

The Spanish Crowdfunding Act

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ABSTRACT

This article analyzes crowdfunding platforms object of Title V, Act 5/2015 of 27 April, on Promoting Business Finance, a Title known as the "Spanish Crowdfunding Act". It studies the background with references to comparative law. Its nature and its legal system are also analyzed as a new financial intermediary subject to rules of conduct. Following this analysis the paper assesses the timing and scope of the new regulation.

Keywords: *crowdfunding platforms, shadow banking, investor protection.*

I. GENERAL CONCEPTS

New technologies allow for the creation of online platforms that connect project owners in need of funding with savers willing to accept risk in exchange for remuneration. The crowdfunding phenomenon is widespread and has thrived mostly in banking-oriented countries, such as Spain, where bank credit has decreased the most as a result of the recession, especially for SMEs that have been forced to seek alternative financing sources.¹

Crowdfunding involves offering securities or loans in order to finance projects over the internet. It provides a mechanism for direct channelling of savings into productive investment alongside the mechanism available through stock exchanges and other regulated markets. The role fulfilled is the same as that of traditional intermediaries but is carried out in different,

¹Cf. MENÉNDEZ Álvaro and MULINO, Maristela: "Evolución reciente del acceso de las pymes españolas a la financiación externa según la encuesta semestral del BCE", *Economic Bulletin*, Bank of Spain, February 2015, p. 52).

more efficient ways.² The wisdom of the crowd related to crowdfunding confirms that this market is the best mechanism for allocation of savings to investment. The internet allows portals to be developed that act as intermediaries between companies seeking to finance their projects and savers wishing to invest in them, outside public offerings of securities subject to regulation by the Spanish National Securities Market Commission (according to its Spanish acronym, “CNMV”). This is how crowdfunding platforms (“PFP”, according to their Spanish acronym) have emerged, which connect project owners with investors wishing to finance them. It is a flexible mechanism that accepts any type of financial product. In addition to transferable securities, such as shares or bonds, units in private limited companies may be used to obtain financing. The difference lies in the lack of trading in the secondary market. Compared to the stock exchanges, which are trading markets, crowdfunding platforms are mere intermediaries between project owners and investors, and they do not guarantee the existence of a secondary market. They use products that are not transferable securities, such as units. Even simple loans are approved as a vehicle for crowdfunding. Along with platforms that use securities as subject matter of the financial transaction arranged (equity-based crowdfunding), are those that act as intermediaries between lenders and borrowers (lending-based crowdfunding). Their economic purpose is the same, specifically, connecting project owners with savers. What does change is the product used to secure financing, in one case securities and in the other loans. These initiatives have sought to avoid the application of financial legislation in order to reduce compliance costs and provide users with a more efficient service. Therefore, projects involving the issuance of securities that constitute public offerings through loans or products not considered transferable securities are avoided.³

The growing importance of this phenomenon calls for its regulation in order to provide safety measures for the portals managing this new financing means to uphold client

² In the words of RODRÍGUEZ DE LAS HERAS BALLELL: "*Crowdfunding creates value because it goes beyond the simple functional emulation of existing financing models*" (in "Las plataformas de financiación participativa (*crowdfunding*) en el Proyecto de Ley de Fomento de la Financiación Empresarial: Concepto y funciones", *Revista de Derecho del Mercado de Valores*, No. 15, 2014, p. 3 from the electronic version).

³ According to the ESMA, "*Many platforms seem to be structuring business models so as to avoid MiFID requirements*" (in *Investment Advice-based crowdfunding*, ESMA / 2014/1560, 18 December 2014, p. 5).

protection and safety of the financial market as a whole. Platforms wish to operate without the risk of being branded as unauthorised firms. In this regard, the scope of rules and regulations for financial markets should be clarified. Financial activities are subject to legal reserves or state supervision in order to ensure efficient allocation of savings into investment and to protect investors. Public offerings of securities require a prospectus filed with the Spanish National Securities Market Commission. They are subject to the Title on the Primary Market of the Spanish Securities Market Act (“LMV”, according to its Spanish acronym). The scope of conduct of business rules protecting financial clients should also be clarified. Furthermore, savers should also know that crowdfunding is an alternative finance mechanism for investment as opposed to banking and the stock exchange, where specific risks are taken and with different protection for clients. Issuances that form the subject-matter for crowdfunding projects have no prospectus filed and are not registered with the Spanish National Securities Market Commission. Furthermore, there is no deposit or investment guarantee fund to cover the losses of operations intermediated by crowdfunding platforms. In short, investors must be protected against the project owner's risk of insolvency, which is higher in start-ups, against the risk inherent in illiquid non-transferable products and against the risk of fraud associated with any financial innovation as crowdfunding is still a little-known model with its boundaries yet to be set.

In turn, banks and the stock exchange face an alternative mechanism whose competition in the market must be fair.⁴ In this regard, it would be unfair if platforms could gain a market share due to legal loopholes, i.e. by taking advantage of lack of client protection or lack of platforms' solvency rules to gain market share.

Due to the previous reasons, crowdfunding regulation has been imposed. In Spain, the Crowdfunding Statute has been included in Title V, Act 5/2015 of 27 April, on Promoting

⁴The banking industry views it as "*a disruptive element in a scenario where traditional banking was used to being virtually alone*" (cfr. CUESTA SAINZ, Carmen; FERNÁNDEZ DE LIS, Santiago; ROIBAS, Irene; RUBIO, Ana; RUESTA, Macarena; TUESTA, David; y URBIOLA, Pablo: “Crowdfunding en 360º: alternativa de financiación en la era digital”, *BBVA Research, Observatorio de Economía Digital*, 28 October 2014. Available at https://www.bbvaesearch.com/wpcontent/uploads/2015/01/Observatorio_crowdfunding.pdf

Business Finance, a Title known as the “Crowdfunding Act”.⁵ Before embarking on an analysis of the legal framework, the background to crowdfunding and alternatives to its regulation will be described. Following this, the set of rules in the Act on Promoting Business Finance with an examination of the six chapters of the Title on Crowdfunding will be analysed. Said examination will begin with the legal concepts and the legal framework on market access for platforms. Then the conduct of business rules, the framework on project owners and projects, and protection of investing clients will be analysed, ending with a brief reference to the disciplinary proceedings. The article will conclude with some final reflections on the legal framework on platforms.

II. BACKGROUND

Crowdfunding is a new area which is growing exponentially.⁶ It has emerged as a variant of crowdsourcing, which connects people interested in contributing to carry out a task via the internet. Wikipedia is the main example of this.⁷ Vis-à-vis this kind of cultural initiative, funding portals are able to appeal to people for funding. Anyone with a good idea can become an entrepreneur, and anyone with a few euros can become an investor.⁸ Portals emerge linked to specific projects in the charity or culture sectors, and are implemented through donations or small rewards, but they can enter the financial market by offering remuneration.

Remunerated financing can be implemented through loans or securities within the scope of legal reserves on different financial activities. Intermediation between lenders and borrowers is limited to the banking legal reserve of activities relating to raising repayable funds from the public. In turn, crowdfunding through securities must respect regulations on

⁵Discussed in ZUNZUNEGUI, Fernando: “Crowdfunding sin Ley de bienvenida”, *El País*, 17 Abril 2015. Available at http://economia.elpais.com/economia/2015/04/16/actualidad/1429195565_310699.html .

⁶Spain has 34 and is the European country with the second largest number of platforms after the United Kingdom, according to Robert WARDROP, Bryan ZHANG, Raghavendra RAU and Mia GRAY, *Moving Mainstream. The European Alternative Finance Benchmarking Report*, February, 2015, p. 14.

⁷Vid. HOWE, Jeff: *Crowdsourcing: Why the Power of the Crowd Is Driving the Future of Business*, New York, 2009, pp. 57-61.

⁸Vid. BRADFORD, C. Steven: "Crowdfunding and the Federal Securities Laws," *Columbia Business Law Review*, no. 1, 2012, p. 10.

public offerings requiring a prospectus to be filed, and legal reserves on the provision of investment services. Additionally, the provision of payment services to crowdfunding clients should respect the legal reserve on these kinds of services.

Legal reserves could be lifted to regulate the crowdfunding phenomenon, to the extent necessary, on various financial activities, creating a safe harbour for these platforms' business activities. Platforms could also be added to some kind of regulated intermediary's articles of association, whose scope could be used to regulate their specialities. Lastly, the new model could be regulated autonomously. The first option seems the most advisable when the company is in its first phase of business development, and its implications are not yet known.

As it is a financial, internet business, it falls within the scope of the global economy. The G-20 and international financial regulatory bodies, especially the Financial Stability Board, the Basel Committee on Banking Supervision (BCBS) and IOSCO, should have laid down the foundations to regulate crowdfunding.⁹ In the European Union, the Commission and the supervisory authorities in coordinated action, are the bodies responsible for setting guidelines to regulate this phenomenon.¹⁰ These bodies have responded with their views on the impact of crowdfunding in their respective spheres of competence.¹¹ The EBA has analysed platforms that operate using loans, dismissing the fact that they fall within the banking

⁹IOSCO has published a research paper that highlights the advantages and identifies the risks of crowdfunding. It proposes the application of principles applicable to securities regulation goals and monitoring of the development of the industry to achieve better regulation. *Vid.* KIRBY, Eleanor; WORNER, Shane: "Crowdfunding: An Infant Industry Growing Fast", *Staff Working Paper of the IOSCO Research Department*, SWP3/2014, which includes a comparative law annex.

¹⁰*Vid.* EUROPEAN COMMISSION *Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions "Unleashing the Potential of Collective Microfinance in the European Union"*, Brussels, 27.03.2014, COM (2014) 172 final; EUROPEAN COMMISSION: *Crowdfunding innovative ventures in Europe. The financial ecosystem and regulatory landscape*, Directorate-General of Communications Networks, Content & Technology, Brussels, 2014. It has also created an expert committee (*European Crowdfunding Stakeholders Forum*).

¹¹According to Angel CARRASCO PERERA, it was advisable to harmonise the restrictions on crowdfunding in the European Union, otherwise the Single Market will become segmented (*vid.* "Proyecto de ley de fomento de la financiación empresarial: la financiación participativa a través de plataformas de "crowdfunding", *Revista CESCO de Derecho de Consumo*, no. 12, 2014, p. 193).

reserves of activities on raising deposits from the public.¹² It suggests there is convergence between supervisory criteria for this new model and existing legislation being applied, without ruling out the development of a set of European regulations. In turn, ESMA has focused its analysis on platforms that intermediate securities in order to clarify how crowdfunding fits into the legal framework and assess whether specific regulation is necessary.¹³ It is in favour of letting this model continue to grow without undue restrictions, but warns against acting outside financial regulations.¹⁴

In the absence of guidelines from international organisations, the various national legal systems are responding to the need for crowdfunding regulation. The first response came from the United States, which passed a law in 2012 to encourage growth of these initiatives.¹⁵ Its aim is to encourage business financing through funding portals by using exemptions to requirements on public offerings.¹⁶

Italy was the first EU Member State to regulate crowdfunding.¹⁷ The legal framework is limited to financing “*start-up innovativas*”: A reductionist approach, which has been strongly criticised.¹⁸ Italy was followed by France, whose system distinguishes between

¹²*Vid.* EUROPEAN BANKING AUTHORITY: *Opinion of the European Banking Authority on lending-based crowdfunding*, EBA /Op/2015/03, 26 February 2015.

¹³*Vid.* EUROPEAN SECURITIES AND MARKETS AUTHORITY, *op. cit.*

¹⁴In this sense, “*ESMA therefore advises the EU Institutions to Consider whether there is a case for action at EU level to reduce the incentive to structure business models so as to fall outside MiFID*” (*idem.*, p. 28).

¹⁵*Jumpstart Our Business Startups (JOBS) Act* 5 April 2012, which has generated vast literature (*vid. all*, BRADFORD C. Steven *op. cit.*; HAZEN, Thomas Lee: “Crowdfunding or Fraudfunding? Social Networks and the Securities Laws - Why the Specially Tailored Exemption Must Be Conditioned on Meaningful Disclosure” *North Carolina Law Review*, 2012, num. 90, pp. 1735-1770; SCHWARTZ, Andrew A.: “Crowdfunding Securities” *Notre Dame Law Review*, 2013, Vol. 88, pp. 1457-1490).

¹⁶*Vid.* SEC Regulation A +, 25 March 2015, building on the *JOBS Act*, which provides SMEs access to capital through crowdfunding, to \$50 million per year, with exemption from the information and registration obligations set out for public offerings.

¹⁷*Vid.* Art. 1.5 novies and 5i, 50 d and 100b Testo Unico della Finanza; art. 25-32 Decreto Legge 179/2012 sobre “*Ulteriori misure urgenti per la crescita del Paese*” (Decreto Crescitalia 2.0) convertido en Legge 17 December 2012 no. 221; Regolamento Consob n. 18592 of 26 June 2013.

¹⁸*Vid.* LAUDONIO, Aldo: “La folla e l’impresa: prime riflessioni sul crowdfunding”, *Rivista Orizzonti del Diritto Commerciale*, 2014, no. 1, pp. 1-43 (who considers that a new legal framework incurs a “*fatale confusione tra*

crowdfunding involving loans and crowdfunding involving securities in order to give them different legal treatment.¹⁹ The variety of responses shows that we are confronted with a nascent phenomenon, still not understood in its entirety that should be regulated to the bare minimum in order to encourage business activities, whilst maintaining adequate protection for clients and the financial system as a whole. In Spain the maximum level of regulation has been chosen with detailed regulation in the Statute on Crowdfunding Platforms, Title V, Act on Promoting Business Finance.²⁰ It is an interventionist and paternalistic framework, which protects the banking *status quo*.

According to the Spanish Council of State, the Act on Promoting Business Finance,²¹ provides for access to financing in a style comparable to a chain reaction machine. After appealing to family and friends, the first step would be crowdfunding; a step that is capped at €2 million per year when managed by non-accredited investors, and €5 million when managed by accredited investors, in accordance with the definition provided by the Act for these new types of investor. The second step consists of multilateral trading facilities like Spain's Alternative Investment Market (the MAB). Stock offerings of up to €2,000,000 can access Spain's alternative investment market. The third step consists of the official markets, such as stock exchanges. This financial planning goes against free enterprise. Even if is considered that corporate governance standards should be extended to companies that trade on multilateral trading facilities or engage with one another using platforms and extend their

“nuovo” ed “innovativo”, that constitutes a “prima incompleta, macchinosa ed inadeguata traduzione normativa di un fenomeno economico che, seppur giovane, ha già assunto una notevole importanza”); ALVISI, Paola: “Equity crowdfunding: uno sguardo comparatistico”, *Riv. dir.banc.*, dirittobancario.it, 10, 2014, págs. 1-22 [who makes a comparative analysis and is puzzled by the Italian approach (p. 4)].

¹⁹*Ordonnance no. 2014-559 du 30 mai 2014 relative au financement participatif*, discussed by Jérôme LASSERRE CAPDEVILLE in “La réforme du crowdfunding en droit français: les aspects du droit bancaire”, *Revue générale du droit, Etudes et réflexions*, 2015, no. 4, pp. 1-10, who considers it a necessary legal framework with an impact on the banking legal monopoly and on investment services.

²⁰*Vid.* ÁLVAREZ ROYO-VILLANOVA, Segismundo: “El “equity crowdfunding” o financiación en masa de inversión: importancia, problemas y opciones en su regulación”, *Cuadernos de derecho y comercio*, 2014, No. 61, pp. 13-58; RODRÍGUEZ DE LAS HERAS BALLELL, Teresa: “Las plataformas de financiación participativa (crowdfunding) en el Proyecto de Ley de Fomento de la Financiación Empresarial: Concepto y funciones”, *op. cit.*

²¹*Vid.* Opinion of the Spanish Council of State 859/2014.

scope to these companies, there is no reason to limit by law the growth of different types of business financing. Legislators should be limited to regulating the various alternative finance providers in a safe and balanced manner, whilst leaving the market to shape these methods without limiting their growth.

Furthermore, regulation should be open to all initiatives even those from abroad. Freedom of establishment for companies and freedom to provide services, in force across the European Union, also apply to services provided by crowdfunding platforms. Therefore, the Spanish Crowdfunding Association's claim should be rejected by which “*local growth of platforms*” is encouraged along with their competition against foreign companies “*to offer not only viability but also to strengthen the growth of a new market*”.²² We are confronted with a network of business activity that does not allow protectionism and must respect Community freedoms under all circumstances.

III. CONCEPT AND LEGAL FRAMEWORK

1. Legal Concept

Under Article 48 of the Act, crowdfunding platforms are “*authorised companies which are engaged in connecting, professionally and through websites or other electronic means, a plurality of natural or legal persons who offer financing in exchange for a monetary return, referred to as investors, with natural or legal persons applying for financing in their own name to be used for a crowdfunding project, referred to as project owners*”. It is a very broad definition that falls within business activity involving connecting developers and investors by electronic means, including the internet as the natural environment in which these initiatives are undertaken. They are intended as funding portals, to connect project owners and investors and which also act as showcases to catch internet users' attention and raise funds, but they are also authorised to provide various ancillary services. However, these

²²*Vid.* ASOCIACIÓN ESPAÑOLA DE CROWDFUNDING: *Propuesta para el Senado*, [Proposal for the Spanish Senate] 5 February 2015, p. 2, available at: http://web.spaincrowdfunding.org/wp-content/uploads/2015/02/Propuesta-para-el-Senado_signed.pdf. What should be avoided is “*an excess of regulation that puts Spanish operators in a worse position than other international operators*” (vid. Dictamen del Consejo de Estado [Opinion of the Spanish Council of State] 859/2014).

platforms are not merely portals that connect investors with project owners. They are financial intermediaries operating over the internet. They constitute a new means to efficiently allocating savings to investment, which uses the internet as a technical medium.²³

Crowdfunding is a new model of Anglo-American origin, and the Act has judiciously chosen to translate this term as “participatory financing platform”. This option matches that which the French legislature has used to refer to crowdfunding: “*financement participative*”.²⁴

“Portals” could have been selected instead of “platforms” as in the United States, where these new intermediaries are referred to as “funding portals.” The term “platform” is more general, although it would have been preferable to use the term “system”, using the terminology present in the Spanish Securities Market Act, where the term “system” has been coined to refer both to the “multilateral trading facilities” (Art .118 Spanish Securities Market Act), and the “Spanish Securities Registration, Clearing and Settlement Systems Company” (trade name, Iberclear) in Art. 44 bis Spanish Securities Market Act. The term “system” has also been used in other laws, for example in Act 41/1999 regulating “securities payment and settlement systems”. However, the distinction between the company and the system that manages it should be clearer.

This legal concept characterises platforms as “companies” and requires them to act in a “professional manner”. They are characterised by their regularity in business activities and by being profit-orientated as companies are. They must act within their corporate purposes in a “professional manner”, therefore knowledge and experience is required from those in senior management positions, who should also have appropriate means available.

Crowdfunding platforms are companies that aim to manage investment transaction portals “by electronic means” normally “via web pages”. It is a “platform” that operates over the

²³As Teresa RODRÍGUEZ DE LAS HERAS BALLELL says, the technological factor has been added into the definition for platforms (*vid.* “Las plataformas de financiación participativa (crowdfunding) en el Proyecto de Ley de Fomento de la Financiación Empresarial: Concepto y funciones”, *op. cit.* p. 9).

²⁴A term established by the Commission générale de terminologie et de néologie, by Notice published in the *Journal officiel* of 18 May 2013, that defines it as “*Financement faisant appel à un grand nombre de personnes, généralement des internautes, pour qu’elles investissent les fonds nécessaires à l’aboutissement d’un projet*”.

internet and provides the range of services for which it is enabled. Within this area it manages a crowdfunding 'system', in the strictest sense of the term, as its main activity based on the corporate purposes.

The legal concept comprises any platform “*that offers financing in exchange for a monetary return*” without making a distinction based on financial product. This seems to be the right choice as the economic role that lending-based platforms and securities-based platforms fulfil is the same, and their client protection requirements are similar.²⁵In fact, the growth of loans-based platforms has been largely due to the departure from financial regulation on public offerings of securities.

Online financial intermediation is what best characterises the platforms, not the provision of services from the information society.²⁶Platforms are not merely information society service providers. They are financial intermediaries operating over the internet to which the Act 34/2002, which regulates such services, may be applicable.

Crowdfunding platforms are classed as “multifunctional financial intermediaries” under Spanish law. This legal framework allows platforms to act as payment service providers, perform recoveries and carry out consumer lending and credit intermediation. To perform all of these functions they must be registered with the Spanish National Securities Market Commission as crowdfunding platforms, and also with the Bank of Spain as hybrid payment institutions with less burdensome articles of association. They must comply with a legal framework, which is also less burdensome, relating to consumer credit and credit intermediation. A platform that performs extra activities on top of its usual business activities becomes a financial intermediary with the most complex system under Spanish law. In reality, this mixture of articles of association complicates the Spanish National Security Market Commission's supervision of such intermediaries. It would have been preferable to

²⁵In contrast, Segismundo ÁLVAREZ ROYO-VILLANOVA, considers that problems on loans-based platforms are very different from those on equity-based platforms, “*which makes it very doubtful that they should be regulated in the same way*” (vid. “El «equity crowdfunding» o financiación en masa de inversión: importancia, problemas y opciones en su regulación”, op. cit., p. 19).

²⁶Art. 46.3 clarifies that “*The legal framework on crowdfunding and its implementing regulations shall be set out in this Act, notwithstanding the remaining regulations applicable to these companies and their activities.*”

regulate the basics, the platforms as funding portals, limiting their activity to only being companies managing an online financial transactions system, with the requirement to seek the services of institutions authorised to provide the following services: to provide payment services, consumer credit or credit intermediation.

Non-financial platforms are excluded from the scope of the legal framework, i.e. those that do not remunerate savers that participate therein. In this regard, donation-based or interest-free loans-based platforms, which make up crowd patronage, are excluded. Platforms or portals that manage the sale of goods or services are not considered financial platforms either. People who donate money or purchase goods and services are not “investors”, subject to those at which the platform services are aimed.

Paragraph 2, Article 46, Act 5/2015 provides the definition of what does not constitute crowdfunding platforms as part of the legal concept thereof. Under this provision, companies that carry out crowdfunding platform activities are not considered crowdfunding platforms “*when funds raised by project owners are exclusively through donations, sales or interest-free loans*”. This means that mixed platforms that combine the management of a financial system with other non-financial systems are subject to the legal framework.

2. Platform Services

Crowdfunding platforms are able to provide the main and ancillary services listed in Art. 51, Act 5/2015. The main services are those involving project approval and engagement in crowdfunding transactions. The project approval service includes “*receiving, selecting and launching projects*”. The service involving engagement in crowdfunding financial transactions is described as: “*Development, establishment and use of communication networking to encourage financing transactions between investors and project owners*”.

The project approval service is provided to the project owner. The service involving engagement in crowdfunding financial transactions is provided to project owners and investors. These services must be included within the corporate purpose of the crowdfunding platform.

The list of services that platforms must provide is very broad and allows many different business models to coexist, as long as they provide the main services of project approval and engagement in financial crowdfunding transactions. With regard to project approval, projects simply need to meet the requirements in Article 66, with platforms carrying out a due

diligence assessment on whether or not to approve the project, verifying that its description enables investors to make an informed judgement about their investment decisions, and meeting the timeframe and quantitative limits set forth in the Act. The “*project selection method*” should be posted on their website [Art. 61.1.a.)], which indicates that the platform should have criteria for project approval that must comply with legal requirements. Furthermore, at the end of each tax year, the Spanish National Securities Market Commission must receive from platforms: “*general information on projects that have not been selected for publication, and categories of reasons for rejections*”. The Commission may thus verify that the platform has achieved its own approval criteria. Within the legal framework, the platform is free to decide which criteria are to be applied in selecting projects, but once determined and posted on its website, it is obliged to apply them.

Descriptions of the communication channels that allow crowdfunding transactions to be arranged should be included in each platform's operating rules. They allow subscription to financial products that shall be governed by the relevant legal system as Article 74.1 states for loans, in a rather superfluous manner. There is no secondary market, which is justified, because trading of products acquired through the platform is not regulated.

Among the ancillary services included in the Act are: analysis and risk assessment for each project, a task similar to bank scoring. The fact that this service is included amongst the ancillary services means that platforms are not obliged to provide it. The provision of this service is voluntary and serves to furnish investors with additional information so that they can make informed decisions.

In addition to this risk assessment service, platforms may provide project owners with ancillary consultancy services for project launching and design, as well as information transfer and also set up communication networking between project owners and investors. They may also provide legal services, such as offering contract templates and credit claims. It is an open catalogue of ancillary services that may be extended by the minister of the relevant ministerial branch or with authorisation from the Spanish National Securities Market Commission.

Platforms have to respect reserves of activity for credit institutions, or those of payment institutions or those of investment services institutions. In this sense, they cannot receive cash or securities from their clients, or grant them credit. They are forbidden from guaranteeing

that project owners will raise funds. Nor can they take orders from clients to be transferred or executed on the market, manage investors' securities portfolios on the platform or advise investors on projects. They may offer investors mechanisms to preselect projects but not automatic investment mechanisms that may hasten their decisions. Crowdfunding platforms cannot provide payment services to project owners and investors, unless they been authorised from a payment institution. In this regard, platforms may request authorisation as “hybrid payment institution” with special articles of association.

Platforms are forbidden from any “*professional financing from third parties and in particular the granting of credit or loans*”. Third parties who grant credit are forbidden from using platforms to finance themselves. For example, platforms cannot manage loans in order to procure resources for an institution that grants microcredit. The borrower must ultimately be the project owner. Obviously, platforms cannot be used as intermediaries for microcredit either. Platforms are portals for financing, not credit allocation.

Platforms serve as intermediaries by connecting the project owner with investors. Article 43, Act 5/2015 amends the last paragraph of Article 30, Spanish Securities Market Act, bis.1 to exclude platforms from the obligation that investment service providers must inspect any public offerings exempt from the obligation to publish a prospectus. This provision is very important because it confirms the validity of the intermediation principle in the allocation of savings to productive investment, whilst classing crowdfunding platforms as new financial intermediaries.

3. Territoriality

The legal framework for crowdfunding applies to anyone carrying on business activities “within national territory” (Art.47). Under this provision, platforms with their registered offices abroad that commercialise their services to persons resident in Spain on their own initiative are subject to Spanish law with regard to activities carried out within national territory. Platforms will be presumed to have acted on their own initiative if they advertise or promote services to investors or project owners with residence in Spain, and also if they attract such persons to their services or aim services at them. Passive commercialisation (situations in which investors contact platforms on their own initiative) does not fall within the activities subject to Spanish law. Thus, “*a service shall not be considered to have taken*

place in national territory if residents in Spain use platforms with registered offices abroad as an investor or project owner on their own initiative”.

This is a territorial legal framework similar to that set out in Article 3 of the Spanish Securities Market Act, under which the provisions of the aforementioned Act apply “to any security whose issuance, trading and commercialisation takes place within national territory”. The case law developed by the Article therefore proves extremely useful in interpreting the scope of the territorial application of the Act on crowdfunding platforms.²⁷

4. Reserves of Activities and Professional Names

Crowdfunding platforms are a new kind of financial intermediary whose activities are conditional on securing authorisation and on being registered in a public register kept by the Spanish National Securities Market Commission. Like other financial intermediaries, platforms enjoy a reserve of activities by law. An unusual provision that the Spanish legal framework has set out is that not even banks, institutions with universal authority to provide all kinds of financial services, may engage in activities typical of platforms. In France and Italy, banks and investment firms are able to manage platforms. In Spain, they are forbidden from doing so.

This reserve of professional activities falls to the expertise typical of financial regulation, which identifies the activity and protects the practice thereof. It is an exclusive and selective activity. Platforms should limit their corporate purposes to activities that the law reserves for them, although they may also engage in providing payment services and certain ancillary services.

The term “participatory financing platform” and its abbreviation “PFP” are distinctive and must be included in each platform's professional name, and they are reserved for this kind of intermediary. One must interpret that the protection deriving from the reserve extends to the use of the more popular term “crowdfunding” in English, since otherwise, it could go against the objective pursued by the legislator.

²⁷*Vid.* SSTS, Sala Contencioso-administrativo, [Spanish Administrative High Court] 1 July 2008 and 20 June 2003.

5. Authorisation and Registration

Crowdfunding platforms are subject to an authorisation and registration procedure similar to that which applies to other financial intermediaries. This procedure is processed by the Spanish National Securities Market Commission, with a binding preliminary report on platforms that manage projects financed by loans from the Bank of Spain.

The Minister of Economy and Competitiveness must be notified of any initiation agreement for authorisation procedures so that a follow-up may be carried out on initiatives that affect this new form of business financing.

In order to be authorised, requirements must be met that are similar to those required for other financial intermediaries. Platforms must have the activities listed in the Act as their exclusive corporate purposes. They must also have registered offices in the European Union, be corporations, meet the financial requirements set out in Article 56, have qualified managers, be well organised, have adequate resources, their own conduct of business rules and continuity planning for provision of services in the event of cessation of activity.

Among the financial requirements, the possibility of combining capital with civil liability insurance is excluded, and own-fund requirements are set out that vary depending on the volume of projects for which financing is managed, ranging from €60,000 to €2,000,000.

Authorisation applications must be accompanied by a draft articles of association, business activity programme, a list of majority shareholders and any other usual documents for those who intend to provide services on the financial market. They should also include a description of the procedure for providing payment services between project owners and investors, either on the platform itself, as a hybrid payment institution or by indicating who will be the external provider of payment services.

Once authorised, and after incorporation and registration as a corporation in the Commercial Register, platforms should be registered in the special register with the Spanish National Securities Market Commission for these kinds of intermediaries.²⁸

Under the normal articles of association for financial intermediaries, substantial changes in the conditions under which the authorisation was granted must be subject to a similar

²⁸Article 43, Five, of the Act introduces a letter ñ.) into Article 92 of the LMV, to add a "crowdfunding platforms register," including official public register of the CNMV [Spanish National Securities Market Commission].

authorisation process. As also happens with these articles of association, business interruption for a year could cause revocation of the authorisation. At the same time, the Spanish National Securities Market Commission must be notified of any waivers. The Commission will accept this unless “*there are reasonable grounds to believe that the cessation of activity may cause serious risks for investors or project owners*”. Although as we have seen for authorisation, it is already required to have mechanisms in place “*so that in case of cessation of activity, services agreed upon may still continue to be provided*”.

Crowdfunding platforms are companies involved in information management and connecting project owners with investors. They are intermediaries that may not touch the funds or the securities that are engaged as part of a financial transaction. Platforms should apply for authorisation as a hybrid financial institution in order to provide payment services. For this reason, the own-funds system for platforms is similar to financial consultancy firms, intermediaries working with information without access to client accounts.

As is the case with other financial institutions, plans to return to normality are provided for in the event of a breach of own funds requirements.

IV. LEGAL NATURE

Crowdfunding platforms are systems for online engagement in financial transactions for securities and loans. They are systems for engaging in primary purchase of financial products from among the platform's clients. They fall therefore within the primary market infrastructure. It is a free-form model that may be associated with trading on the secondary market. This trading depends on the type of financial product. Shares and bonds are transferable securities which platforms may use to create a secondary market, although this activity is not provided for among ancillary services. Units are non-transferable securities, and the creation of a secondary market for trading depends on their standardisation or securitisation. Loans are not financial instruments either, but platforms may standardise them into transferable units.

Crowdfunding platforms are closed electronic platforms limited to clients on the platform, which aim to generate financing. Platforms are intermediaries that manage access to systems and engagements in financial transactions through their system. They are systems that allow one person to connect with many others; project owners with investors. The purpose is to

finance projects over the internet. These systems engage in transactions of financial products characterised by the medium used.

Crowdfunding platforms are regulated systems for arranging financial transactions. This feature brings them closer to regulated markets recognised in the MiFID. They differ in purpose; regulated markets by the MiFID are secondary markets. PFP crowdfunding platforms are involved within the primary market area, placing financial products on the market. At this time, they are not offering secondary trading services.

Under Article 61.1, the PFP crowdfunding platforms must include the “basic operation of the platform” on their websites that is, the “*operating rules*” referred to on three occasions in Article 69. These operating rules must comply with legal provisions on “*access conditions*” for clients on the platform system (Arts. 66-67 for project owners, and 81-82 for investors), the “*approval for engagement in financial transactions*” for projects (Arts. 61.1.a), 68-80), the “information” to be supplied to the Spanish National Securities Market Commission and the 'advertising' of operations through the platform's website (Art. 61). “Operational procedures” for arranging transactions of financial products are not regulated by law. It is a system for engagement in financial transactions regulated in a manner analogous to that of “regulated secondary markets” as defined in Article 36.1 of the Spanish Securities Market Act, except for anything regarding operational procedures. This is somewhat reasonable given that crowdfunding platforms are systems for engagement in financial transactions in the primary market, which lack a trading facility, the main purpose of regulated secondary markets.

V. DIFFERENCES TO RELATED INSTITUTIONS

Platforms are not trading markets. Therefore, they do not fit within multilateral systems for engagement in financial transactions, nor within systems which form part of regulated secondary markets and MTFs, nor to bilateral trading facilities such as internalisation facilities in Article 128 of the Spanish Securities Market Act. Trading of products subject to financial transactions is not covered by the legal definition and does not fall within the corporate purposes of platforms. The Government and, with its authorisation, the Spanish National Securities Market Commission, may expand platforms' ancillary services and could authorise them to provide trading services for arranged products. In such a case, when the

corporate purpose of platforms includes any instrument provided for within Article 2 of the Spanish Securities Market Act, the provision of trading services shall be governed by the provisions of that Act for trading facilities.

The natural growth of platforms that will offer trading services is that of MTFs registered under “SME growth market” under the framework section on these markets in Article 33 of the MiFID II, as an extra option to “*encourage access to capital for SMEs*”(§132 of the Preamble of MiFID II).

VI. CLIENTS

The platforms' clients are project owners and investors that supply financing.

1. Concept of Project Owner

“Project owners” are people requesting financing in their own name, used for crowdfunding projects. This type of project is defined in Article 49, under which it must be a project owner's specific project of a “*business, training or consumption*” nature. This concept contrasts business projects with consumption projects. This means that you can finance a product for consumption, such as purchasing a car, with the project owner being a consumer who accesses consumer credit in this way. Regardless of whether training projects are profit-orientated, they can fall within those of a business nature.

Project owners are those issuing securities or receiving loans through which crowdfunding is implemented. They are the issuers of securities or borrowers who have requested loans.

Crowdfunding platform project owners should identify and carry out due diligence assessments on projects, verifying that they meet legal requirements. Project owners may be legal persons incorporated in the European Union or natural persons with tax residence in the European Union. Project owners, and for legal persons their manager or partner, may not be disqualified nor serve sentences for certain economic crimes.

Financing should be sought for a specific project in their own name and on their own account. Under Article 46.1, project owners must seek funding “*in their own name*”. However, “in their own name” should be construed in a broad sense, as can be inferred from the legal framework. The legislative intent is to limit the generation of financing not only to their own name but also to their own account. Projects from owners acting through other

individuals or organisations cannot be processed by platforms. This thus excludes anyone acting indirectly through front men or nominees.

Article 49 prohibits platforms from providing services to projects which are intended to finance third parties, including those aimed at the granting of credit, whether in the form of credit agreements or loans. The purpose of platforms is to connect end clients both from the perspective of project owners seeking to be financed and investors who offer this. This aims to avoid activity reserved for credit institutions being provided through this channel.

Project owners cannot raise repayable funds from the public for granting credit or loans because dealing with credit is an activity reserved for financial institutions. Nor may they engage in general to “*raise repayable funds from the public, whatever their end use, in the following and any other analogous forms: Deposits, loans, repurchase agreements*” (Art. 3.1 Act 10/2014). However, Article 50.2 clarifies that requesting loans to finance a crowdfunding project “*shall not be considered as raising repayable funds from the public*”. An exception to the legal reserve to raise repayable funds is thus established. Therefore, owners of crowdfunding projects that operate using loans may raise funds from the public. However, although no provision of this new Act requires a deadline for repayment, it must be understood that the receipt of refundable deposits is not discernibly included as it is an activity reserved for banking credit institutions.

The Act regulates platforms' conduct when providing credit facilities vis-à-vis project owners having consumer status. Consumers may use platforms as owners of projects that involve obtaining loans financed by investors. These are services falling under special laws regulating credit intermediation with consumers or consumer credit. When platforms provide services to connect lenders to project owners who are consumers, Article 86.1 of the Act states that platforms act as intermediaries to which Act 2/2009, of March 31, applies, which regulates transactions with consumers taking out loans or mortgages and intermediation services for the signing of loan or credit agreements, establishing a less burdensome legal framework. Registration with consumer authorities is not required, liability insurance or bank guarantees are not required for this activity, and obligations do not have to be complied with on commercial communications, advertising, or those arising from their independence or links to credit institutions.

In turn, under Article 86.2 platforms intermediating in the consumer loans for project owners are considered intermediaries for the purposes of Law 16/2011, on consumer credit contracts, also with a less burdensome legal framework. The requirement to submit a binding offer is deemed to have been met when the project is launched on the platform as well as the requirement for notification of preliminary information and advertising thereof.

The platforms are therefore authorised in compliance with these requirements to facilitate consumer credit, circumventing credit institutions and over-indebtedness prevention checks. The law does not impose responsibilities on crowdfunding platforms offering consumer credit to assess the creditworthiness of indebted project owners.²⁹ However, it does establish a duty to warn of the risk of over-indebtedness on the part of project owners who have the status of consumer (Art. 88).

2. Concept of Investor

“Investors” are persons who “*offer financing in exchange for a monetary return.*” To be included on the platform, projects must be aimed at a plurality of profit-oriented persons expecting to receive a monetary return. Investors may be natural or legal persons who may or may not invest professionally.

They may offer financing through subscription of securities or by granting loans. They may therefore be investors in securities or lenders. For this reason, they should be referred to as financiers, participants (“crowdfunders”) or contributors. However, the improper use of the term “investors” has been preferred. This choice is a consequence of the designation of the Spanish National Securities Market Commission as the supervisory body for platforms. This organisation has the “protection of investors” as its main function,³⁰ and for this purpose platform clients are classed as “investors”, regardless of how financing is granted.

Under Article 85, platform activity and the relationship between project owners and investors is subject to the rules protecting consumers and users with the special provisions in the Act's Chapter on investor protection. The new Act therefore provides investor protection

²⁹*Vid.* Article 18, Order EHA / 2899/2011, of October 28 on Transparency and Client Protection of Banking Services.

³⁰Art. 13. II LMV [Spanish Securities Market Act].

rules that operate through platforms as a special set of regulations in relation to the general regulations on consumers. However, this solution goes against case law that considers the conduct of business rules on client protection that act in the financial market as an autonomous set of regulations with a different subjective scope to that which governs consumer protection law. If banking clients are also consumers, the existence of banking regulations on transparency and client protection “*does not prevent the Spanish General Contractual Terms Act (LCGC according to its Spanish acronym) from being applicable*” (cf. STS 241/2013 [judgement citation], Paragraph 178).

In short, investors who operate across platforms are users of their services and may also be protected by the General Act for the Protection of Consumers and Users when they fall within its subjective scope. As platform clients they receive protection under the Act, which governs platforms. If they also fall within the subjective scope of the General Act for the Protection of Consumer and User protection of consumers and users, they shall be protected as users of platform services.

With regard to the protection mechanisms for financing clients, the new Act incorporates platforms to the Complaints and Claims Resolution system for the securities market via the customer service department or the ombudsman for clients or the Claims Service for the Spanish National Securities Market Commission. Without any express mention thereof, the obligation of having a customer service department or ombudsman to deal with claims and complaints from investors is imposed upon the platforms. Under this system, if complaints are dismissed or a two-month administrative silence occurs, investors may make use of the Claims Service for the Spanish National Securities Market Commission, so it may settle the claim.

VII. PROJECTS

The main activity on platforms is management of projects that meet certain subjective and objective requirements. From an objective point of view, the law sets out the way in which crowdfunding may be implemented.

1. Types of Projects by Funding Method

There are two types of projects based on the type of crowdfunding, either through loans or securities.

1.1. Equity-Based Crowdfunding (Crowdfunding through Securities)

Crowdfunding may be implemented through shares, units or other securities representing capital, or bonds. The issuance or offering thereof does not require an informative prospectus to be drawn up under Title III of the Securities Exchange Act. Securities that have been subject-matter of an offering with prospectus subject to the framework under the aforementioned Title of the Spanish Securities Market Act cannot be approved even if they fall outside the scope of the obligation to draw up a prospectus. Crowdfunding is thus confined to offerings that do not require a prospectus or that have not been subject-matter of a public offering with prospectus. The scope of crowdfunding has therefore been reduced to companies that have had no contact with the transferable securities market or that, if they have had contact, their offers have been excluded from the obligation to publish a prospectus.

Article 45, Act 5/2015 removes the prohibition on private limited companies issuing bonds.³¹This reform aims to encourage new financing means for companies that use this company format, particularly SMEs, who may use platforms to finance themselves by issuing bonds as of its entry into force. Moreover, as we have seen, Act 5/2015 allows crowdfunding platforms to approve projects financed through the purchase of shares in private limited companies. These changes affect the nature of private limited companies. They are no longer closely-held partnerships and have become true corporations which can use public savings to finance themselves. Otherwise, crowdfunding platforms approve projects financed by hybrid instruments that incorporate embedded derivatives as preferred shares, although in these cases the offering can only be aimed at accredited investors.

1.2. Loan-based Crowdfunding (Crowdfunding through Loans)

Crowdfunding can be implemented through loans, with the limitation that mortgages may not be secured on a borrower's primary residence. (Art. 74.2). This limitation is justifiable as

³¹Amending Article 401 of the Ley de Sociedades de Capital [Spanish Companies Act].

it respects the constitutional right to decent and adequate housing (Art. 47, Spanish Constitution). Protection of this right should be taken into account when interpreting the rules on mortgage lending, also when this is arranged through financing platforms, which can lead to cancellation thereof.

What is unjustifiable is the prohibition on loans or mortgages in consumer projects provided for by Article 87. Under this provision: “*Crowdfunding platforms shall not launch funding projects in which clients apply for loans or security-based mortgages*”.

The main *in rem* security is a mortgage and the growth of platforms as an alternative to bank financing necessarily involves the use of security-based mortgages. Beyond the limits arising from home protection rights, it is unjustifiable to limit the use of security-based mortgages in crowdfunding platform projects. Consumers should also be able to use real property different to their primary residence as collateral to obtain credit through the platforms. The legal prohibition of projects using security mortgages is a measure which goes against the promotion of platforms as an alternative to bank financing and a clear expression that the banking industry does not want to open the mortgage market to new competitors.

2. Limits on Projects

Promoters may promote only one project per platform at any given time for a maximum amount of €2 million, rising to €5 million when aimed exclusively at accredited investors. Several rounds of financing may occur without exceeding those limits.

It is an “all-or-nothing” model. Projects must set financing goals they intend to achieve and a maximum term for participation that cannot be exceeded. Upon expiry of this period without achieving the success expected, the amounts paid by investors must be returned. However, the goal and term may be exceeded by 25 percent with prior notice, and projects may be considered successful when 90% of the goal is reached, not including participation on the platforms themselves. This level of flexibility is unnecessary and creates confusion at the time of business consolidation when clarity is most required.

3. Investment Limits

The system in the Act limits the amount that non-accredited investors may venture. It is a structural protection system to avoid the most vulnerable investors suffering catastrophic

losses. The limit is set at €3,000 per project and €10,000 euros per year for all platforms. It falls to investors to declare on platforms that they are committed to compliance with the maximum limit of €10,000 euros per year.

Before operating on platforms, non-accredited investors must accept that they have received notice of the operating conditions, specifically that platforms operate outside financial authorities' supervision without prospectuses filed with the Spanish National Securities Market Commission, without a guarantee fund and that they are aware of the risk of losing their capital and of illiquidity that jeopardises recovery of their investment. This aims to make it very clear that risks are accepted by investors, and that they are not protected by the safety net of financial supervision, which is not entirely true as crowdfunding platforms are registered and are subject to supervision by the Spanish National Securities Market Commission. Accepting this risk acts as an official disclaimer for public supervisory authorities. It warns clients that if a loss is made, any claims procedure for state liability is virtually unavailable.

Declarations from clients of awareness of risk and compliance with operating limits may be handwritten, made by telephone call or electronically in accordance with the safety terms provided for in Article 84. Platforms must keep declarations received for five years.

4. Information on projects

Project owners must transfer for publication any information about the project “*necessary to allow the average investor an informed judgement about financing decisions*”. Information must be concise and clear, in non-technical language, sufficient to enable investors to make an informed decision. The new legal framework meets the same principles that govern information obligations over the market. Indefinite legal terms are used to which case law and technical criteria from supervisory bodies will provide content.

Project owners are accountable to investors for any information they provide on the platform for publication. They shall be liable for any damages they may have caused

investors from securities purchased as a result of false information or omissions of relevant details in the information supplied.³²

Platforms must post any relevant information known about projects and project owners. They must post relevant information received from project owners but must also post any other relevant information of which they become aware. The conduct of business rules on market abuse should be applied in order to manage this important information.³³

Platforms may create investor forums as a channel of communication with the owner of projects in which they participate, similar to the electronic shareholders' forum provided for in Article 539.2 of the Spanish Companies Act. Although the information provided through this communication channel should be accessible not only to investors but also to potential investors. In this sense, in the initial subscription period, or period for engagement in financial transactions, information about financing participation shall be included in the channel on a daily basis.

Project information published by the platform must be accessible to investors for a period no less than one year from the end of the fundraising campaign, and investors may request any information published on the communication channel from platforms for up to five years afterwards.

4.1. Information requirements applicable to loans

Information required from project owners raising funds via loans depends on whether they are natural or legal persons. If they are natural persons, they have only to provide their CV, place of residence and financial position, including any indebtedness. If they are legal persons, the information requirements are the same as those to be supplied by project owners who issue securities. They shall provide information about the company, their board members, number of employees and financial position, including the capital structure and any indebtedness.

³²*Vid.* Article 28 of the LMV [Spanish Securities Market Act] on liability for false prospectuses or those that omit relevant details, which are useful in introducing the project owner's liability to crowdfunding projects.

³³From Chapter II of Title VII of the LMV [Spanish Securities Market Act].

Platforms may allow owners of projects financed by loans to conceal their identity from investors provided they make it available to them before payment is made. Although not provided for expressly in the Act, it should be understood that investors can withdraw their transaction order after learning a project owner's identity, it being essential information in making investment decisions.

Information on loans must include their essential characteristics with the total amount, any collateral that may be secured against them, payment and duration, with amortisation schedules, highlighting associated risks and the type of loan, for example, if it is a consumer loan. Furthermore, it should include information on the total cost, including the annual percentage rate (APR), and late-payment interest. Although the acceptance period may begin without supplying this information, it must be listed before the execution of payment.

4.2. Information requirements applicable to securities

Owners of projects financed through issuing securities do not have to submit a prospectus to platforms. They have only to submit a document on securities that includes information on their essential characteristics and risks, with a description of rights and forms of exercise, with mention of the collateral secured against them that has been paid off.

Project owners must include in their articles of association or general shareholders' meeting regulations the right to attend the meeting via electronic means, acknowledging the right to representation, and the obligation to announce shareholders' agreements on voting rights or on securities transferability. Except for this requirement, the corporate framework on issuance of securities arranged through platforms is very haphazard. For example, tag-along rights are not even regulated that allow investors to sell on the same terms as majority shareholders. Drag-along rights are not regulated either, opposite to the previous rights, which enable a majority shareholder to force a minority shareholder to join in a sale in order to not hinder the purchase of the company by a third party, which are standard clauses for loan-based platforms.³⁴

³⁴*Vid.* ÁLVAREZ ROYO-VILLANOVA, Segismundo, “El “equity crowdfunding” o financiación en masa de inversión: importancia, problemas y opciones en su regulación”, op. cit., pp. 49-51.

VIII. CONDUCT OF BUSINESS RULES

Crowdfunding platforms must meet principles and obligations of conduct similar to those governing investment service companies. They must “*carry out their activities in accordance with the principles of neutrality, diligence and transparency in accordance with the client's best interests*”. While “neutrality” is a platform-specific principle that is not required for investment service companies, it is also a principle inherent to market infrastructures. Under this principle, platforms must not participate in the business activities of participant companies in the market. However, as will be expanded upon later, Article 63 of the Act allows platforms to have low-level participation in the projects they manage, thereby going against the principle of neutrality.

The principle of diligence requires professional activity. Platforms are companies specialising in crowdfunding management, and the diligence standard is high.

In turn, information transparency is a general principle of the financial market that also governs platforms' activities. It continues to be the chosen means to protect investors, a principle that also applies to project owners in their relations with investors. Given the importance of transparency, Article 60.3 of the Act requires information on the rights and obligations that clients accept in order to operate through platforms to be “*clear, appropriate, adequate, objective and not misleading*”. These are common characteristics for information to be supplied by providers of investment services, except for the “objective” nature of the information. Platforms act as project analysts and it is essential that the information supplied to investors is objective. In this sense, they cannot give their opinion on projects. It is forbidden for them to make personalised recommendations incompatible with the principle of objectivity.

Finally, platforms' activities must be oriented towards their clients' best interests, those of investors and project owners. Platforms are intermediary service providers taking into account the best interests of clients, so they should avoid any conflict of interest.

1. Investor Categorisation

In providing services to investors, platforms must distinguish between “accredited” and “non-accredited” investors in order to offer greater protection to non-accredited clients, who are more vulnerable to crowdfunding risks. This categorisation overlaps with the distinction

between “professional” and “retail” investors in Article 78 bis of the Spanish Securities Market Act, originating from MiFID.

Article 81 of the Act governing crowdfunding platforms defines accredited investors and considers that any investor who is not eligible to be classified as an accredited investor “*shall be considered non-accredited*”. This is a continuation of the MiFID technique of considering “retail investors as any which are not professional” (Art. 78 bis.4 Spanish Securities Market Act).

Accredited investors are considered to be those who invest in units of private limited partnerships or in loans included on the list of de jure professional investors in Article 78 bis.3 of the Spanish Securities Market Act, with the stipulation that the quantitative requirements for entrepreneurs are reduced in Paragraph c) of the aforementioned Article. In order to be an accredited investor one only has to meet two of the following three conditions, specifically that: Total assets reach €1 million, annual turnover reaches €2 million, or in possession of own funds that reach €300,000. Meeting two of these three requirements satisfies the “accounting threshold” that turns an entrepreneurial investor into an accredited investor.

From the above, it can be inferred that, due to their accounting details, some entrepreneurs are not professional investors under MiFID. In relation to their investments in units or loans on crowdfunding platforms, they are considered accredited investors.

In addition, natural persons who can prove an annual income exceeding €50,000 or financial assets worth €100,000, SMEs that are natural persons and generally all legal persons may apply to be treated as accredited investors when investing in shares or loans. In order to be approved, applications must be accompanied by a waiver stating that one does not wish to be treated as a non-accredited investor and the preliminary assessment of the client's experience and knowledge so as to allow platforms to ensure that clients “*can make their own investment decisions and understand their risks*”. With regard to this client assessment, the Act governing crowdfunding platforms goes further than the Spanish Securities Market Act, as it requires “ensuring” that clients understand the risks vis-à-vis the Spanish Securities Market Act in which the provider has only to verify the suitability of the product to customer profiles and to warn them of any unsuitability.

In addition, investors who can prove that they have contracted a financial consultancy service on behalf of an investment services company are considered accredited. With this measure, originating from UK regulation, consultancy is prioritised as a protection against the growing complexity of financial instruments.³⁵ The best way to access risky markets, such as the market managed by crowdfunding platforms, is considered to be through a financial consultant registered with the Spanish National Securities Market Commission. The consultant's intervention determines the application of MiFID regulations, and in particular requires the consultant to carry out a suitability test. This means the investment recommendation is conditional upon their compliance with the knowledge, experience, financial position and investment goals of the client. Under this measure, access for non-accredited investors, above €3,000 per project and €10,000 per year, is conditional upon investor suitability as assessed by the consultant. However, it is not enough just to prove that a consultancy service has been contracted, since it is necessary that investors declare that their suitability has been assessed by a consultant for particular investments.

Otherwise, all accredited investors should declare to platforms that they accept being exposed to increased risk and benefiting from less protection: A declaration of awareness that reverses the burden of proof in the event that a dispute between the client and the platform arises. In the event that a dispute arises between the client and the platform, it shall fall to clients to prove that, despite the declaration made, they were unaware of the increased risk and loss of protection accepted on being classified as an accredited client.

This system we have been describing protects clients who invest in projects financed by shares and bonds more than those who invest in units or loans as the latter two have less barriers for accreditation.

We are confronted with a categorisation system that is difficult to learn and very difficult to manage. Assimilating the MiFID categorisation between professional and retail investors has required several years and training programs for employees and financial education for clients. Currently a complex new system that does not match up with MiFID concepts has

³⁵*Vid.* FINANCIAL CONDUCT AUTHORITY: *The FCA's regulatory approach to crowdfunding over the internet, and the promotion of non-readily realisable securities by other media*, PS14/4, 6 March 2014.

been created for crowdfunding projects. It should be simplified and should converge with MiFID concepts already assimilated by market participants.

2. Disclosure Obligations

Platforms must comply with certain disclosure obligations within the framework of principles governing exercise of their activity and, in particular, the transparency principle. As the main element of this obligation, the platforms should outline “basic information for clients”, as it is referred to, on their website, doing so with brief and simple terms. Basic information for the customer means information about rates, procedure for engagement in financial transactions and billing method, as well as warnings about risk of capital loss and illiquid investments. As the Preliminary Recitals to the Act state: *“It should be made clear that investment in these projects involves inherent risk because project owners may be unable to return or remunerate funds received, and the fact that platforms in their role of intermediary, notwithstanding due diligence requirements over them. At no time does it guarantee the creditworthiness or viability of project owners”*.

There should also be warnings on websites that platforms are neither investment services companies nor credit institutions, that there is no attached guarantee fund, and that projects and the information on them have not been monitored by financial authorities.

In addition to this basic information, platforms' websites should include any other relevant information about platform operation and prevention measures against fraud and conflicts of interest and also complaints procedures. Websites should also include information about project selection, treatment and publication of information received from project owners, and investment products with which platforms operate as well as the service delivery mechanism after the cessation of the activity. Websites must also mention if platforms provide payment services as hybrid payment institutions, and if they offer a debt collection service.

Platforms must keep information available for the Spanish National Securities Market Commission for at least five years, without prejudice to keeping documentation for the limitation or expiry period of any claims that may be brought by clients.

3. Conflicts of interest

Crowdfunding platforms should have policies for managing conflicts of interest similar to those that exist for investment service providers. In this sense, policies for managing conflicts of interest are governed by the principle of proportionality, i.e. a requirement that conforms to the size and organisation of each platform. These policies extend to all board members, directors, employees and shareholders of platforms. Senior management and employees of the platform are prohibited from carrying out activities involving conflict of interest. They cannot provide advice about projects published on platforms. Any provision of investment consultancy services from shareholders is conditional upon proper management of conflicts of interest.

4. Related projects and marketing

The Act allows platforms to participate in projects for which they manage financing. This goes against the principle of neutrality and jeopardises adequate prevention of conflicts of interest. The best doctrine emphasises the importance of prohibiting this kind of participation. However, Article 63 of the Act allows platforms to participate in projects posted on platforms up to 10% of the financing target, although they are unable to control the company in any way.³⁶ Platforms should inform investors of the total amount of their participation. It even allows platforms to select projects of which they are owners, provided they do not represent more than 10% of the projects published.

Senior management, majority shareholders and persons linked to them, may also participate up to 10% in projects that they promote and that are published by platforms.

Otherwise, platforms can market and advertise projects published on the platform “*provided the selection thereof is based on objective and non-discriminatory criteria*” whilst respecting the duty of neutrality (cf. Art. 64).

³⁶The Opinion of the Spanish Council of State justifies the desirability of allowing platforms to have up to a 10% participation in the projects posted on the grounds that in practice “*the success or failure of a project depends on whether the crowdfunding platform reaches the funding amount requested*”. As such, it should be a temporary and exceptional measure, aspects not provided for in the Act.

This is a commercial activity which also jeopardises the necessary neutrality of platforms even though it is conditional upon objective project selection.

It is a matter of principle. Platforms should be showcases of projects to enable investors to acquaint themselves with them and decide whether to invest in them. Participation in projects or in their commercialisation should have been forbidden.

What it does forbid is participation in projects published on other platforms, which, although it is a conflict of interest, is not of the same seriousness as that which arises from participating in projects on their own platforms.

IX. SUPERVISORY FRAMEWORK, INSPECTION AND DISCIPLINARY PROCEEDINGS

The Act devotes a chapter in the Title on Crowdfunding Platforms to supervision, inspection and disciplinary proceedings. These are control functions that fall to the Spanish National Securities Market Commission. With regard to loans-based platforms, they are governed by the principle of cooperation and collaboration of the Bank of Spain, which shall provide the Commission with information and necessary assistance, and develop, at the request of the Commission, the powers that fall to it vis-à-vis credit institutions.

Platforms must submit audited annual accounts to the Commission, accompanied by the audit report and a report with content set out in the Act. In addition, the Commission may require from platforms however much information it considers necessary for the proper practice of its inspection functions.

With regard to disciplinary procedures, it falls to the Commission to initiate disciplinary actions. Initiation agreements must be sent to the Ministry.

The Act lists offences according to their pertinent seriousness and penalties, with the usual structure for disciplinary procedure of financial intermediaries.³⁷The disciplinary proceedings for the securities market applies secondarily. For very serious offences, penalties may be a fine of 10% of total annual net business or €200,000, along with a revocation of

³⁷*Vid.* Article 98 LMV [Spanish Securities Market Act].

authorisation to operate and removal from office of board members, with a 10-year disqualification period.

There is no framework for crisis management of platforms. It is a serious loophole because the failure of operators is foreseeable in a newly created market. Given the business structure, the existence of isolated cases of fraud must not be dismissed.

X. FINAL REFLECTIONS

Far from being a simple framework, encouraging crowdfunding platform activity as a new means to finance businesses, the Spanish Crowdfunding Act regulates platforms in excessive detail, beyond that which is necessary to encourage business in a safe environment. The legal framework is so intensive that it leaves little room for regulatory development.

A new financial market should have a flexible legal framework, based on principles, leaving the regulation and criteria to the supervisory bodies to make rules more specific. However, in Spain, platforms are regulated more than the stock exchanges. The Spanish Securities Market Act devotes a chapter with 11 articles to the stock markets and the Act on Promoting Business Finance devotes a title with six chapters and 47 articles to crowdfunding platforms.

The legal framework creates a high burden of regulatory compliance, which increases the cost of business and may make it unfeasible. There is a danger that business associated with platforms may be transferred to other EU Member States that offer a simpler and safer environment. This doctrine emphasises the importance of containing the cost of managing crowdfunding projects. This involves creating portals that serve as channels for financing small and medium-sized companies that cannot cope with the costs of using public offerings for flotation on the stock market or the Spanish Alternative Finance Market (“MAB” according to its Spanish acronym). Intensive platform regulation means high costs which raise service provision prices and hamper business growth.³⁸

³⁸As Segismundo ALVAREZ ROYO-VILLANOVA, says "*capitalisation, supervision and registration requirements should not be too onerous to avoid creating insurmountable barriers to entry for new crowdfunding platforms*" (in “El “equity crowdfunding” o financiación en masa de inversión: importancia, problemas y opciones en su regulación”, op cit, p 55).

From a technical point of view, we are confronted with a legal text that appears to be regulatory with many references that hinder comprehension thereof. It creates new articles of association for platforms, when it would have been better simply to lift the legal reserves of financial activities or define the model as a new type of investment service company subject to less burdensome conduct of business rules. The management of multilateral trading facilities is an investment service with certain similarities to crowdfunding platforms in terms of its principles. Nothing is preventing the creation of a new kind of investment services company for the management of crowdfunding platforms, with a special framework with regard to the provision of services relating to financial products other than transferable securities.

In this regard, the Spanish Government should extend the range of financial instruments to include the shares in Article 2 of the Spanish Securities Market Act.³⁹ At the same time, the service that platforms provide should be added as a new investment service. This would thus fall within crowdfunding platforms' activities in the legal framework of the securities market and could provide this intermediary with simplified articles of association. This framework would provide legal certainty to the platforms' activities and client protection. Special provisions for platforms as consistent service providers in managing a system for trading financial instruments over the internet would definitely have to be included in the Spanish Market Securities Act. Loans traded through platforms are financial products that would be assimilated as financial instruments in terms of platform activities.

³⁹In accordance with the authorisations contained in Articles 2.1.k) and 63.5 LMV. The Italian supervisory body has already included units in private limited companies offered by crowdfunding portals in the list of financial instruments [Art. 2 h) Reg. CONSOB. No. 1852, 26 June 2013]. Commented upon by Andrea GUACCERO in “La start-up innovativa in forma di società a responsabilità limitata raccoglie del capitale di rischio ed equity crowdfunding”, Banca Borsa Titoli di Credito, Vol. 67, No. 6, 2014, p. 715.