank, fairgive.org). Transaction fees (Paypal, credit card, GoCardless, etc.) are also incurred by the supporter/investor even if funding does not succeed. As a result, the *financial gateways* are the sure winners in these transactions.

General terms and conditions of business (GTCB) were present in almost every case (with two exceptions: one in England and one in Austria) but it was not always possible to find **Website Information/Disclaimer** along with a description of the line of business or the business permit or business license:

- **Germany:** All four German platforms had a "Website Information/Disclaimer" section.
- **Switzerland:** Only one of the four Swiss websites examined did not have a "Website Information/Disclaimer" section.
- **England:** The English platforms did not have a "Website Information/Disclaimer" section but there was usually information about the service providers in menu points such as "*About us*" or under "*Privacy Policy*".
- **Austria:** All Austrian platforms had a "Website Information/Disclaimer" section.

It is therefore not always easy for consumers to determine the "platform provider" and its commercial thrust (line of business). It was striking that many platforms explicitly stated that they **do not provide investment advice** (seedmatch.de, Conda.at).

The German stock trading platform bergfürst.com has a BaFin license (e.g. a license from the Federal Financial Supervisory Authority in Germany). It too stated that it did not provide investment advice. The Swiss company cashware.ch stated in its general terms and conditions of business that it conducted **"no consulting"** and made no recommendations.

All platforms examined contained a large **number of crowdfunding terms** that sounded good but that were not self-explanatory. There are a lot of designations requiring further explanation particularly in the investing area, e.g. equity-based crowdfunding, asset participation rights, participating certificates, initial contributions by an atypical silent partner as "mezzanine capital", funding threshold, funding limit, etc. Although almost no glossaries are provided, there are often FAQs (Frequently Asked Questions) with explanations of terms. These FAQ lists are geared to project initiators and to investors.

The brief descriptions below of different platforms vividly show how varied the characteristics of the crowdfunding platforms can be:

BankToTheFuture (https://banktothefuture.com) BF Ventures Limited) presented itself as a start-up on its own platform. The commission doubles from 5% to 10% if merely the "minimum funding goal" is achieved. This 10% figure is not indicated in the price list of BF.

bergfürst (www.de.bergfuerst.com) presented itself as an independent "exchange" for equity trading and has a BaFin licence (i.e. from the German financial supervisory authority). No start-ups are allowed to be presented on this platform, only established companies.

seedmatch (www.seedmatch.de) reached project volumes of up to € 250,000 using “subordinated loans with profit participation” (“partiarische Nachrangdarlehen”) and € 1 million with follow-up financing (“Anschlussfinanzierung”).
wemakeit (www.wemakeit.ch) openly explained that transaction costs are billed to the investor if funding is not successful. That means any time an investor participates in failed funding, the capital paid in is reduced. The funding period was at most 45 days. At **100-days.net,** the maximum period for collecting donations was set at 100 days.

The GTCB at **cashare** (www.cashare.ch) explicitly noted that the Federal Consumer Credit Act did not apply. The interest rate on loans at ***cashare*** was 7.5% to 9.4% and thus above the customary bank interest rates (as of August 2013).

crowdcube (www.crowdcube.com) charged project beneficiaries a host of costs whereas investors paid no expenses. On the **crowdfunder.co.uk** website, investors also paid quite substantial transaction expenses: 20 pence (flat fee) plus 1.9% of the amount paid in.

After the initial collection of data in August 2013, the platform **fundthegap** could be opened more at http://darwinonline.com, a successor website primarily focusing on initial public offerings of companies in England and serving as an electronic trading platform.

3. Detailed analysis of the Austrian platforms

Three of the six Austrian providers of crowdfunding were strictly donation platforms; three of six Austrian platforms provided investments for investors in the form of participation rights (investing platforms). These **investment products** definitely involve risks. These investments in companies are similar in character to equity shares and ensure the holder a share of the company profit and of liquidation proceeds. The return from the investors’ perspective is therefore uncertain.

How are investors informed about the **risks**?
The three Austrian donation platforms had no risk notices whereas the investing platforms did present risk information. The quality of that information varied greatly, however. The most incisive was a button on the platform conda.at with the visually striking message “*Loss of amount paid in”* as a possible risk. All three platforms examined contained a notice about possible “total loss”. That is basically a positive sign because it shows that risk is not being downplayed. More incisive explanations would be desirable.

What **costs** are incurred for investors?
The information ranged from “completely cost-free” (greenrocket.com) to “6 euros on the sale of a share” (conda.at).

What information was provided on withdrawal rights?
Only one of the three investing platforms had "visible" notices regarding a **right to withdraw** (14 days after entry into the agreement). That is not consumer friendly as it pertains to a distance selling transaction (transaction conducted over the Internet)

involving financial services for which there is a legal right to withdraw for a period of 14 days.

How long is the transaction **binding** on investors?
According to information on the homepage, the holders of participation rights (participating certificates) are entitled to terminate the agreement for the first time after a period between five and ten years (after five years at 1000x1000.at; after ten years at conda.at and greenrocket.com). It can also happen that a company can terminate the participating right after a certain set period. In summary, one can say that the information on withdrawal and termination could stand improvement.

All six Austrian platforms had links to the **General Terms and Conditions of Business (GTCB)** on their homepage with the exception of conda.at and all of them had a “Website Information/Disclaimer” section. The examination of the business permits/business licences, however, revealed that only one of the three investing platforms had a financial consulting license.
That is surprising because the platforms may state that they do not engage in investment consulting but they are acting nonetheless as intermediaries for an investment product. AK believes a business licence is also required for that for financial consulting according to §136a Austrian Trade Regulation Act (Gewerbeordnung).

4. Demands made by AK from the perspective of consumers

- Clarify terms and definitions, particularly on crowdfunding categories (crowd lending, crowd investing, etc.). Clarify the terms “platform” and “portal”, which might suggest, for example, that myriad projects are involved and independence prevails (in intermediary services).

- Set **formal requirements** on content and structure for the **crowdfunding websites** (Website Information/Disclaimer, terms and conditions of business, rights of withdrawal, risk notices, duration, number of projects, etc.) to ensure cross-border standards for information. Crowdfunding websites in England lack a “Website Information/Disclaimer” section altogether.

- Implement **mandatory and clearly visible risk notices** for each type of project (traffic light as a striking information instrument for the Internet) regardless of whether donations, investing or lending is involved.

- **Distinguish clearly between donations), investing** (monetary investment, participation) **and lending** (credit facilities, loans) and impose defined, non-product-specific duties to provide consumers with information (in the form of a product information sheet). A higher level of protection should be ensured for platforms appealing to the wider investing public to lend and invest than for platforms involved (solely) in the collection of donations.

- **Distinguish clearly** between product intermediation (for lending and investing.) for investors and advisory activity for companies or capital recipients (to avoid conflicts of interest).

- **Ensure** that the activities of platform operators satisfy the licence obligations for credit and securities transactions and/or requirements under trade law for intermediary services for investments.

- **Regulate credit transactions strictly**: Austria prohibited bankless-life.at from conducting business, thereby clearly drawing the line at non-regulated credit transactions:
  http://www.fma.gv.at/fileadmin/media_data/1_Ueber_die_FMA/3_Presse/1_Pressemitteilungen/Deutsch/2010/07_01_10_pm_banklesslife.pdf

- **Obligate** crowdfunding platforms **to be registered** by the supervisory authorities and to be published in a public register (on the Internet).

- **Ensure consumer rights** especially the right to withdraw from distance selling agreements (credit, securities purchase, participations)

- The platform operations themselves are obligated to **examine projects** and subject them to logical examination criteria.

- **Do not soften licence obligation by modifying deposits business in the Banking Act**

Deposits business in the Banking Act is defined narrowly for good reason. This definition should not be diluted with extremely vague formulations in cases where companies are said not to fall under "deposits" provision as the term is defined in the Banking Act if the financing money accepted is used for an "activity for the real economy". "Activities for the real economy" are impossible to narrow down in actual practice. One main risk from the standpoint of savers cannot be ruled out, namely that the funding raised from the public is not used to finance assets (having a long-term effect; e.g. purchase of means of production), but merely to plug up holes and overcome liquidity bottlenecks (that can no longer be fixed). Accepting deposits without being a member of a deposit insurance system would also not be in conformity with the pertinent directives.

- **Refrain from further weakening of prospectus law**

The central idea of prospectus law is to make available in one document all essential information an interested investor needs to decide on an investment and to make the issuer, prospectus auditor and auditors of the annual accounts liable according to Article 11 Capital Market Act (Kapitalmarktgesetz (KMG)) for the correctness and completeness of this information (in the sense that all essential information under Article 7 para 1 KMG is included). The prospectus for an issue (or a subsequently issued prospectus) contains an ex-ante examination and is grounds for liability of incorrect and incomplete information in the prospectus. The issue prospectus must be published and is subject to the principle of disclosure. Any weakening of the prospectus obligation for crowdfunding platforms would cause liability provisions to be eliminated and dilute prospectus law as a whole.