

## **ESMA final report on the draft technical standards under the Regulation 2020/1503 on European crowdfunding service providers for business. International Bulletin, June 2022.**

On 10 November 2021, ESMA published its final report on the draft technical standards developing Regulation (EU) 2020/1503 of the European Parliament and of the Council of 7 October 2020 on European crowdfunding service providers for business.

Regulation (EU) 2020/1503, which was published in the Official Journal of the European Union on 20 October 2020 and began to apply on 10 November 2021, required ESMA to develop 12 technical standards: eight regulatory technical standards (RTS), including two to be developed in close cooperation with EBA, in addition to four implementing technical standards (ITS) on a variety of topics. ESMA had to send eight of these draft technical standards to the European Commission by 10 November 2021 at the latest, while the other four drafts had later delivery deadlines, until 10 May 2022. However, ESMA decided to fulfil all its mandates simultaneously on the first delivery date in order to provide, given the novelty of the matter, as complete and rapid guidance as possible to both the National Competent Authorities (NCAs) and the interested parties on how apply the Regulation, especially some novel aspects in terms of investor protection.

ESMA published a consultation, which was open from 26 February to 28 May 2021, on seven of the draft RTS and two of the draft ITS, and this final report contains some of the comments received. The draft technical standards on cooperation between Authorities were excluded from the consultation, as the consultation was considered disproportionate in relation to its scope and impact.

The European Commission has a period of three months from their reception in which to decide whether or not to adopt the regulatory and implementing technical standards in accordance with Articles 10 to 15 of Regulation (EU) No 1095/2010 establishing a European Supervisory Authority (ESMA), which it has so far not done by means of delegated acts.

Regulation (EU) 2020/1503 regulates for the first time the provision of crowdfunding services throughout the European Union, allowing the cross-border provision of crowdfunding services and establishing harmonised investor protection requirements and standards.

Crowdfunding services are defined as 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: a) the placing without a firm commitment basis of transferable securities and instruments admitted for crowdfunding purposes issued by project owners or a special purpose vehicle, and the reception and transmission of client orders in relation to those transferable securities (investment crowdfunding) or b) the facilitation of the granting of loans (lending crowdfunding). In addition, crowdfunding service providers can provide the service of individual portfolio management of loans. Although the activities of letter i) are two activities of Annex I to

the Markets in Financial Instruments Directive (MiFID II), Article 2.1.p) of this directive (added by Directive (EU) 2020/1504) excludes crowdfunding service providers from the scope of application of MiFID II.

Regulation (EU) 2020/1503 contains a set of its own provisions for the adequate protection of the investor so that the level of protection of the client of a European crowdfunding service provider (ECSP) is appropriate to the activity that they carry out and their objectives (alternative source of financing for companies, visibility of projects, etc.).

Recitals 70 to 72 of Regulation (EU) 2020/1503 establish that the objective of technical standards is to promote a consistent application of the Regulation and sufficient protection for investors and consumers throughout the European Union. Indeed, the technical standards develop some of the main innovations in terms of investor protection or refer to other novel aspects of the Regulation.

The regulatory technical standards specify or establish the following aspects:

1) *The requirements, standard formats and procedures for **complaint handling**.* (Article 7.5 of Regulation (EU) 2020/1503). ECSPs must publish an updated description of the procedures for submitting complaints on their website in each of the languages used to prepare the Key Investment Information Sheet or marketing communications. Complaints may be submitted in any of the languages in which the crowdfunding service or offer to which it refers is marketed. The ECSP will acknowledge receipt of the complaint and confirm its admissibility within 10 days of acknowledgment of receipt and the decision on the complaint must be communicated within the period determined in the procedure. The technical standard includes an annex with a model complaint form.

2) *Requirements for the maintenance or operation of internal rules to prevent **conflicts of interest**; appropriate steps to prevent, identify, manage and disclose conflicts of interest between ECSPs and their clients, or between two clients, and arrangements for the disclosure of information on conflicts of interest.* (Article 8.7 of Regulation (EU) 2020/1503). The internal rules, which must be proportionate to their size and organisation (taking into account their membership in a group) and the nature, scale and complexity of the business and which will be updated at least annually, will require ECSPs to at least: a) identify whether shareholders holding more than 20% of the share capital, managers or employees or persons linked to them by control (relevant persons) have been accepted as investors; b) identify any other circumstances that could give rise to an actual or potential conflict of interest and c) adopt measures to ensure that relevant persons do not receive preferential treatment or have privileged access to information. To ensure that the relevant persons who may be involved in a conflict of interest carry out their activities with the degree of independence appropriate to the size and activities of the ECSP and the risk of harm to clients' interests, the ECSP must establish measures for the control of the exchange of information, the separate supervision of the relevant persons, the elimination of any direct links between the activity and remuneration and the prevention of inappropriate exercise of influence on said relevant persons. The *measures to prevent and manage conflicts of interest* between ECSPs (or their shareholders, managers, employees or persons linked to them by control) and their clients, or between two clients, will have the objective of ensuring that the risk of harm to clients' interests is prevented and, when this is not possible, adequately mitigated. In addition to the provisions of the Regulation, it is understood that such harm exists when there may be a financial gain (or a loss avoided) at the expense of the client, an interest other than that of the client in the result of the provision of the service or an incentive to favour a particular client over the interests of other clients. ECSPs must *disclosure* on their websites, information on the nature and sources of conflicts of interest, as well as the measures adopted to mitigate them and communicate this information to the client unless no conflict of interest has been identified. This communication will allow the client to make an informed decision about the service in relation to which the conflict of interest has arisen.

3) *The measures and procedures for the **business continuity plan**.* (Article 12.16.b of Regulation (EU)

2020/1503). ECSPs shall have a continuity plan in the event of the ECSP's failure or any significant business interruption. Its minimum content shall include: a) measures and procedures to ensure the continuity of the provision of critical services (even delegated to third parties) defined as those whose default or non-compliance would materially affect compliance with the conditions of the authorisation or others established in the Regulation, its financial performance or solvency with respect to its clients and b) measures and procedures to guarantee the good administration of the agreements between the ECSP and its clients and of critical commercial data, such as the traceability of payments between clients and project owners. The procedures must detail, at least, the three most likely scenarios of failure and the measures to mitigate their impact on the continuity of critical services.

4) *The requirements and arrangements for **applying for authorisation** to operate as an ECSP, including model forms, templates and procedures for requesting authorisation. (Article 12.16.a of Regulation (EU) 2020/1503).* The technical standard establishes a model form to communicate to the NCAs the request for authorisation to operate as an ECSP. To facilitate communication, the NCA must designate a specific point of contact for this purpose, which must be published and kept updated on the NCA's website. The NCA will acknowledge receipt of the application within 10 days of receipt, including the contact details of the person in charge of managing the application. This 10-day period is different from the 25-day period that the NCA has to check whether the information is complete, so that, if the NCA requires the ECSP to provide the information necessary for it to be considered complete, the 25-day period is suspended until the date of receipt of the information. Regarding changes in the information presented in the application for authorisation, the prospective ECSP must communicate them to the NCA and the period of three months to resolve the authorisation will count from the receipt of the updated information. The technical standard includes an annex with a model application for authorisation form that is very detailed and explains the information to be included therein.

5) *The **default rate calculation methodology** (annual default rate and expected and actual annual default rates by risk category) of the projects offered on the crowdfunding platform (Article 20.3 of Regulation (EU) 2020/1503).* ESMA has prepared this technical standard in close cooperation with EBA, having taken the concept of non-payment or default of the banking sector: a default shall be considered to have occurred with regard to a particular loan offered on the platform when one or both of the following events take place: a) the ECSP considers it unlikely that the project owner will pay in full or otherwise fulfil its credit obligations without recourse, for example, to actions such as realising the security and/or b) the project owner is more than 90 days overdue on any material credit obligation related to a particular loan.

Indicators of the improbability of payment are considered: a credit restructuring if it can result in a cancellation or deferral of the debt and the request to declare bankruptcy or similar protection that prevents or delays payment. The methodologies that ECSPs must follow to publish the three different default rates are as follows: 1) the annual default rate of the loans offered on the platform is calculated as the simple average of non-defaulted loans at the beginning of the year taken into account as the observation period (in the denominator) and the loans included in that denominator with at least one event of default during that same observation period (in the numerator); 2) the effective annual default rate of all loans offered by risk category established in the risk management framework is calculated as the simple average of the non-defaulted loans of a risk category at the beginning of the year taken into account as the observation period (in the denominator) and of the loans included in that denominator with at least one event of default during that same observation period (in the numerator); and 3) the expected annual default rate of all loans by category of risks will be estimated based on the effective default rate by risk category.

6) *The arrangements in relation to prospective non-sophisticated investors necessary to: a) carry out the **appropriateness assessment** of services (**entry knowledge test**); b) carry out the **simulation of the ability to bear loss** and c) to provide the necessary information and warn of the possible unsuitability and risk of the investment. (Article 21.8 of Regulation (EU) 2020/1503).* ESMA has prepared this technical standard in close

cooperation with EBA. ECSPs must seek information from potential non-sophisticated investors to assess whether they have sufficient experience and knowledge to understand the risks of investing in general and of investing in products offered by an ECSP. For these purposes, ECSPs shall adopt such measures as they deem reasonable to ensure that said information is true and reflects knowledge, experience, financial situation, investment objectives and basic understanding of risks. The information will be proportional to the service or type of investment and granular, including in the investment objectives the expected period of holding of the investment, risk profile, preferences in relation to the sustainability of the investments and purpose of the investment. When the investment is inappropriate or the information is not provided, the ECSP will display on its website a warning about the risk of losing all the money invested, which will remain open until the investor expressly acknowledges its reception and understanding. The ECSPs will also request the simulation of the capacity to bear losses carried out using the calculation tool that they will make available to prospective investors on their website and that will perform the calculation based on the information provided. ECSPs may also offer the ability to simulate their ability to bear losses through a different method. Loss-bearing capacity is calculated as 10% of net worth (annual income and total income + liquid assets - annual financial commitments).

7) *The requirements for and content of the model for presenting the information to be contained in the **Key Investment Information Sheet (KIIS)**; the main types of risks associated with the crowdfunding offer and which must therefore be disclosed; the use of certain financial ratios to enhance the clarity of key financial information; and commissions, fees and transaction costs, including a detailed breakdown of direct and indirect costs to be borne by the investor. (Article 23.16 of Regulation 2020/1503).* The KIIS, which is one of the main novelties of the Regulation as regards investor protection, is a pre-contractual information document that must be available to potential investors as soon as the offer is published on the ECSP's website. The technical standard includes an annex with a KIIS model that facilitates the comparability of the different offers and their preparation by the project owners. The KIIS model bears on the first page the disclaimer clause and the risk warning of Article 23.6. of the Regulation, the possibility of a pre-contractual reflection period for non-sophisticated investors of Article 22 of the Regulation, as well as a summary of the offer, including its identifier. Next, the KIIS, following the sections described in Annex I of the Regulation, must contain detailed information about the project owner and the crowdfunding project (hyperlinks to recent financial statements, etc. may be included), the process and conditions for raising capital or borrowing funds, the main types of risks, information on the offer of negotiable securities (or instruments admitted for crowdfunding), information on special purpose vehicles (SPVs), investor rights, communications related to loans and fees and legal redress.

8) *The **information to be exchanged** between NCAs to cooperate in investigation, supervision and enforcement activities. (Article 31.8 of Regulation (EU) 2020/1503).* Information must be of sufficient scope and nature to enable NCAs to carry out their investigative, supervisory and enforcement activities. The technical standards specify the information that could be requested from ECSPs, as well as from other natural or legal persons. Specifically, in relation to the ECSP, information could be requested on the ECSP itself (for example, on the authorisation process or sanctions imposed), on the natural persons responsible for the management of the ECSP (for example, honourability and suitability, dismissals, criminal record and civil/administrative sanctions or ongoing investigations) and on shareholders with more than 20% of the ECSP (such as no criminal record or information on civil/administrative sanctions).

9) *Data standards and formats, templates and procedures for the **annual information to be reported by ECSPs to NCAs and from NCAs to ESMA**. (Article 16.3 of Regulation 2020/1503).* The technical standard includes three tables. The first, explanatory of the terms used in the other two; the second, with the information to be sent by the ECSPs to the NCAs on the lists of projects funded (specifying, among other things, the amount raised and aggregated information on the investors and the amount invested) and the third, with the information to be sent by the NCAs to ESMA on said projects in anonymised format. The information to be notified for each project will include identifiers of the ECSP and the project owner.

10) *Forms, templates and procedures for the **notifications by NCAs on the publication of national provisions concerning marketing requirements**. (Article 28.5 of Regulation (EU) 2020/1503).* ESMA will inform the NCAs of a point of contact that shall be used for the notifications. The technical standard contains two annexes: Annex I, which includes the information to be sent on the national provisions on marketing, which must be sent within two months of the entry into force of the Regulation and Annex II, with the information to be sent in the event of changes in said provisions without delay and always before the entry into force of said provisions in the Member State.

11) *Models of forms, templates and procedures for the **cooperation and exchange of information between NCAs**. (Article 31.9 of Regulation (EU) 2020/1503).* To ensure that NCAs can cooperate and exchange information in an efficient and timely manner, they must designate a point of contact. The technical standard includes several annexes: Annex I, for the request for cooperation or exchange of information, including the reasons for the request; Annex II, for the acknowledgment of receipt of the request; Annex III, to respond to a request or for unsolicited exchanges of information; and Annex IV, to deny cooperation in exceptional circumstances. The procedures for requesting a statement or an on-site inspection or an investigation are specifically established, including the possibility that the latter be joint in the context of a request for cooperation.

12) *Models of forms, templates and procedures for the **cooperation and exchange of information between NCAs and ESMA**. (Article 32.4 of Regulation (EU) 2020/1503).* Both the NCAs and ESMA must designate a point of contact for requests for cooperation and exchange of information. It also includes several annexes: Annex I, for the request for cooperation or exchange of information, including the reasons for the request; Annex II, for the acknowledgment of receipt of the request; Annex III, to respond to a request or for unsolicited exchanges of information; and Annex IV, to request that ESMA coordinate an on-site inspection or an investigation with cross-border effects. For this ESMA coordination function, it is established that the NCAs will provide this Authority with all the necessary information, and that ESMA may establish a temporary group that includes the NCAs of the Member States affected by the inspection or investigation.

**Useful link:**

[ESMA final report on the draft technical standards under the European crowdfunding service providers for business Regulation \(Regulation \(EU\) 2020/1503\)](#)