

DNB and AFM give further interpretation on crowdfunding

Introduction

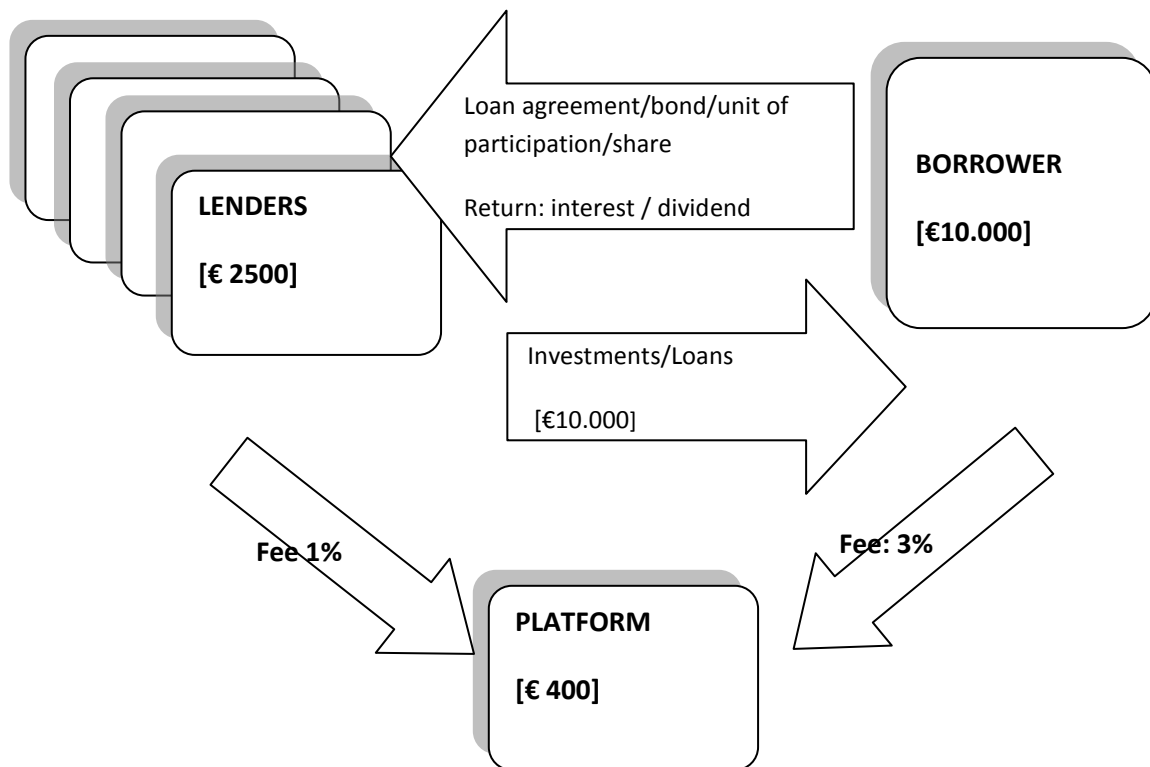
The Netherlands Authority for the Financial Markets (AFM) and De Nederlandsche Bank (DNB) regularly receive requests from market participants wishing to develop crowdfunding initiatives. In many cases, the question asked is whether the Financial Supervision Act (*Wet op het financieel toezicht*, or 'Wft') applies. The AFM and DNB accordingly wish to clarify the regulations governing crowdfunding with regard to lending and investment types of crowdfunding. In May 2011, the two regulators already provided market parties with some guidance with respect to crowdfunding.¹ Consumers were also informed regarding the risks.

Types of crowdfunding

Crowdfunding appears in various forms, depending on the objective of the party seeking to obtain funding (hereinafter: the borrower). Using a platform, in most cases online, the operator of the platform (hereinafter: the crowdfunding platform) brings several investors (hereinafter: the lenders) and borrowers together for a wide variety of usually small-scale projects of an idealistic or a commercial nature. Examples include the funding of a business in the start-up phase, the issuance of microcredits or the publication of a CD or book. From the lender's point of view, crowdfunding occurs essentially in four different forms²: 1) donations – giving money for a good cause; 2) sponsoring – supporting a project of a business or a private person, for a small (non-financial) consideration; 3) lending – lending money to a business or a private person; 4) investment – investing in companies.

Each project in which a lender participates, contains the a risk that his trust is abused. Donation and support initiatives usually involve small amounts and relates to good causes. The lending and investment forms of crowdfunding however may involve significantly greater sums, and the motivation of the lenders to participate is usually commercial in nature. In these cases there is an increasing risk of misleading the public, which may damage the lenders' interests. For the crowdfunding platform, this type of initiative is usually subject to supervision based on Dutch financial supervision legislation.

The flow of funds for crowdfunding for lending and investing



Activities of the crowdfunding platform

The business model of a crowdfunding platform is –in short- to attract mostly small sums from a large group of financiers (the ‘crowd’) in order to fund a project (the ‘funding’).

For bringing the lenders and borrowers together, the operator of the platform receives a payment from either the borrowers or the lenders, or from both. This may be a fixed amount per participant and/or a percentage of the project funding. The platform can also generate income on a continuous basis, if the interest and repayment of a loan or distribution of dividends and repayment of sums invested are processed via the platform. The operator generally charges a fee for these activities. The payment of funds usually happens via a trust or escrow account (*Stichting Derdengelden*). The lenders transfer their loan or investment to the trust account and after successful subscription to a

project, the funds are transferred to the borrower. In the case that the funds subscribed are insufficient, the payments are returned to the lenders.³

An operator of a crowdfunding platform offers lenders and borrowers the possibility to participate in a project through the intermediation of the platform, via a donation, loan or investment. The activities of the crowdfunding platform focus on the creation of an agreement between the lenders and a borrower. These activities are commercial in nature, since the crowdfunding platform receives a fee for this service.

In general the activities of crowdfunding platforms do not vary significantly. In the opinion of the AFM, a crowdfunding platform does not simply act as a bulletin board or a meeting place for supply and demand. A crowdfunding platform's business model focuses on successful funding or investment. It also offers a range of services to both lenders and borrowers in order to achieve a successful funding. Also after the funding, the crowdfunding platform carries out activities designed to ensure that the borrower meets its payment obligations to the lenders. The activities of an online crowdfunding platform are not further specified in the Wft, but the AFM considers that these activities clearly constitute intermediation activities. In the Wft several financial enterprises are defined, that act as intermediaries in the financial markets. The AFM has considered the relationship with the activities of these parties, and makes a distinction in the licensing obligation for each type of crowdfunding platform. The kind of permit or exemption that applies depends mainly of the form of funding or investment involved.

Step-by-step plan for crowdfunding

Using the step-by-step plan below, an operator of a crowdfunding platform can establish whether they need a permit or exemption, and if so, which. The AFM may attach further conditions or limitations to either a permit or an exemption, for example with respect to the conduct of the business⁴ and the transfer of funds.

Step-by-step plan for crowdfunding for loans to consumers and/or businesses

- Does the platform provide funding in the form of loans?
 - YES: in that case this qualifies as repayable funds as defined in the Wft.⁵ The crowdfunding platform acts as an intermediary for the purpose of raising or providing repayable funds from or to the public.⁶ This activity is prohibited without an exemption from the AFM.⁷ The platform must therefore apply for an exemption for intermediary services in relation to repayable funds.⁸ This activity may also qualify as consumer credit as defined in the Wft. Continue with question 2.
 - NO: this activity may then qualify as crowdfunding for investments, if the funding is not in the form of a donation or gift. Continue with the step-by-step plan for investments in companies.
1. Is the platform (also) used to provide loans to consumers?⁹
- YES: in this case this qualifies as consumer credit as defined in the Wft.¹⁰ The crowdfunding platform acts as an intermediary¹¹ consumer credit and this activity is prohibited without a permit from the AFM.¹² The platform must apply to the AFM for a permit¹³ to be able to act as intermediary for consumer credit. The crowdfunding platform does not have to obtain *both* a permit for consumer credit intermediation *and* an exemption for intermediation in repayable funds. An application may be made for a permit to intermediate in consumer credit, with the addition of the extra product/service combination 'intermediation in savings and current accounts'. In this case, a separate exemption for intermediation in repayable funds is not necessary.¹⁴
 - NO: in this case this activity does not qualify as consumer credit as defined in the Wft. This is the case if loans are provided to businesses only.¹⁵ An exemption for intermediation in repayable funds is then required (see question 1).

Step-by-step plan for crowdfunding for investments in businesses

1. Are investments made via the platform in the form of shares?¹⁶
 - YES: in this case securities may be involved (financial instruments).¹⁷ Continue with question 3.
 - NO: continue with question 2.
2. Are investments made via the platform in the form of bonds?
 - YES: in this case securities may be involved (financial instruments). Continue with question 3.
 - NO: if the investment does not involve shares or bonds, it still may involve securities in the case that other transferable negotiable instruments or debt instruments are used. In case of doubt, submit your business model to the AFM for assessment.
3. Are the shares or bonds concerned transferable?¹⁸
 - YES: then the situation involves securities, and therefore financial instruments. The AFM takes the view that the activities a platform carries out must be qualified as the receiving and transmitting of orders from lenders with respect to these financial instruments (order referral). The situation therefore concerns the provision of an investment service, and this activity is prohibited without a permit from the AFM.¹⁹ The platform must apply to the AFM for a permit²⁰ as an investment firm.
 - NO: the situation does not concern securities. It may however involve a different financial instrument. In case of doubt, submit your business model to the AFM for assessment.

Summary

As shown in the step-by-step plan above, three different supervisory regimes may apply to crowdfunding platforms: 1) permit for credit intermediation, 2) exemption for intermediation in repayable funds, and 3) permit for the reception/transmission of orders in financial instruments. The AFM may attach further conditions or limitations to either a permit or an exemption, for example with respect to the conduct of the business²¹ and the transfer of funds. The requirements applying to the granting of a permit or an exemption vary, and the ongoing relevant supervisory regulations may also vary. An exhaustive description of these variations is beyond the scope of this document. In conclusion, the AFM notes that there are currently two crowdfunding platforms in the Netherlands that have obtained a permit from the AFM. Geldvoorelkaar.nl has a permit for intermediation in consumer credit, and may therefore also act as an intermediary in repayable funds. Crowdboutnow has a permit to operate as an investment firm.

Further information

If you require further information on the requirements set by the AFM with respect to a permit and/or an exemption, go to the AFM's website at:

<http://www.afm.nl/nl/professionals/diensten/starters/wet-regelgeving/ontheffing-bemiddelen-aantrekken-opvorderbare-gelden.aspx>

Questions regarding the application procedure for a permit and/or exemption from the AFM should be addressed to the AFM's Business Desk, which is available by telephone on 0900-6800 680 or by e-mail to ondernemersloket@afm.nl

List of references

¹ For further information, see: <http://www.afm.nl/layouts/afm/default.aspx~/media/files/publicatie/2011/dnb-afm-orientatie-crowdfunding.ashx>

² Source: Classification taken from: <http://nl.wikipedia.org/wiki/Crowdfunding#Varianten>

³ The prohibition of Section 3:5 subsection 1 Wft does not apply to the platform, also not if it temporarily holds the funds it has raised or that have been made available, as long as this concerns funds provided to it as part of an actual transfer instruction. The platform may not retain the funds for longer than necessary for technical or organisational reasons; this means that a connection must continue to exist between the funds and the instruction to the platform to transfer these funds to the borrower. Such a connection in any case will no longer exist as soon as it is established that the deal will not go through or the funds will otherwise not be transferred to the borrower(s) for whatever reason. See the website of DNB : <http://www.toezicht.dnb.nl/3/50-224922.jsp>

⁴ In its assessment of the business operation of a crowdfunding platform, the AFM will apply its KNVB criteria for service concepts to establish the extent to which the customer's interests are prioritised. For further information, see: <http://www.afm.nl/nl/professionals/afm-voor/adviseurs-bemiddelaars/advies/bedieningsconcept/knvb.aspx>

⁵ Section 1:1 Wft defines repayable funds as: "funds that must be repaid at some point, for whatever reason, and regarding which it is clear beforehand which nominal sum must be repaid." See also: <http://www.toezicht.dnb.nl/2/50-201848.jsp>.

⁶ See Section 3:5 Wft. For further information, see: <http://www.toezicht.dnb.nl/2/50-202240.jsp>.

⁷ Under Section 4:3 subsection 1 Wft, no party operating from or in the Netherlands may perform activities in another Member State (a state that is a member of the European Union or a state which is not a Member State of the European Union that is a party to the agreement concerning the European Economic Area) in the pursuit of a profession or business in order to attract or obtain the disposal of repayable funds from others than professional market parties beyond a restricted circle. For more information on what constitutes a 'restricted circle', see: <http://www.toezicht.dnb.nl/2/50-201980.jsp>. Briefly, a professional market party is a party that provides a loan of at least €100,000.

⁸ Section 4:3 subsection 4 Wft states the cases in which the AFM grants an exemption and refers to further regulations on this point.

⁹ Section 1:1 Wft defines a consumer as: "a natural person not acting in the pursuit of his business or profession [...]"

¹⁰ According to Section 1:1 Wft, the definition of a loan or credit includes: "making a sum of money available to a consumer, regarding which the consumer is required to make one or more payments". The Wft does not apply to certain loans, see Section 1:20 Wft.

¹¹ The definition of intermediation in Section 1:1 Wft includes: "all activities carried out in the pursuit of a profession or business focused on establishing, as an intermediary, a contract regarding credit between a consumer and a provider, or on assisting in the administration and performance of such a contract." This document assumes that lenders are also providers as defined in the Wft (providers acting in the pursuit of a profession or business). If this is not the case, then no licence for loan intermediation is needed for the platform (Section 2:80 Wft), however an exemption from the prohibition of intermediation in repayable funds from the public is required (Section 4:3 Wft). See also question 1.

¹² Under Section 2:80 subsection 1 Wft, the performance of intermediary services without a licence from the AFM is prohibited.

¹³ The requirements for obtaining a licence are stated in Section 2:83 Wft.

¹⁴ See Section 4:3 subsection 2 item f Wft.

¹⁵ In this document, the term 'business operator' is defined as all parties who are not consumers (a consumer is a natural person not acting in the pursuit of his business or profession).

¹⁶ A share is a certificate of participation in the equity of a company with legal personality. A lender is a co-owner of the company in proportion to his or her shareholding.

¹⁷ Section 1:1 Wft includes a summary of the types of financial instrument: securities, money market instruments, units in a collective investment scheme, options, futures, swaps, derivative instruments for the transfer of credit risk and financial contracts to settle differences.

¹⁸ In its 'Policy rule on negotiability' the AFM defines negotiability [see: <http://www.afm.nl/~media/Files/wetten-regels/beleidsregel/beleidsregel-verhandelbaarheid.ashx>] as: *"All constructions whereby the economic interest of a standardised negotiable instrument or right of participation is or may be transferred directly or indirectly to a third party."*

¹⁹ Section 2:96 subsection 1 Wft prohibits the performance of investment services without a licence from the AFM.

²⁰ The requirements for obtaining a licence are stated in Section 2:99 Wft.

²¹ In its assessment of the business operation of a crowdfunding platform, the AFM will apply its KNVB criteria for service concepts in order to establish the extent to which the customer's interests are prioritised. For further information, see: <http://www.afm.nl/nl/professionals/afm-voor/adviseurs-bemiddelaars/advies/bedieningsconcept/knvb.aspx>