Regulating Crowdlending: A Critical Analysis of the European Union’s ECSPR

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CHAPTER IV. INTERNATIONAL REGULATORY RESPONSE TO CROWDLENDING

A. Introduction

Using the findings from chapter 3 and the framework developed in chapter 2, this chapter explores the regulatory responses to crowdlending across various jurisdictions. This chapter assists in answering the central research question by answering the third ancillary research question asking:

1. how the other jurisdictions have achieved goals that can be described to be similar or closely related to the ECSPR’s goals identified in chapter 2¹ and

2. whether, by comparison, the ECSPR is adequate in achieving its regulatory goals for crowdlending against the approach in Australia, New Zealand, the UK, and the US in achieving goals that are similar to the ECSPR’s goals.

This chapter undertakes a functional legal comparative analysis of the regulatory response to crowdlending in four jurisdictions: Australia, New Zealand, the UK, and the US.

This thesis uses the ECSPR’s taxonomy for the entirety of the analysis. In some jurisdictions, their definition of a non-sophisticated investor is not directly comparable to the ECSPR’s definition.² However, this thesis is not exploring the

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² See for example Australia - Corporations Act 2001 s 761G; ECSPR article 2(1)(j), (k); New Zealand - Financial Markets Conduct Act 2013 s 6(1), Schedule 1 Clause 3, 35.
varying policy positions taken in legislation as to who or what constitutes a sophisticated or non-sophisticated investor and what parameters should be placed on those definitions.

The exploration of crowd-lending regulation in Australia, New Zealand, the UK, and the US is conducted using the analytical framework provided in chapter 2 which begins with a financial regulatory goal analysis in Section B, then moves to a financial regulatory model analysis in Section C, and closes with a regulatory theory analysis in Section D. In Section B financial regulatory goal analysis will examine competition, market efficiency, and investor protection and other users. In Section C financial regulatory model analysis will focus on a risk-based regulatory model using the risks identified in this chapter namely: liquidity risk, default risk, CSP failure, information asymmetry, inexperience, fraud risk, pricing, credit risk assessment and credit scoring, and systemic risk. Finally, in Section D the regulatory theory analysis will close with the examination of legal certainty.

B. Financial Regulatory Goals
This section provides the financial regulatory goal analysis examining competition, market efficiency, and investor protection and other users.

1. Competition
The investigation of competition in this chapter also focuses on marketing communications and enforcement. In chapter 3, these measures were examined because they were two areas where the ECSPR was not fully harmonised. The analysis in chapter 2 showed that the UK’s conception of competition is goal oriented (focusing on consumer welfare) whereas the EU’s conception is process-oriented (removal of barriers). There is significant overlap between the
measures examined under the market efficiency, investor protection and other users, and information asymmetry and inexperience headings and the measures used to promote effective competition in the interests of consumers. As a result, enforcement mechanisms and marketing communications are analysed under this competition goal heading because of the comparative value for the analysis in chapter 3. The enforcement and marketing communications requirements are also scrutinised under this heading because the measures would contribute to the UK’s configuration of competition. However, these measures will only make a positive contribution if they are adequately designed to ensure compliance with the regulatory framework and by ensuring clear, comprehensible accurate information in marketing communications.

\textit{a) Enforcement}

\textit{(1) Enforcement Roles}

Both public and private actors have enforcement roles under the regulatory frameworks in Australia, New Zealand, the UK, and the US. The public actors are the Australian Securities and Investment Commission, the Financial Markets Authority (NZ), the Financial Conduct Authority (UK), and the US Securities and Exchange Commission. The private actors with enforcement roles are the CSPs

\begin{itemize}
\item See further \textit{2. Market Efficiency}.
\item See further \textit{3. Investor Protection and Other Users}.
\item See further \textit{d) Information Asymmetry and Inexperience}.
\item This is also noted in chapter 2.
\end{itemize}
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and complaints mechanisms⁸ that allow the public at large to be an enforcer also.

Enforcement roles are one of the few areas where the EU aligns with all four of the comparator jurisdictions.⁹ Thus, there is agreement internationally that regulators and CSPs should have regulatory responsibilities. It is a very well-established enforcement tool.

The public actors in Australia, New Zealand and the UK do not face the same coordination and market fragmentation challenges which are posed by the minimum sanctions in the ECSPR and the challenge of having 27 different enforcers of the ECSPR in the EU.¹⁰ In Australia, New Zealand, and the UK the public actors can focus their enforcement roles on compliance with their regulatory frameworks rather than coordination. The US faces some coordination issues in relation to enforcement however its coordination issue is slightly different. There is only one public actor tasked with enforcement of Regulation Crowdfunding in the US, the SEC, and therefore the regulatory framework is subject to one public actor’s interpretation and application. The coordination and enforcement challenges arise in the US because it is possible

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⁹ See chapter 3.

¹⁰ See further chapter 3 b) Enforcement.
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to operate within a State’s regulatory framework if the services are only offered within the State and do not use Regulation Crowdfunding.\textsuperscript{11} This may lead to regulatory arbitrage. Offenders could possibly establish their services within multiple States and commit frequent minor offences across all the States which by themselves are insufficient to merit enforcement action but taken together constitute a major issue. As a result, the SEC and the co-ordination body of the financial State regulators signed a Memorandum of Understanding to share information and collaborate.\textsuperscript{12}

When the EU is compared to the US, the US is more adequate in achieving the competition regulatory goal because the same penalties apply to all CSPs operating within Regulation Crowdfunding. In the ECSPR, minimum sanctions apply where each Member State can add to\textsuperscript{13} and criminalise the offence.\textsuperscript{14} On the other hand, the ECSPR is more adequate in achieving its competition goal because the Member State regimes for business crowdlending will no longer have effect once the ECSPR’s transitional period ends.\textsuperscript{15}

\textsuperscript{11} See further b) Cross-Border.
\textsuperscript{13} ECSPR article 39(3).
\textsuperscript{14} ECSPR article 39(1); See further chapter 3.
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When the EU is compared to Australia, New Zealand and the UK, these comparator jurisdictions are more adequate in achieving the competition goal. In Australia, New Zealand, and the UK if a CSP operates within the same regulatory framework all the CSPs are subject to the same penalties. In the EU Member States can goldplate the minimum sanctions. As a result, one CSP may receive a different penalty for the same infringement than another CSP purely because a different NCA was imposing the penalties.

(2) Enforcement Mechanisms and Sanctions
Compliance can be ensured with a range of enforcement measures. Some enforcement measures are explicit, and others are more subtle. An example of a harm-based enforcement measure in New Zealand is the civil liability which may be imposed if a CSP operates without a licence. A more subtle prevention-based enforcement measure would be the requirement in the UK for a CSP to have an internal complaints procedure.

Australia, New Zealand, the UK, and the US have not designed crowdlending-specific enforcement mechanisms. Each jurisdiction applies its pre-existing portfolio of enforcement mechanisms to crowdlending. For example, in


See further Ian Ayres and John Braithwaite, Responsive Regulation: Transcending the Deregulation Debate (Oxford University Press 1995).


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Australia Division 7 Part 7.9 of the Corporations Act 2001 outlines the enforcement measures that can be taken for breach of the PDS requirements in Chapter 7 Part 7.9 of the Corporations Act 2001. Similarly in New Zealand, for example, breach of the licensing requirement is subject to the general enforcement provisions for breach of the licensing requirement. In the UK, CSPs are subject to general complaints and dispute resolution rules, penalties and enforcement mechanisms. In the US a project owner’s failure to comply with Regulation Crowdfunding can mean that the Regulation Crowdfunding exemption will no longer apply. However, if the project owner’s breach was insignificant the borrower might be able to continue to rely on Regulation Crowdfunding if certain grounds are met. However, in Australia, New Zealand and the UK, the enforcement concerns as against project owners and investors mainly relate to fraud or anti-money laundering measures. The responses to fraud or anti-money laundering are explored later.

Taking the international approach into context, the EU is unusual in setting out crowdlending specific enforcement measures. Most of the enforcement measures have been left to NCAs. The EU sets the floor for enforcement mechanisms, but Member States may provide for additional or higher

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20 New Zealand - Financial Markets Conduct Act 2013 s 388.
22 UK - FCA Handbook DISP2.1, DEPP.
26 See further e) Fraud Risk.
27 ECSPR article 39; See further chapter 3.
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penalties.\(^{28}\) Greater harmonisation is achieved in the comparator jurisdictions on penalties.

Nevertheless, it is not thought that there is much to read into the EU designing a specific suite of enforcement mechanisms under the ECSPR. While Australia, New Zealand, the UK, and the US have all used their pre-existing enforcement framework for sanctions. The difference is rooted in the basic differences between the EU and the comparator jurisdictions. The EU is an international set of institutions while the comparator jurisdictions are all national legislators. The EU’s regulatory style is to design enforcement mechanisms for specific harms, preventative purposes, and regulatory frameworks. It is well within the comparator jurisdictions’ remit to create a standard suite of sanction enforcement mechanisms for the financial sector overall. It is an adequate use of the legislator’s resources to create standard penalties for breach of for example the licence or authorisation.\(^{29}\)

\(b\) Marketing Communications

Australia and New Zealand use a general principle approach to marketing communications. New Zealand requires fair dealing in relation to crowdlending.\(^{30}\) Australia bans misleading or deceptive conduct, false or misleading misrepresentations in relation to financial services\(^ {31}\) or misleading

\(^{28}\) ibid.
\(^{29}\) See further \(a\) Authorisation.
\(^{31}\) Australia - Australian Securities and Investments Commission Act 2001 s 12DA, 12DB.
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or deceptive conduct in relation to financial services.\textsuperscript{32} Both jurisdictions use guidance material to further elaborate on what these general principles mean. New Zealand explains that the broad fair dealing principle prohibits:

misleading or deceptive conduct, false or misleading representations, unsubstantiated representations and offers of financial products in the course of unsolicited meetings.\textsuperscript{33}

The guidance also elaborates further with examples that important information should not be buried and future events ‘should be presented as “something that might happen”’.\textsuperscript{34}

In Australia, the guidance states that there is a ‘legal obligation to not make false or misleading statements’.\textsuperscript{35} Advertisements for example should contain messages that are balanced regarding ‘returns, benefits and risks’ and should not have headlines that contradict disclaimers and fees and costs should be realistic.\textsuperscript{36}

The UK also uses a general principle, but its principle is that financial promotions must be fair, clear and not misleading.\textsuperscript{37} The UK combines this

\textsuperscript{32} Australia - Corporations Act 2001 s 1041H.
\textsuperscript{33} Financial Markets Authority, ‘Fair Dealing in Advertising and Communications - Crowdfunding and Peer-to-Peer Lending’ (n 31) 4.
\textsuperscript{34} Financial Markets Authority, ‘Fair Dealing in Advertising and Communications - Crowdfunding and Peer-to-Peer Lending’ (n 31) 7.
\textsuperscript{37} UK - FCA Handbook COBS 4.2.
principle with detailed business conduct rules on matters such as direct offer financial promotions, cold calls and promotions not in writing, financial promotions with overseas elements, systems and controls for approving and communicating financial promotions, and record keeping. The UK rules detail for example that financial promotions should:

- make it clear that capital is at risk,
- that the yield figure is balanced,
- where there are complex charging structures, that the information is fair, clear, and not misleading and contained sufficient information for the recipient’s needs and
- be clear whether they are regulated by the UK regulators.

Most of the US’ marketing communications requirements focus on the project owner. Project owners are only allowed to advertise if the advertisement directs investors to the CSP’s website and ‘includes no more than’:

- ‘a statement’ that the project owner is seeking funding under Regulation Crowdfunding with the CSP’s name and directing them to the CSP’s website,
- the ‘terms of the offering’, and
- contact details and ‘brief description of the business’.

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38 See further a) Theory of Legal Certainty.
41 UK - FCA Handbook COBS 4.9.
42 UK - FCA Handbook COBS 4.10.
43 UK - FCA Handbook COBS 4.11.
44 UK - FCA Handbook COBS 4.2.4G.
45 US - Rule 204(b) Regulation Crowdfunding, 17 CFR § 227.204(b) (2021)
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Project owners may also communicate ‘to determine whether there is any interest’ in their project.\textsuperscript{46} However, project owners can use the CSP’s communication channels\textsuperscript{47} to communicate information about the project.\textsuperscript{48} This approach evidences a more precautionary approach in relation to project owner marketing communications and contrasts with the other jurisdictions with their focus on the CSP’s marketing communications. It remains to be seen whether marketing communication requirements will be necessary for the other jurisdictions.

The US focuses only on CSP’s advertisements in relation to the CSP’s website. These advertisements must be listed according to objective criteria that are ‘reasonably designed to identify a broad selection of’ project owners.\textsuperscript{49} These criteria can include matters such as the maximum offering amount, the project owner’s location, and the business segment in which the project owner operates.\textsuperscript{50} Furthermore, CSPs must not receive additional compensation for these advertisements.\textsuperscript{51}

The EU\textsuperscript{52} is similar to Australia as both require marketing communications that are not misleading\textsuperscript{53} and that the marketing communications are consistent with the standardised disclosure document.\textsuperscript{54} However, the EU’s duty that

\begin{itemize}
\item \textsuperscript{46} US – Rule 206 Regulation Crowdfunding, 17 CFR § 227.206 (2021).
\item \textsuperscript{47} US – Rule 303(c) Regulation Crowdfunding, 17 CFR § 227.303(c) (2021).
\item \textsuperscript{48} US – Rule 204(c) Regulation Crowdfunding, 17 CFR § 227.204(c) (2021).
\item \textsuperscript{50} ibid.
\item \textsuperscript{51} ibid.
\item \textsuperscript{52} See further chapter 3.
\item \textsuperscript{53} Australia - Australian Securities and Investments Commission Act 2001 s 12DA, 12DB; Australia - Corporations Act 2001 s 1041H; ECSPR article 27(2).
\item \textsuperscript{54} Australia – Corporations Act 2001 s 734; ECSPR article 27(2); See further (1) Standardised Disclosure Document.
\end{itemize}
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‘marketing communications shall be fair, clear and not misleading’\textsuperscript{55} is very similar to the UK’s requirement that financial promotions must be fair, clear, and not misleading.\textsuperscript{56}

Parts of the ECSPR’s marketing communications requirements\textsuperscript{57} align with those found in Australia and the UK. Neither Australia nor the UK’s requirements depend on further Member State national laws. As a result, the ECSPR is not by comparison inadequate in addressing legal certainty because it is respecting Member State sovereignty.\textsuperscript{58}

c) Conclusion

Chapter 2 noted the different focuses of the competition goals in the ECSPR and the UK. These differences are also reflected in the enforcement and market communication requirements analysed in this section. As explored in chapter 3, because the ECSPR’s competition goal is process-oriented focusing on harmonisation and must take Member State sovereignty into account, a minimum standards approach to enforcement largely attains the ECSPR’s competition goal. The same cannot be said for the marketing communications requirement which could be fully harmonised and could focus on a goal such as consumer welfare. The marketing communications requirements in the UK adequately address its competition consumer welfare goal.\textsuperscript{59} Arguably the less prescriptive principles-based approach in the ECSPR does not adequately

\textsuperscript{55} ECSPR article 27(2).
\textsuperscript{56} UK - FCA Handbook COBS 4.2.1R(2)(c).
\textsuperscript{57} See further chapter 3.
\textsuperscript{58} ibid.
\textsuperscript{59} See further chapter 2.
address its focus on SMEs and start-ups.\textsuperscript{60} If misleading or inaccurate information is advertised about crowdlending services the reputational damage could negatively impact the CSP and the project owners. Therefore, limiting their capacity to participate in market competition. Furthermore, there could be reputational damage to the entire industry. Thus, negatively impacting the crowdlending market’s capacity to allocate credit to SMEs and start-ups.

2. Market Efficiency

\textit{a) Authorisation}

All jurisdictions have a process that ensures CSPs meet and continues to meet certain standards.\textsuperscript{61} This process whether it is called authorisation or licensing grants CSPs’ access to the market. Australia, New Zealand, and the US all have specific authorisation processes that CSPs must follow. In New Zealand, the process is specific to crowdlending: in the US, it is specific to crowdfunding. In Australia, it is specific to registered managed investment schemes which is the relevant authorisation process for crowdlending for this thesis. Australia, New Zealand, and the US are all very similar to the EU.\textsuperscript{62} It is clear from the regulatory framework what information must be provided in the authorisation process. Each jurisdiction lists its authorisation process requirements in its

\textsuperscript{60} ibid.


\textsuperscript{62} See further chapter 3.
regulatory frameworks. The list includes basic information requirements\textsuperscript{63} to system requirements\textsuperscript{64} to requirements for business closure plans.\textsuperscript{65}

The UK is more complicated. The UK has a single authorisation process. It is not immediately clear from the UK’s regulatory framework what is required as part of the authorisation process. However, the UK regulator has various regulatory interfaces which provide opportunities to meet with applicants and significant guidance materials to communicate what is required.

The single authorisation process simplifies matters for the regulator. Thus, the UK’s single authorisation position acts as a speedbump to market efficiency that necessitates increased engagement with potential applicants to guide them through the process. In Australia, the EU, New Zealand, and the US it is considerably easier to navigate the regulatory framework and find what is required as part of the authorisation process.

As set out in chapter 3, authorisations are a powerful trust indicator to the market, investors, and project owners. Being authorised in the market is a feature of allocative efficiency, as the regulator is signalling to the market that the CSP meets the required standards to offer a crowdlending service to the market, investors, and project owners.


\textsuperscript{64} Australia - Corporations Act 2001 s 912A(1)(a), (aa), (d), (h); ECSPR article 12(2)(e), (f); New Zealand - Financial Markets Conduct Act 2013 s 396(c); New Zealand - Financial Markets Conduct Regulations 2014 reg 187(a), (c), (e), (g), (h);

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*b) Secondary Markets*

This section examines the regulatory treatment of secondary markets across the jurisdictions examined. However, secondary markets are also examined from the perspective of liquidity risk later in this chapter.\(^66\) New Zealand and the UK are the only jurisdictions that explicitly address secondary markets or bulletin boards\(^67\) in their crowdlending regulatory frameworks. Australia and the US do not directly address secondary markets in their crowdlending regulatory frameworks.

New Zealand deals with the issue of a secondary market rather rapidly and simply includes the operation of an ancillary market in its definition of crowdlending:

> A crowd funding service or a peer-to-peer lending service also includes—[...]

> (b) any service of operating an ancillary market for trading financial products that have been offered on the facility referred to in subclause (1)(a).\(^68\)

The next tangential reference is the requirement to disclose the risks involved in the standardised disclosure document.\(^69\) New Zealand’s licensing guide developed for CSPs provides further information on the requirements for secondary markets. The licensing guide states that secondary markets are

\(^{66}\) See also a) Liquidity Risk.
\(^{67}\) Ibid.
\(^{68}\) New Zealand – Financial Markets Conduct Regulations 2014 reg 185(2)(b).
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assessed on whether they are fair, orderly, and transparent and the FMA needs to be informed on how the secondary market will operate.\textsuperscript{70} However, in the UK specific disclosures must be made regarding the operation of the secondary market\textsuperscript{71} and investors’ understanding of the secondary market and liquidity risk\textsuperscript{72} is tested in the appropriateness assessment.\textsuperscript{73}

In the US there is no provision for the operation of a secondary market under Regulation Crowdfunding. Nevertheless, the SEC has sought public comment as to whether it should extend a ‘federal pre-emption’ to secondary sales under Regulation Crowdfunding.\textsuperscript{74} The SEC does not give any clear reason as to why secondary markets have not developed but attributes the high costs of compliance and due diligence surrounding providing quotes for securities.\textsuperscript{75}

Currently, Regulation Crowdfunding refers to the transfer of an investment in passing. However, investors are restricted from transferring their investment within the first year with limited exceptions.\textsuperscript{76}

Australia does not refer to secondary markets in its crowdlending regulatory framework. The closest reference is the possibility to withdraw in certain

\textsuperscript{70} Financial Markets Authority, ‘Licensing Application Guide: Peer-to-Peer Lending Part B2’ (n 9) 16.
\textsuperscript{71} UK - FCA Handbook COBS 18.12.24R(8).
\textsuperscript{72} See also a) Liquidity Risk.
\textsuperscript{73} UK - FCA Handbook COBS 10.2.9G(j).
\textsuperscript{76} US - Rule 501(a) Regulation Crowdfunding, 17 CFR § 227.501(a) (2020).
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circumstances under s 601KA of the Corporations Act 2001. Nevertheless, withdrawal depends on liquidity. It appears that once the loan has been originated, the investment is deemed to be illiquid under the Corporations Act 2001. If the investment is illiquid, chapter 5C Part 5C.6 of the Corporations Act 2001 applies. chapter 5C Part 5C.6 of the Corporations Act 2001 requires for example a copy of the offer to be given to all the other investors\textsuperscript{77} and for a copy of the offer to be lodged with ASIC.\textsuperscript{78}

These requirements were quite burdensome and ASIC agreed.\textsuperscript{79} ASIC stated these measures were ‘disproportionately burdensome’ for CSPs.\textsuperscript{80} Thus ASIC granted relief from the withdrawal requirements to a CSP so that a secondary market could be operated.\textsuperscript{81} In this instance, ASIC placed four requirements on the operation of the secondary market.\textsuperscript{82} One the CSP must set out procedures for making and dealing with investor requests to exit their investment early.\textsuperscript{83} Two the CSP must place prominent disclosures on the website and the standardised disclosure document.\textsuperscript{84} Three that the early exit request is satisfied within five business days if the CSP accepts it.\textsuperscript{85} Four the CSP thinks the request will not impact the other investors’ investments.\textsuperscript{86}

\textsuperscript{77} Australia - Corporations Act 2001 s 601KB(2)(b).
\textsuperscript{78} Australia - Corporations Act 2001 s 601KB(5).
\textsuperscript{80} ibid.
\textsuperscript{81} ibid.
\textsuperscript{82} ibid.
\textsuperscript{83} ibid.
\textsuperscript{84} Australian Securities and Investment Commission REP 420 (n 80) 22.
\textsuperscript{85} ibid.
\textsuperscript{86} ibid.
The operation of secondary markets has produced the most diverse range of regulatory responses internationally. None have taken the bulletin board approach found in the EU. The bulletin board only allows investors to advertise their interest in selling and the exchange itself must take place outside of the CSP’s platform. It seems the bulletin board is a creature of potential overlap with MiFID II’s multilateral trade facilities (‘MTF’) which does not pose similar challenges internationally.

c) Upper Limits
Upper limits are one of the few instances where there is a bifurcated approach. New Zealand and the US have an upper aggregate limit on what a project owner may seek within 12 months. In New Zealand’s limit is $2 million (NZD). In the US, the limit recently increased from $1.07 million (USD) to $5 million (USD). On the other hand, Australia and the UK have no prescribed limit in their regulatory frameworks. There is no upper limit in the UK. However, the running-account credit must not exceed the maximum debit balance which is set out in the contract.

Australia and the UK take a less paternalistic approach and firmly place the decision as to appropriate loan amounts in CSPs’ hands. New Zealand is the

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87 ECSPR article 25; See further chapter 3.
89 New Zealand – Financial Markets Conduct Regulations 2014 reg 187(g).
90 US - Rule 100(a)(1) Regulation Crowdfunding, 17 CFR § 227.100(a)(1)
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most paternalistic as it has the smallest limit. From an allocative efficiency perspective, the Australian and UK approach is the most adequate. Australia and New Zealand enable the greatest amount of capital to be placed in the hands of SMEs.

As such by comparison, the EU’s limit is somewhat of a middle ground between Australia and the UK on one hand and New Zealand on the other. The EU’s limit is not as low as New Zealand’s, but it is not unlimited either. The EU likely set its €5 million limit because it must navigate a line between the same activity same rules principles considerations for the ECSPR’s interaction with prospectus requirements in the EU and the allocative efficiency of having no upper limit. The UK’s position and market strength lend a lot of weight to the argument of having no upper limit. Questions also arise as to who a bigger limit benefits and whom it harms in the context of crowdlending. There is research to suggest that larger limits tend to harm borrowers and benefit lenders. However, it is thought that the removal of the upper limit in the EU’s regulatory framework would be unlikely. The EU must also navigate Member States’ views on the matter and respect their sovereignty.

3. Investor Protection and Other Users
As set out in chapter 3, this investor protection and other users analysis focuses on whether the ECSPR is adequate in protecting investors and clients. The

93 See further chapter 3.
examination touches on some of the risks that investors and clients are exposed to, but the risks are explored in-depth in the risk-based regulatory model section.

**a) Investors**
The ECSPR deals with investor protection by disclosing the risks, investor limits, knowledge assessments and so on. The majority of the investor protection measures were defaults or nudges rather than mandatory protections. Thus the ECSPR relies on a self-responsibility principle for investor protection. The self-responsibility principle for investor protection means that the ECSPR is not paternalistic. It was also found that there were other indirect investor protection mechanisms in the form of business conduct requirements placed upon the CSPs. These CSP business conduct requirements are further evidence of the ECSPR’s non-paternalistic inclinations for investor protection.

This section will seek to find out whether the other jurisdictions are relying on a self-responsibility principle. If yes to what extent? If not, what is the mainstay of their investor protection? Whether consumer project owners were included in the crowdlending regulatory framework?

The investor self-responsibility principle can be seen in the other jurisdictions examined. The investor self-responsibility principle is employed to lesser and

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96 See further chapter 3.3. Investor Protection and Other Users.
97 Except for, for example, the KIIS. ECSPR article 23.
99 See further c) Business and Consumer Crowdlending.
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greater extents in each jurisdiction and each investor protection tool. The requirements also vary from mandatory to optional formats.100

(1) Investor Classification

At the investor classification level, some jurisdictions allow non-sophisticated investors to change their status to less restrictive categorisations.101 The US does not explicitly refer to investor status reclassification in their regulatory framework.102 Thus it seems there is no way to opt-out of the non-sophisticated investor classification in the US.

In Australia, New Zealand, and the UK, there is an option for investor classification change, non-sophisticated investors can self-certify to an investor class that receives fewer protections.103 In other words, provided certain conditions are met, non-sophisticated investors can shed the non-sophisticated investor protections and expose themselves to sophisticated investor risks. The opt-out format for investor classification means that those that are sufficiently motivated and incentivised will change status. Nevertheless, in the UK sophisticated investors may request re-categorisation to receive higher protections.104

In the UK, if the non-sophisticated investor wishes to ‘age out’ of non-sophisticated investor protection they can do so if they have made 2

100 See further chapter 3.
102 There is no mechanism to change investor status once the status has been assigned in the relevant provision for Regulation Crowdfunding. US - Rule 501 Regulation D, 17 CFR § 230.501(a).
103 Australia - Corporations Act 2001 s 761G(7)(c); New Zealand - Financial Markets Conduct Act 2013 Schedule 1 Clause 41; UK - FCA Handbook COBS 4.12.7R-11G.
104 UK - FCA Handbook COBS 3.7.
investments over 2 years.\textsuperscript{105} Thus adding another layer and another nudge to non-sophisticated investor protection while still relying on the self-responsibility principle.

(2) Investor Tests
The general category of investor tests is used to when comparing the tools protecting investors in Australia, New Zealand, the UK, and the US to those in the EU. Sometimes the same tools are present across most jurisdictions such as the knowledge tests.\textsuperscript{106} Knowledge tests,\textsuperscript{107} as the subsequent analysis shows, are present in the EU, UK, and US. Some investor tests are only present in a particular jurisdiction. For example, the EU’s simulation of loss tool\textsuperscript{108} for non-sophisticated investors is not found in Australia, New Zealand, the UK, or the US. Where there are similar tools across the jurisdictions these tools are compared directly to each other in the subsequent sections.\textsuperscript{109} However, those tools that have no comparators are discussed in this part.

In terms of a general approach to suitability tests, there are two approaches evidenced in the comparator jurisdictions. One approach is very much ‘hands-off’ and reliant on free-market considerations as seen in Australia, New Zealand, and to a large extent in the US. The other approach is far more

\textsuperscript{105} UK – FCA Handbook COBS 4.7.7R-13G.
\textsuperscript{106} See further (a) Knowledge Tests.
\textsuperscript{107} ibid.
\textsuperscript{109} See further (a) Knowledge Tests, (b) Anti-Impulse Measures, (c) Investment Limits.
involved, seeking to, for example, alert investors to possible market failures and demonstrating a more paternalistic stance such as in the EU or UK.

Australia and New Zealand rely on a combination of a very high investment threshold\textsuperscript{110} and disclosures\textsuperscript{111} to protect their investors and nothing further. The US uses some investor tests such as a knowledge test\textsuperscript{112} and cooling-off period\textsuperscript{113} but these are by comparison significantly milder than those found in the other jurisdictions. In the main, the US relies on disclosures to protect its investors.\textsuperscript{114} By contrast, the EU and the UK use multiple tools to protect investors from knowledge tests\textsuperscript{115} to anti-impulse measures\textsuperscript{116} to disclosures\textsuperscript{117} to increased regulatory requirements where individual loan portfolio management services are provided.\textsuperscript{118}

Interestingly, the good practice guidance in Australia specifically refers to providing investors with a suitability test in the form of an optional knowledge test.\textsuperscript{119} The good practice guidance also expressly states that the examples given in the guidance are not intended to be exhaustive and that CSPs are encouraged to develop good practices as the industry develops.\textsuperscript{120} This indicates an awareness in Australia of the additional tests and tools which could protect investors but that, at this moment in time, the Australian legislature is of the

\textsuperscript{110} See further (c) Investment Limits.
\textsuperscript{111} See further d) Information Asymmetry and Inexperience.
\textsuperscript{112} See further (a) Knowledge Tests.
\textsuperscript{113} See further (c) Investment Limits.
\textsuperscript{114} See further d) Information Asymmetry and Inexperience.
\textsuperscript{115} See further (a) Knowledge Tests.
\textsuperscript{116} See further (b) Anti-Impulse Measures.
\textsuperscript{117} See further d) Information Asymmetry and Inexperience.
\textsuperscript{118} See further (3) Individual Loan Portfolio Management.
\textsuperscript{119} ASIC INFO 213 (n 36).
\textsuperscript{120} ibid.
view that these tests and tools do not need regulatory footing. It also indicates that Australia is relying on responsible conduct by its CSPs to somewhat self-regulate themselves and create good practices. Furthermore, it implies that Australia is satisfied that its current measures to protect investors are sufficient to address rogue actors.

Simulation of loss tests\(^\text{121}\) represents a new way of thinking about investor tests that have not spread beyond the EU yet. However, it is uncertain if this tool will be adopted in jurisdictions such as Australia, New Zealand, and the US given their ‘hands-off’ or free market regulatory approach to investor protection. Perhaps, in time, it might be considered by the UK as simulation of loss tests align with the UK’s overall approach to investor protection.

(a) Knowledge Tests
The UK and the US both have knowledge test requirements.\(^\text{122}\) The US requires the investor to complete a questionnaire to demonstrate an understanding of the investor’s rights, the difficulty of reselling and risk.\(^\text{123}\) The UK’s knowledge assessment is more detailed as it lists the risks that must form part of the knowledge assessment and that the assessment must not be a yes or no test.\(^\text{124}\)

The UK specifies that default risk,\(^\text{125}\) liquidity risk\(^\text{126}\) and CSP failure\(^\text{127}\) must be

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\(^{121}\) ECSPR article 21(5); Delegated Regulation [2022] OJ L287/26 (n 109) articles 6-12; For full analysis of simulation of loss tests see chapter 3.


\(^{124}\) UK - FCA Handbook COBS 10.2.

\(^{125}\) See also b) Default Risk.

\(^{126}\) See further a) Liquidity Risk.

\(^{127}\) See further c) CSP Failure.
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The UK also tests the non-sophisticated investor’s understanding of:

- the relationship with the project owner and CSP,
- contingency fund,
- that crowdlending is not covered by the deposit guarantee scheme and is not analogous to a savings account,
- any guarantees,
- risk diversification undertaken by the CSP,
- risk mitigation measures undertaken by the CSP,
- where the CSP has no risk mitigation measures the likelihood for loss is higher, and
- the CSPs role.\(^\text{129}\)

When the UK’s knowledge test is compared to the EU’s knowledge test, the comparison shows that the UK’s knowledge assessment requirements are more detailed and specific\(^\text{130}\) than the EU’s knowledge assessment test.\(^\text{131}\) The EU’s knowledge test does not specify the risks that must be assessed and does not stipulate the assessment must not be a yes or no test.\(^\text{132}\) The EU assesses prospective non-sophisticated investors’ knowledge according to their:

- experience,
- investment objectives,

\(^{128}\) UK - FCA Handbook COBS 10.2.9G(1)(b), (c), (j), (l).
\(^{129}\) UK - FCA Handbook COBS 10.2.9G(1)(a), (c), (d), (f)-(l), (k).
\(^{130}\) See further a) Theory of Legal Certainty.
\(^{131}\) ECSPR article 21.
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- financial situation,
- ‘basic understanding of risks in general’ and in crowdlending,
- past investments,
- understanding of crowdlending, and
- professional experience in crowdlending.\textsuperscript{133}

When the EU’s approach\textsuperscript{134} is compared with the other jurisdictions, there is one area that is lacking in the EU’s approach - the risks to be included in the assessment of the investor’s understanding of the risks. The UK is explicit that an investor’s understanding of matters such as liquidity risk\textsuperscript{135} and default risk\textsuperscript{136} must be assessed.\textsuperscript{137} Yet the draft Delegated Regulations merely outline that an investor’s understanding of the risks must be assessed.\textsuperscript{138} This would be a minimal addition to the EU regulatory framework and add clarity. It is unclear at present why ESMA has taken the position to leave the risks unenumerated. Perhaps it was a policy decision that ESMA thought was best answered by the CSPs themselves.

\textit{(b) Anti-Impulse Measures}

Another investor protection tool is the anti-impulse measure which commonly is a mandatory period within which an investor can change their mind without penalty. The period within which the investor can change their mind varies from jurisdiction to jurisdiction. The name varies from jurisdiction to jurisdiction

\textsuperscript{133} ECSPR article 21(2); See further Delegated Regulation [2022] OJ L287/26 (n 109) article 2.
\textsuperscript{134} See further chapter 3.
\textsuperscript{135} See further a) Liquidity Risk.
\textsuperscript{136} See also b) Default Risk.
\textsuperscript{137} UK - FCA Handbook COBS 10.2.9G(1)(b), (c), (j), (l).
\textsuperscript{138} Delegated Regulation [2022] OJ L287/26 (n 109) article 1(2).
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and applies at different points in time. Some jurisdictions have a pre-contractual reflection period which applies before entering the investment contract. The investor in the pre-contractual reflection period is deemed to be able to revoke the offer or expression of interest to invest. Others have a cancellation right or right of withdrawal which applies once the investor has entered into the investment contract.

In most circumstances, Australia’s cooling-off period does not apply in the context of crowdlending.¹³⁹ As explained in chapter 1, Australia does not have a sui generis crowdlending regulatory framework. Australia applied its managed investment scheme regulatory framework to crowdlending. The reason why the cooling-off period does not apply to crowdlending is because of how the managed investment scheme regulatory framework is structured. Cooling-off periods only apply to liquid managed investment schemes in Australia.¹⁴⁰ Crowdlending is generally an illiquid investment in Australia¹⁴¹ and as a result, the cooling off period will not apply to crowdlending. The UK has a right to cancel for 14 days after the investment agreement is made or on the day the project owner receives the contract whichever is later.¹⁴² New Zealand does not have an anti-impulse measure for their investors. Although, the US allows investors to cancel their investment commitment up to 48 hours before the deadline in the disclosure materials.¹⁴³ The EU’s pre-contractual reflection

¹³⁹ Australian Securities and Investments Commission INFO 213 (n 29).
¹⁴⁰ Australia - Corporations Regulations 2011 reg 7.9.64(1)(e).
¹⁴¹ Australian Securities and Investments Commission INFO 213 (n 29).
¹⁴² UK - FCA Handbook CONC 11.2.3R.
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period is four days from the date the interest in investing was indicated and applies only to non-sophisticated investors.\textsuperscript{144}

The anti-impulse measure is the strongest measure taken to combat inexperience\textsuperscript{145} in crowdlending regulation internationally. Nevertheless, it is the investor’s responsibility to act if the investor thinks the investment is not suitable. The anti-impulse measure enables investors who may have on impulse perhaps due to their inexperience\textsuperscript{146} indicated their interest in a loan but upon reflection decide against the investment. The anti-impulse measure allows the investor to change their mind without any negative consequences. A disadvantage of the anti-impulse measure is that it slows the distribution of funds to the project owner. Thus, negatively impacting the allocative efficiency in favour of investor protection.

The ECSPR’s timeline\textsuperscript{147} is closer to the US’ 48 hours than to the UK’s 14 days and begs the question as to which is the more adequate timeline to protect investors. Obviously, the UK’s 14 days gives the investor more time to decide whether they wish to continue with the investment. However, it could potentially give so much time that the investor forgets about the anti-impulse measure even though the investor might have decided against the investment and might not action the decision to withdraw. The investor might not action the decision to not invest because they are insufficiently motivated. Considering the ECSPR’s primary goal which focuses on allocative efficiency and

\textsuperscript{144} ECSPR article 22(2).
\textsuperscript{145} See also d) Information Asymmetry and Inexperience.
\textsuperscript{146} ibid.
\textsuperscript{147} See further chapter 3.
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competition, for the purposes of the ECSPR the 4-day period is more adequate by comparison to protect investors.

(c) Investment Limits
At the other end of the spectrum, investment limits are where most of the mandatory investor protection measures are found. Investment limits are an adequate measure to limit investor risk exposure by setting out how much an investor can invest per year.

Investment limits are used in the UK and the US. Non-sophisticated investors in the UK can only invest 10% of their net assets.\(^{148}\) The US non-sophisticated investor limits vary according to the investor’s income and net worth.\(^{149}\) Depending on the circumstances, the limit will be based on a percentage of income, net worth or $2,200 (USD).\(^{150}\)

Australia and New Zealand’s investment limits operate slightly differently. In Australia, if the investment price is over $500,000 (AUSD) the investor is categorised as a sophisticated investor.\(^{151}\) In other words, if a non-sophisticated investor spends over $500,000 (AUSD) on a financial product the non-sophisticated investor becomes a sophisticated investor. Similarly in New Zealand where an investment is at least $750,000 (NZD), the investor will be a sophisticated investor.\(^{152}\) In effect, these limits mean non-sophisticated investors in both Australia and New Zealand are subject to investment thresholds. The investment limits in Australia and New Zealand are significantly

\(^{148}\) UK – FCA Handbook COBS 4.7.7R-13G.
\(^{149}\) US – Rule 100(a)(2) Regulation Crowdfunding, 17 CFR § 227.100(a)(2).
\(^{150}\) ibid.
\(^{151}\) Australia – Corporations Regulations 2001 reg 7.1.18; See also (1) Investor Classification.
\(^{152}\) New Zealand - Financial Markets Conduct Regulations 2014 Schedule 8 Clauses 3-5.
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higher than the EU investment threshold. The EU investment threshold is the higher of €1,000 or 5% of the investor’s net worth. The EU’s thresholds are the lowest of the jurisdictions examined.

In chapter 3 some commentary was provided on the EU’s investment threshold. The analysis demonstrated that the investment threshold may act as a nudge to indicate “appropriate” risk appetite to non-sophisticated investors and indicate that the large sum could perhaps be better spread over multiple investments that are below the investment threshold. However, this possible nudge might only affect non-sophisticated investors that are relatively risk aware and understand the consequences of crossing the threshold. There are a few implications that can be taken from the international comparison. The EU puts a very low price on its non-sophisticated investor protection. Thus, reducing the impact that non-sophisticated investors could have on the allocative efficiency of the ECSPR in placing non-sophisticated investors’ funds in the hands of SMEs. The investment threshold can be seen as a nudge against the investor. The nudge to the investor indicates the risk involved in a crowdlending investment, that €1,000 or 5% of the investor’s net worth is the limits of what a non-sophisticated investor’s risk appetite should be and that should a non-sophisticated investor wishes to invest more it ought to split over different invests or projects. In other words, from this perspective, it nudges the investor to diversify their investment portfolio across different crowdlending projects or completely different investment opportunities altogether. If the investment threshold is a nudge by the EU to investors to

153 ECSPR article 21(7).
diversify, the nudge only works if investors understand the investment threshold and what falls on crossing the investment threshold.

Upon crossing the investment threshold, the EU has communication measures in place that convey the message that non-sophisticated investor protections no longer apply. The combination of measures used by the EU are: 1 a risk warning, 2 the investor must provide the CSP with explicit consent to continue as a sophisticated investor and 3 the investor must prove to the CSP. The investor’s understanding may be evidenced by the results of the knowledge assessment as set out in article 21 of the ECPSR.

(3) Individual Loan Portfolio Management
Individual loan portfolio management is a service some CSPs provide. In individual loan portfolio management, the investor sets out in an investor mandate the acceptable risk levels, loan term, rate of return and so on. The CSP makes investments on behalf of the investor according to the terms of the mandate.

The UK is the only regulatory framework to specifically address individual loan portfolio management. The UK’s individual portfolio management requirements detail the CSP’s responsibilities, disclosure requirements and risk management requirements. The UK’s requirements for individual loan portfolio management are very similar to the requirements in the ECSPR. Both require robust risk management frameworks, and disclosures on top of the

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154 ECSPR article 21; See further chapter 3.
155 UK - FCA Handbook COBS 18.12.11R-15G.
158 ECSPR articles 3(4), 4(2), 6(2)-6(4); See further chapter 3.
standard disclosures where investor selects their investments and requirements to stay within the investor's mandate.

(4) Conclusion
Both the knowledge assessment and the simulation of loss\textsuperscript{159} are new financial regulation tools that communicate the risks associated with financial products. Furthermore, loss simulation tools have proven adequate at communicating risk.\textsuperscript{160}

In summary, the investor self-responsibility principle is evident in all the crowdlending regulatory frameworks examined. The investor self-responsibility principle is used with varying degrees. Overall, a similar level of investor self-responsibility is found in the EU as in the other jurisdictions examined. There are, however, instances where the EU could learn from the regulatory frameworks examined. For example, the disclosures required in New Zealand and the UK regarding project owner selection criteria.\textsuperscript{161}

b) Clients
At times, the approach to client protection internationally somewhat aligns. In other instances, it does not. Section 1 explores the similarities and section 2 explores the differences.

\textsuperscript{160} ibid.
(1) Similarities

(a) Conflicts of Interest

Broadly, the ECSPR\textsuperscript{162} aligns with the approach in Australia, New Zealand, and the UK on conflicts of interest.\textsuperscript{163} Australia, New Zealand, and the UK require the CSPs to take appropriate steps or have adequate systems in place to manage, prevent or identify conflicts.\textsuperscript{164} The US takes a different approach where it uses disclosures for conflicts of interest involving the project owner\textsuperscript{165} and only allows certain kinds of conflicts of interest for the CSP. A project owner must disclose a description of any transactions in the past fiscal year where the amount exceeds 5\% of the aggregate amount raised in reliance on Regulation Crowdfunding where the following have an indirect or direct interest:

- The project owner’s director or officer of the project owner,
- The project owner’s beneficial owner of 20\% of the project owner’s voting power,
- Any promoter of the project owner where the project owner was incorporated in the past three years, or
- Any family member of the above persons.\textsuperscript{166}

\textsuperscript{162} See further chapter 3.
\textsuperscript{164} Australia - Corporations Act 2001 s 912A(1)(aa); New Zealand - Financial Markets Conduct Regulations 2014 reg 187(a); UK - FCA Handbook SYSC 10.1.3R; Australian Securities and Investments Commission INFO 213 (n 29); Financial Markets Authority, ‘Licensing Application Guide: Peer-to-Peer Lending Part B2’ (n 9) 15.
\textsuperscript{165} US - Rule 201(r) Regulation Crowdfunding, 17 CFR § 227.201(r) (2021).
\textsuperscript{166} US - Rule 201(r) Regulation Crowdfunding, 17 CFR § 227.201(r) (2021).
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CSPs on the other hand are only allowed to have an interest in return for services provided under Regulation Crowdfunding or an interest that is the same as those being offered under Regulation Crowdfunding.167

All the jurisdictions impose some form of best interests duty on CSPs. New Zealand implies a term containing a duty to exercise care, diligence, and skill where the CSP exercises any of its powers in client agreements.168 As explored in (3) Other Information Asymmetry Tools, it is unclear why the duty is imposed using an implied term in a client agreement rather than having a standalone provision that imposes a duty on the CSP. The EU’s approach in applying a best interests duty on CSPs is far more direct.169 The US similarly imposes a duty in its regulatory framework although it requires that CSPs must have a ‘reasonable basis for believing’ a project owner complies with Regulation Crowdfunding.170 This is a duty but not something that imposes fiduciary obligations. The UK has a common law fiduciary duty which is at times based on statute171 and CASS 7 gives guidance on how to discharge it when holding client assets.172 However, Australia imposes a best interests duty which is only owed to investors.173 This contrasts with the EU position where the duty is owed to clients.174 This means that a project owner’s position is likely to be more precarious in Australia than

168 New Zealand - Financial Markets Conduct Act 2013 s 429(c); New Zealand - Financial Markets Conduct Regulations 2014 regs 223, 225(1).
169 ECSPR article 3(2). See further chapter 3 b) Clients.
172 UK - FCA Handbook CASS 71.2.4BG(2).
173 Australia - Corporations Act 2001 s 601FC(1)(c).
174 ECSPR article 3(2).
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in the EU\textsuperscript{175} as where there is a conflict between the interests of project owners and investors in Australia the CSP is obliged to act in the interests of the investors only. It does mean that by comparison, the ECSPR is more adequate in protecting investors and other users because it balances project owners’ and investors’ interests. The ECSPR is also by comparison more adequate because explicitly imposes the duty in the regulatory framework which aligns with its legal certainty goal.\textsuperscript{176}

The approach in Australia, New Zealand, the UK and the ECSPR demonstrates the use of the self-responsibility principle for client protection beyond the investor protection context. It indicates that certain kinds of conflicts of interest are manageable for client protection purposes. By comparison, the ECSPR is adequate at protecting CSP clients from conflicts of interest. However, time will tell if a disclose and manage certain conflicts approach is in and of itself an adequate client protection measure.

\textit{(b) Ex-Ante Controls on Access to Management}

Another example of a client protection measure are the ex-ante controls on access to management. All the comparator jurisdictions seek criminal history information about the natural persons who constitute the CSP’s management. In New Zealand and the US, a criminal history means that the person cannot constitute the management of the CSP.\textsuperscript{177} The US also bans persons connected

\textsuperscript{175} See further chapter 3.
\textsuperscript{176} See further chapter 2, 3, 1. Legal Certainty.
to the project owner such as directors with a criminal history.\textsuperscript{178} In Australia, a criminal history is something that may indicate a person is not fit and proper for the role.\textsuperscript{179} The UK goes further than Australia stating that it will have regard to ‘the seriousness of and circumstances surrounding the offence’, an explanation, relevance to the role, how long ago the offence occurred and evidence of rehabilitation.\textsuperscript{180}

The majority require information about the education, skills and experience of the persons constituting the CSPs management. However, the US focuses on the experience of the persons constituting the project owner.\textsuperscript{181} These persons include the directors and officers of the project owner whose names and past 3 years of experience must be disclosed. The remainder varies in their prescription. Australia employs its combined general principles approach in its legislation with detailed regulatory guidance material.\textsuperscript{182} There is an overall obligation to maintain organisational competence\textsuperscript{183} and CSPs must ensure that staff are trained and competent to provide the financial service.\textsuperscript{184} The regulatory guide sets out the ‘minimum expectations for demonstrating organisation competence’.\textsuperscript{185} The competency requirements focus on staff that

\begin{flushright}
\textsuperscript{178} US - Rule 503(a) Regulation Crowdfunding, 17 CFR § 227.503(a) (2021).
\textsuperscript{180} UK - FCA Handbook FIT 2.1.1G.
\textsuperscript{181} US - Rule 201(b) Regulation Crowdfunding, 17 CFR § 227.201(b) (2021).
\textsuperscript{182} See also a) Theory of Legal Certainty.
\textsuperscript{183} Australia - Corporations Act 2001 s 921A(1)(e).
\textsuperscript{184} Australia - Corporations Act 2001 s 921A(1)(f).
\end{flushright}
are responsible for day-to-day functions in the business which depending on the size of the business could be middle managers or CEOs. CSPs must demonstrate in the authorisation application\textsuperscript{186} that each of the responsible persons has appropriate skills and knowledge for the role.\textsuperscript{187} This can be demonstrated in one of five ways.\textsuperscript{188} The first four ways are a combination of experience such as three years of relevant experience in the past five years and knowledge such as a relevant university degree and relevant short industry course.\textsuperscript{189} The fifth way is where a written submission can be made covering:

- The nature of the role,
- Relevant qualifications,
- Experience in the past 10 years,
- Credentials and
- Why do they think they have appropriate knowledge and experience for the role.\textsuperscript{190}

In contrast, the UK is less detailed,\textsuperscript{191} uses non-exhaustive lists and targeted questions. In the UK persons with controlled functions\textsuperscript{192} such as Director, Partner, and Non-Executive Director among other persons\textsuperscript{193} are examined for their (1) honesty, integrity, and reputation,\textsuperscript{194} (2) competence and

\textsuperscript{186} See also a) Authorisation.
\textsuperscript{187} Australian Securities and Investments Commission RG 105 (n 186) 4.
\textsuperscript{188} ibid.
\textsuperscript{189} ibid.
\textsuperscript{190} Australian Securities and Investments Commission RG 105 (n 186) 19-20.
\textsuperscript{191} See also a) Theory of Legal Certainty.
\textsuperscript{192} UK - FCA Handbook SUP 10.A.
\textsuperscript{193} UK - FCA Handbook FIT 1.1.1G.
\textsuperscript{194} UK - FCA Handbook FIT 2.1.
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capability,195 and (3) financial soundness.196 Honesty, integrity and reputation relate to a range of matters including criminal history as explored above, whether the person has been subject to a justified complaint regarding regulated activities, whether a licence has been refused, or whether the person has been dismissed, asked to resign, or resigned from a position of trust.197 Competence, capability and financial soundness are assessed having regard to a non-exhaustive list of factors such as whether the person satisfies the UK’s training and competency requirements, whether the person has the time to perform the function and associated responsibilities,198 or whether the person has filed for bankruptcy.199

New Zealand’s approach resembles both the UK and Australia at various points. Similarly to Australia, the capability of the management team is collectively and individually assessed in New Zealand.200 However, New Zealand does not go into the same level of detail201 as Australia in elaborating how capability is assessed by simply requiring CVs.202 New Zealand specifically requires CSPs to set out their recruitment and HR processes will ensure the management team has the right skills and experience.203 Neither Australia nor the UK makes this type of requirement explicit in their regulatory frameworks. Both Australia and

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195 UK - FCA Handbook FIT 2.2.
196 UK - FCA Handbook FIT 2.3.
197 UK - FCA Handbook FIT 2.1.3G.
198 UK - FCA Handbook FIT 2.2.1G.
199 UK - FCA Handbook FIT 2.3.1G.
201 See further a) Theory of Legal Certainty.
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the UK rely on overarching general principles that are interpreted to mean that the CSP must continually comply with the experience and skills requirements.\textsuperscript{204} However, New Zealand’s business conduct requirement makes it explicit that the organisation of the recruitment and HR processes must be established to ensure the correct skills and experience are recruited.

The EU’s approach has features of the approaches in Australia, New Zealand, and the UK frameworks. For example, the EU and the UK both examine the time a person sets aside for their role.\textsuperscript{205} Australia,\textsuperscript{206} New Zealand\textsuperscript{207} and the UK\textsuperscript{208} also overlap with the EU\textsuperscript{209} as all require an assessment of the person’s capability by examining their knowledge and experience. There are some measures that the EU could use to make the ECSPR more adequate in protecting clients namely (1) an examination of the organisational competence, and (2) a requirement for CSPs to establish recruitment and HR processes to ensure the right skills and experience are recruited. An examination of the organisation’s competence would ensure that the organisation as a whole has sufficient competence to engage in crowdlending. A requirement to establish recruitment and HR processes to ensure the right skills and experience are recruited would further ensure and make it clear that continuous compliance is necessary with

\textsuperscript{204} Australia - Corporations Act 2001 s 921A(1)(f); UK - FCA Handbook FIT 2.2.
\textsuperscript{206} Australia - Corporations Act 2001 s 921A(1)(e), (f).
\textsuperscript{208} UK - FCA Handbook FIT 2.
\textsuperscript{209} ECSPR article 12(1)(k), (l); Delegated Regulation [2022] OJ L287/5 (n 206) annex field 13.
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the capability requirements. Both these measures would make the ECSPR more adequate in protecting clients. The EU could also consider at some point in the future using some form of periodic NCA review clause to ensure continuous compliance with the capability requirements in the ECSPR. A periodic NCA review mechanism would be useful if it is found that there is widespread non-compliance with the capability requirements in the future.

(2) Differences
Yet from other perspectives, differences arise in the regulatory approach to client protection. The Australian regulatory framework contains broad general principle requirements. The Australian client protection measures are largely found in the constitution requirements, the compliance plan requirements,210 and the Australian Financial Services (‘AFS’) Licence.211 ASIC’s regulatory guides set out a list of specific questions for the CSP to consider in constructing their business model to comply with the regulatory framework.212 For example, CSPs ought to consider the procedures in place to ensure the technology complies with legal requirements.213 The guidance also asks about the procedures in place to ensure transaction costs are not inflated by bundling the fees for crowdlending with fees for other services.214 ASIC’s regulatory guides also give good practice examples.215 For example, the guidance outlines which types of

210 Australia – Corporations Act 2001 s 601EA.
211 Australia – Corporations Act 2001 s 601FA.
213 Australian Securities and Investments Commission RG 132 (n 213) 54.
214 Australian Securities and Investments Commission RG 132 (n 213) 55.
215 Australian Securities and Investments Commission RG 234 (n 37).
fee waivers are permissible in advertising.\textsuperscript{216} In one of the examples, an advertisement stating that there were no fees should not be advertised if the fee is only waived in certain circumstances.\textsuperscript{217}

New Zealand also has broad general principles in its regulatory framework which are elaborated upon in guidance material. For example, one of the licence eligibility criteria is that CSPs are required to have ‘fair, orderly, and transparent systems and procedures for providing the service’.\textsuperscript{218} New Zealand’s guidance material interprets the fair, orderly and transparent requirement into 19 minimum requirements.\textsuperscript{219} These 19 requirements range from requirements that the directors and senior managers must be fit and proper\textsuperscript{220} to conflict-of-interest requirements.\textsuperscript{221} The guidance material elaborates on the fit and proper requirement by providing information on how the FMA assesses good character, and capability and a requirement that the CSP must disclose how it will maintain and meet the proper standards.\textsuperscript{222} The guidance document provides further information on the conflict-of-interest requirements.\textsuperscript{223} The document requires CSPs to disclose details regarding fees and charges, the extent associated parties use the service and explain their

\textsuperscript{216} Australian Securities and Investments Commission RG 234 (n 37) 19.
\textsuperscript{217} ibid.
\textsuperscript{218} New Zealand - Financial Markets Conduct Regulations 2014 reg 187 (a).
\textsuperscript{221} Financial Markets Authority, ‘Licensing Application Guide: Peer-to-Peer Lending Part B2’ (n 9) 15.
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procedures for handling conflicts. The UK’s client protection measures are very similar to the EU’s approach.

However, the UK uses a mix of daily conduct including complaints, marketing and general conduct requirements. This mix of daily and general conduct requirements ensures that CSPs conduct their business to a certain standard which indirectly protects clients. The UK uses the business conduct requirements with general principles that have an overall message that the regulated should demonstrate how they comply with the requirements. For example, where CSPs determine the price of the loan a CSP must have a risk management framework that is appropriate to their business. The risk management framework must set out in writing how the CSP will categorise the loan agreements according to their risk when the CSP will review the loan valuation, and take into account the credit risk or creditworthiness assessment. The risk management framework requires the CSP to build certain practices into its business model. On the other hand, the EU is far more detailed with its risk management framework requirements in the context of loan portfolio management. The draft regulatory technical standards mirror the UK’s requirements but prescribe greater detail. For example, the EU

224 ibid.
226 UK - FCA Handbook DISP 2.7.
227 UK - FCA Handbook PERG 7.1, 7.4; See further b) Marketing Communications.
229 UK - FCA Handbook COBS 18.12.18R.
230 ibid; See further f) Pricing, Credit Risk Assessment, and Credit Scoring.
231 ibid.
232 See further chapter 3.
233 UK - FCA Handbook COBS 18.12.18R.

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prescribes loan risk categorisation to reflect certain levels of risk and specific factors.\(^{234}\)

Even so, Australia, New Zealand, and the UK demonstrate, similarities through their use of guidance documents and broad principles, a market facilitatory approach. This shows the regulator is willing to engage with the market and is open to different ideas on what compliance may look like for each actor in their particular business model. The market facilitatory approach is not seen in the EU at present. There is time for the EU to publish guidance documents once the ECSPR reaches full effect. It seems that the ESMA Q&A document could eventually develop into a quasi-guidance document.\(^{235}\) However, it would be challenging for the EU to take the general principles and interpretative guidance document approach.

The US has a markedly different approach to client protection in its crowdlending regulatory framework. The US focuses less on business conduct requirements and focuses more on disclosures. One of the more unusual aspects of the US’ client protection is that the requirements are placed on the CSP and sometimes the requirements are placed on the project owner. For example, the US crowdlending regulatory framework is silent on credit risk assessments.


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carried out by the CSP. Credit risk assessments protect clients as they provide a neutral assessment of the risk the loan represents. Thus, increasing the likelihood that clients will have a realistic opportunity to seek funding. However, the project owner is required to disclose a ‘discussion’ of the project owner’s financial condition.236 Then the US can be extremely prescriptive with its detail on certain areas of client protection such as requiring the CSP to disclose the CSP’s remuneration when the investment is confirmed.237 The US regulatory framework is very detailed on permissible advertising238 and how the CSP communication channels can be used by promoters.239 Yet the US crowdlending regulatory framework is silent on CSP failure.240

Complaints mechanisms are present to varying extents in all jurisdictions.241 Thus not only does the US focus on disclosures but the US also focuses less on the business risks the CSP may have and focuses more on the business risks the project owner may have.

(3) Conclusion
The varying positions taken on prescriptive to broad general principle client protection measures could indicate varying levels of trust between the legislator and regulatory on the one hand and the regulated on the other. Thus,

236 US - Rule 201(s) Regulation Crowdfunding, 17 CFR § 227.201(s) (2021).
238 US - Rule 204 Regulation Crowdfunding, 17 CFR § 227.204 (2021); See further b) Marketing Communications; See also a) Theory of Legal Certainty.
240 See further c) CSP Failure.
the EU possibly trusts CSPs the least because of the level of detail in its client protection mechanisms.\textsuperscript{242} However, Australia, New Zealand, and the UK lean towards the other end of the spectrum with less detail and perhaps more trust in the CSPs to protect clients.\textsuperscript{243} However, this conclusion does not align with the self-responsibility principle evidenced in the conflicts of interest measures\textsuperscript{244} by not only Australia, New Zealand, and the UK but in the EU also. Thus, the analysis of the client protection measures could be termed something like a regulatory “pick ‘n’ mix” as there are times when the approaches align, and times when they do not.

C. Financial Regulatory Model
This section provides the financial regulatory model analysis that focuses on the risk-based regulatory model using the risks identified in this chapter namely: liquidity risk, default risk, CSP failure, information asymmetry, inexperience, fraud risk, pricing, credit risk assessment and credit scoring, and systemic risk.

1. Risk-Based Regulatory Model

\textit{a) Liquidity Risk}
Similarly, to the EU,\textsuperscript{245} project owner liquidity risk is not specifically mentioned in any of the other jurisdictions’ regulatory frameworks. It seems at present the risk of the CSP exposing the project owner to liquidity risk by being

\textsuperscript{242} See also \textit{a) Theory of Legal Certainty}.
\textsuperscript{243} ibid.
\textsuperscript{244} See further \textit{(a) Conflicts of Interest}.
\textsuperscript{245} See further chapter 3.
ineffective in ensuring that the funds reach the project owner is not a high-priority concern.

Contrastingly, the majority of the jurisdictions have addressed liquidity risk for the investors and secondary markets. New Zealand and the UK are the only jurisdictions that explicitly address secondary markets in their crowdlending regulatory frameworks. Furthermore, the UK is the only one to explicitly address liquidity risk in its regulatory framework. The US regulatory framework is silent on the operation of secondary markets. Currently, Regulation Crowdfunding refers in passing to the transfer of an investment. However, investors are restricted from transferring their investment within the first year with limited exceptions.

New Zealand’s focus is mainly on secondary markets and informing the regulator about how the secondary market will operate. The only reference to liquidity risk is in the standardised disclosure document requirements. Yet in the UK specific disclosures to investors must be made regarding the operation of the secondary market and investors’ understanding of the secondary market and liquidity risk is tested in the appropriateness assessment.

246 See also b) Secondary Markets.
247 ibid.
248 ibid.
249 ibid.
251 Financial Markets Authority, ‘Licensing Application Guide: Peer-to-Peer Lending Part B2’ (n 9) 16; See also b) Secondary Markets.
253 UK - FCA Handbook COBS 18.12.24R(8); See also b) Secondary Markets.
254 UK - FCA Handbook COBS 10.2.9G(j).
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Australia engaged with secondary markets and liquidity risk with its exemption powers under s 601QA of the Corporations Act 2001. Thus ASIC granted relief from the unsuitable requirements so that a secondary market could be operated. In this instance, ASIC placed four requirements on the operation of the secondary market. One the CSP must set out procedures for making and dealing with investor requests to exit their investment early. Two the CSP must place prominent disclosures about the procedures on the website and the PDS. Three that the early exit request is satisfied within five business days if the CSP accepts it. Four the CSP thinks the request will not impact the other investors’ investments.

When the EU’s approach to liquidity risk is compared with the other jurisdictions, it is thought that the EU’s approach is inadequate. Admittedly liquidity risk is one of the main risks that must be outlined in the EU’s standardised disclosure document and there is an overall requirement to disclose to clients the nature of bulletin boards. However, a key component to improving in particular for non-sophisticated investors’ choices is the

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255 See also b) Secondary Markets.
256 Australian Securities and Investment Commission REP 420 (n 80) 21.
257 Ibid; See also b) Secondary Markets.
258 Ibid.
259 Australian Securities and Investment Commission REP 420 (n 80) 22.
260 Ibid.
261 Ibid.
262 See further chapter 3.
264 ECSPR article 25(3); See further chapter 3.
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delivery of information upfront and early in the process.\textsuperscript{265} In this instance, Australia’s position is more adequate at addressing liquidity risk. Australia requires prominent disclosures on the website. However, Australia’s website disclosures concern the procedures rather than highlighting that secondary markets\textsuperscript{266} do not guarantee an early investment exit. Considering the risk of a non-sophisticated investor misinterpreting the presence of secondary markets\textsuperscript{267} as a guarantee of investment liquidity, CSPs should be required to place prominently on their website a risk warning on this possible issue.

This risk warning could be similar to the risk warning required under article 21(4) of the ECSPR.\textsuperscript{268} The risk warning required under article 21(4) of the ECSPR relates to the risk that the entirety of the investment could be lost. In other words, the risk warning concerns default risk.\textsuperscript{269} The ECSPR currently prescribes a set wording for the risk warning which must be prominently displayed on the website until the investor acknowledges the risk warning to which a liquidity risk warning could be added.

\textit{b) Default Risk}

Australia responds to default risk in three ways using a mix of disclosures and business conduct requirements. First, a CSP must have a constitution that contains a procedure for winding up.\textsuperscript{270} However, the winding-up procedure

\begin{footnotesize}
\textsuperscript{266} See also \textit{b) Secondary Markets}.
\textsuperscript{267} ibid.
\textsuperscript{268} Delegated Regulation [2022] OJ L287/26 (n 109) article 4.
\textsuperscript{269} See further \textit{b) Default Risk}.
\textsuperscript{270} Australia - Corporations Act 2001 s 601GA(1)(d); See further Australian Securities and Investments Commission RG 134 (n 9) 51-54.
\end{footnotesize}
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may not specifically mention project owner default, it is possible that project owner default could be included in a plan for a winding-up procedure. Second, the AFS Licence requires a CSP to have adequate risk management systems.\(^{271}\) One of the key risks included in an adequate risk management system are project owner defaults.\(^{272}\) Third, the standardised disclosure document must disclose the steps taken where there is a default and the effect of the default on investors.\(^{273}\)

There are no specific regulatory measures taken to cater for contingency funds in Australia. The operation of contingency funds in Australia is complicated by the requirement to treat the contingency fund’s underlying assets as scheme property.\(^{274}\) However, ASIC can grant specific relief from the scheme property requirement to a CSP.\(^{275}\) The exempted contingency fund operates under a trust deed.\(^{276}\) ASIC set out that the compliance plan must establish adequate measures for the contingency fund.\(^{277}\) ASIC also required that the constitution outline the contingency fund obligations, procedures and rights.\(^{278}\)

New Zealand uses business conduct requirements\(^{279}\) and disclosures\(^{280}\) to address default risk. The business conduct requirement in New Zealand is that

\(^{271}\) Australia - Corporations Act 2001 s 912A(1)(h).

\(^{272}\) Australian Securities and Investments Commission INFO 213 (n 29).

\(^{273}\) ibid; See further (1) Standardised Disclosure Document.


\(^{276}\) Australian Securities and Investments Commission REP 435 (n 275) 19-20.

\(^{277}\) ibid.

\(^{278}\) ibid.

\(^{279}\) New Zealand - Financial Markets Conduct Regulations 2014 reg 187(c).

\(^{280}\) New Zealand - Financial Markets Conduct Regulations 2014 regs 215(4), 228(e).
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the CSP must check the risk investors may not be paid back.281 The standardised disclosure document must also include information about the CSP’s monitoring of repayments and a description of processes in the event of default.282 Default rates also must be published.283 New Zealand’s CSP regulatory framework is silent on the operation of contingency funds. Contingency funds are operated under trust law.284 The contingency fund is held by a trustee and deed of trust.285

The UK mainly addresses contingency funds286 rather than default risk.287 The UK uses a mix of disclosures, knowledge assessments288 and business conduct requirements to address default risk and contingency funds. The disclosures are a mix of providing information about the procedures and descriptive information289 reports of past performance290 to standardised risk warnings.291

The knowledge assessment292 only refers to contingency funds and does not assess the investor’s understanding of default risk.293 The business conduct

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285 ibid.
286 UK - FCA Handbook COBS 10.2.9G, 18.12.33R-40G.
288 See further (a) Knowledge Tests.
291 UK - FCA Handbook COBS 18.12.33R.
292 See also (a) Knowledge Tests.
293 FCA Handbook COBS 10.2.9G.
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requirements outline the price\textsuperscript{294} must be re-evaluated when there is a default.\textsuperscript{295}

The US does not seem overly concerned with default risk and contingency funds. The US requires project owners to disclose their anticipated business plans.\textsuperscript{296} The disclosure is made to the investors and the CSP.\textsuperscript{297} The US relies on disclosures and free market considerations as in its opinion the risk flows from the project owner. Thus, the CSP and investor should once equipped with the information, be able to decide whether the project owner presents a risk portfolio suitable for their purposes.

The EU, UK and New Zealand are the only jurisdictions to specifically calibrate their regulatory response to address default risk. Although Australia’s regulatory framework does not directly respond to default risk and contingency funds, ASIC’s interpretations and exemptions powers\textsuperscript{298} mean that default risk and contingency funds have been responded to in the regulatory framework. The EU and the UK are the only jurisdictions to directly address the risks presented by contingency funds. The question will be whether a detailed approach as seen in the EU will prove more adequate over time than the UK’s approach.\textsuperscript{299} The UK by comparison to the EU has taken a freedom-of-contract approach where the bulk of the measures aims to inform the market.\textsuperscript{300}

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\textsuperscript{294} See further f) Pricing, Credit Risk Assessment, and Credit Scoring.
\textsuperscript{295} UK - FCA Handbook COBS 18.12.16R.
\textsuperscript{296} US - Rule 201(d) Regulation Crowdfunding, 17 CFR § 227.201(d) (2021).
\textsuperscript{297} US - Rule 201(d) Regulation Crowdfunding, 17 CFR § 227.201(d) (2021).
\textsuperscript{298} Australia - Corporations Act 2001 s 601QA.
\textsuperscript{299} See also a) Theory of Legal Certainty.
\textsuperscript{300} ibid.
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The EU has the most detailed and prescriptive requirements on default risk and contingency funds. The US is at the other end of the spectrum with a tangential reference to default risk implied from the business plan requirement. New Zealand has specifically acknowledged the risk but has gone into little detail. Australia’s broad strokes with exemption powers approach, while challenging to untangle, manages in specific circumstances to address contingency funds. Furthermore, Australia’s wind-up requirements in the constitution and AFS Licence requirements set business conduct requirements to deal with default risk.

Despite the EU having very detailed requirements, the EU is exposed in a key area. Notably, the UK’s requirements for contingency funds apply regardless of whether the investor or the CSP selects the loans. The EU’s requirements for contingency funds only apply where the CSP selects the loans as part of its portfolio management services. It is unclear why this policy decision was made to be silent on the use of contingency funds where the investor selects

301 ibid.
304 Australia - Corporations Act 2001 s 601QA.
305 See further chapter 3.
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the loan. It is a position that goes against the same activity same rules principle. A consideration that was highly influential for the EU’s bulletin boards is all but disregarded in the context of contingency funds.\textsuperscript{306}

There is some form of transplant occurring between Australia and the UK impacting market practice. Some of the UK CSPs have expanded their business to Australia. These UK CSPs are bringing with them established and proven business models which are permissible under the UK regulatory framework. The contingency fund part of the business model is not as has been shown in the above analysis catered for in the Australian regulatory framework. However, the UK CSPs are using the exemptions powers\textsuperscript{307} in the Australian regulatory framework. As a result, in a convoluted way, parts of what is permissible under the UK regulatory framework are impacting the Australian regulatory framework through the Australian exemptions mechanism.

Chapter 3 found that the EU’s regulatory treatment of buy-back obligations was unclear. It is also unclear in the majority of the comparator jurisdictions. Australia might require a disclosure in its standardised disclosure document regarding the buy-back obligation.\textsuperscript{308} The standardised disclosure document requires disclosure of a source of protection for investor losses, and how it is funded and accessed which could include a buy-back obligation.\textsuperscript{309} Regulation Crowdfunding does not refer to forms of credit protection. As found in this part, New Zealand uses trust law to regulate contingency funds. It is possible that a

\textsuperscript{306} ibid.
\textsuperscript{307} Australia - Corporations Act 2001 s 601QA.
\textsuperscript{308} Australia - Corporations Act 2001 Part 7.9; Australian Securities and Investments Commission INFO 213 (n 29); See further (1) Standardised Disclosure Document.
\textsuperscript{309} See further (1) Standardised Disclosure Document.
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buy-back obligation would come within its remit also. The UK does not specifically refer to buy-back obligations, but the knowledge test does refer to testing the knowledge of guarantees. Although as explored in chapter 3 it is difficult to interpret an obligation as a guarantee particularly seeing as the CSP who offers it refers to the discretion exercised in relation to it. It appears once again that time will tell if buy-back obligations will require a response.

c) CSP Failure
The response to CSP failure has varied across the world. In Australia, the CSP must provide a procedure for winding up in its constitution. This may relate to the scenarios of CSP failure, the CSP choosing to close the business or project owner default. ASIC further elaborates that the CSP must disclose in the standardised disclosure document the risk of CSP failure and what occurs when a CSP fails. This is not a requirement to have a business continuity plan. Yet the requirement to disclose what occurs when a CSP fails is a nudge for the CSP to contemplate this scenario.

Both the UK and New Zealand require CSPs to have arrangements to administer services in the event of CSP failure. New Zealand does not provide

310 See further (a) Knowledge Tests.
311 UK - FCA Handbook COBS 10.2.9G(1)(g)(i).
313 Australia - Corporations Act 2001 s 601GA(1)(d); See also Australian Securities and Investments Commission RG 134 (n 9).
314 Australian Securities and Investments Commission INFO 213 (n 29); See further (1) Standardised Disclosure Document.
315 UK - FCA Handbook SYSC 4.1.8AR-ER.
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much detail[^317] other than it must ‘cover all parts of the service you normally provide’.[^318] New Zealand’s business continuity plan ‘could include’ an income and expenses model that could cover the period to administer the outstanding loans.[^319] The plan could also include a service agreement with a reputable third party to administer the loans.[^320] If the New Zealand regulator deems the plan to be complex, they may ‘make it a condition’ of the licence ‘to obtain an assurance review about its adequacy’ from auditors.[^321] New Zealand’s adequate arrangements are required if the CSP ceases to operate and the plans are not contingent on platform failure but upon the cessation of services. Therefore, the plans can cover situations where the CSP fails and where the CSP chooses to cease its services.

The same cannot be said for the UK’s arrangement requirements which are significantly more detailed.[^322] CSPs must have a business continuity plan[^323] and if client asset rules apply,[^324] a plan for client assets.[^325] In the UK, the business continuity plan must include:

- how the ongoing disclosures will be provided,
- any contract terms that may need to be relied upon to ensure continuity,
- the steps necessary to implement outsourcing arrangements, and

[^317]: See further a) Theory of Legal Certainty.
[^319]: ibid.
[^320]: ibid.
[^321]: ibid.
[^322]: See further a) Theory of Legal Certainty.
[^323]: UK – FCA Handbook SYSC 4.1.8AR-DDR.
[^324]: Such as UK – FCA Handbook CASS 7.
specifications of the day-to-day management including matters such as critical staff, critical premises, IT, records, relevant external persons, relevant legal documents, structure chart, and details about any security held.\textsuperscript{326}

In the UK, CSPs should take insolvency law and the possible need for professional advice into account when designing their business continuity plan.\textsuperscript{327} When assessing the business continuity plan the CSP should consider matters such as the enforceability of contract terms, practical obstacles, ancillary services the plan could depend on and tax arrangements.\textsuperscript{328} CSPs should notify the UK regulator if it is considering ceasing their services.\textsuperscript{329} The CSP must have arrangements that ensure that the plan is immediately available to persons such as an administrator or receiver or if requested the UK regulator.\textsuperscript{330} The business continuity plan must be stored with the client assets plan (if applicable).\textsuperscript{331}

The client assets plan is to assist an insolvency practitioner in returning client assets if the CSP holds client assets.\textsuperscript{332} The client asset plan is similar to the business continuity plan as it details the critical information, persons and services that are necessary to return client assets to clients. The client asset plan must include:

- information about who holds client money,
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- details of critical persons or those with oversight functions,
- copies of agreements for operational functions with third parties,
- how to access information held by third parties, and
- a copy of the CSP’s client asset holding manual.\textsuperscript{333}

The UK’s arrangements requirements are contained in a section titled ‘in the event of platform failure’. Nevertheless, the UK provisions themselves refer to ‘if at any time it ceases to manage and administer those’ loans.\textsuperscript{334} Furthermore, the most recent FCA policy statement discussed the matter in terms of ‘if the platform ceased to carry out those functions itself’.\textsuperscript{335} On the whole, it seems to imply the arrangements are for situations where the CSP chooses to cease its business or fails. Nevertheless, the title of the section muddies the waters somewhat. The UK provides more detail\textsuperscript{336} than New Zealand on what an adequate plan is by detailing reasonable steps. For example, a reasonable step is to provide a written explanation in its P2P resolution manual of ‘what the day-to-day operation’ of the business ‘entails and what resources would be needed to continue’ should the firm cease to carry on and a list is made of what should be specified.\textsuperscript{337}

When a CSP chooses to close rather than fail the risks are lower. However, this should not negate a requirement for a business continuity plan where a CSP

\textsuperscript{333} UK - FCA Handbook CASS 10.2.1R.
\textsuperscript{334} UK - FCA Handbook SYSC 4.1.8AR.
\textsuperscript{336} See further a) Theory of Legal Certainty.
\textsuperscript{337} UK - FCA Handbook SYSC 4.1.8.DBR(1).
chooses to close as a CSP could choose to close its business without continuing to service the active loans. The risks will differ depending on the CSP’s motivations for closing. The risks could be higher if, for example, the CSP is leaving the market for good. It may not be in the CSPs interest to maintain a good relationship with its clients involved in active loans. Equally, it may not be in the CSP’s interests to consider the potential negative impact its actions could have on the entire crowdlending market’s reputation. The risks are likely to be lower when a CSP is choosing to evolve its business into something else such as a bank and close its crowdlending services. In this instance, it is likely to be in the CSP’s interests to maintain client relationships in the future and continue servicing the loans.

The US it seems is not concerned with crowdlending platform failure. The US only is concerned with the project owners’ business plans. The US does, however, require CSPs to promptly withdraw their registration when they cease to operate their business.

Business continuity plans are a feature of risk-based regulation. Business continuity plans address ‘risks to the organization’s ability to operate efficiently and the sources of risk are seen to arise principally from within the organization itself’. Most of the jurisdictions agree that business continuity plans are required except for the US and Australia. Australia relied on a nudge

341 Ibid.
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in their standardised disclosure document\(^{342}\) indicating that CSPs should plan for scenarios where their business fails. It is thought considering the potential harm caused by complete CSP failure that a nudge in a standardised disclosure document\(^{343}\) is insufficient to adequately address the risk of CSP failure.

The EU’s approach\(^{344}\) is both similar and different to the UK’s approach. Both require the development of business continuity plans in case of CSP failure. Both have detailed requirements\(^{345}\) on the contents of the business continuity plan. Both require similar information about critical persons and relationships\(^{346}\) and arrangements for outsourcing functions in the event of a failure.\(^{347}\) The UK places a stronger emphasis on the risks surrounding the return of client assets if held.\(^{348}\) On the other hand, the EU refers to the ‘handover of asset safekeeping services\(^{349}\) but does not prescribe a separate plan specifically for client assets. The UK also emphasises the need to share information about key contract terms,\(^{350}\) the enforceability of contract terms, practical obstacles, and tax arrangements.\(^{351}\) These matters are not explicitly referred to in the EU’s requirements.

\(^{342}\) See further (1) Standardised Disclosure Document.
\(^{343}\) ibid.
\(^{344}\) ECSPR article 12(2)(j).
\(^{345}\) See further a) Theory of Legal Certainty.
\(^{346}\) ECSPR article 5; UK – FCA Handbook CASS 10.2.1R, SYSC 4.1.8DBR.
\(^{348}\) UK – FCA Handbook CASS 10.1.2G.
\(^{350}\) UK – FCA Handbook SYSC 4.1.8DBR.
\(^{351}\) UK – FCA Handbook SYSC 4.1.8DG.
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It is difficult to say which approach is by comparison the most adequate. The EU, New Zealand, and the UK all specifically address CSP failure with a continuity of business plan requirement. The EU and UK are highly prescriptive and detailed with their business continuity plan while New Zealand requires CSPs to have the plan with a few additional requirements. Whether detailed prescription or general principles is more adequate in addressing CSP failure, depends on a variety of factors. It depends on whether legal certainty is valued. Detailed regulatory requirements tend to increase legal certainty when an area is first regulated as is the case for crowdlending. The general principle approach in New Zealand demonstrates a market facilitatory approach and allows greater flexibility on what compliance might look like. However, the UK and EU demonstrate more paternalistic motivations towards their clients ultimately underpinning the detailed business conduct requirements. This is where the EU’s legal certainty goal and primary goal of competition and allocative efficiency conflict. More detailed requirements like those in the UK assist with the goal of legal certainty but would increase regulatory costs for CSPs. If regulatory costs would be raised too high by detailed requirements, CSPs may close for business. This would reduce allocative efficiency as the number of CSPs would reduce in the market thereby limiting SMEs’ access to capital.

352 See further a) Theory of Legal Certainty.
353 See further a) Theory of Legal Certainty.
354 ibid.
356 See further a) Theory of Legal Certainty and chapter 2, 3.
357 See further a) Theory of Legal Certainty.
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The EU’s approach\textsuperscript{358} could be made more adequate in its aims to address CSP failure by mirroring New Zealand in one area. New Zealand makes it clear that the business continuity plan applies where the CSP ceases to provide its services whereas the EU’s business continuity requirement is solely applicable in scenarios where the CSP fails or where there is a significant business interruption.\textsuperscript{359} However, it is unclear at this moment in time whether more detailed 'UK-like' requirements would be necessary for the EU because of the conflict between legal certainty\textsuperscript{360} on one side, and allocative efficiency and competition on the other.

\textit{d) Information Asymmetry and Inexperience}

This section explores each jurisdiction’s response to information asymmetry and inexperience. One of the main regulatory tools used to combat information asymmetry and inexperience are standardised disclosure documents. Nevertheless, the UK has decided against having a standardised disclosure document and has used other disclosure tools such as, risk warnings, and client agreement requirements. The standardised disclosure documents will be explored first. Then the tools that the UK uses in place of standardised disclosure documents are examined. Penultimately, the other information asymmetry and inexperience tools are explored. Finally, the CSP’s role in putting the measures in place is examined.

\textsuperscript{358} See further chapter 3.

\textsuperscript{359} European Securities and Markets Authority, ‘Final Report Draft Technical Standards under the European Crowdfunding Service Providers for Business Regulation’ (n 264) 77.

\textsuperscript{360} See further a) Theory of Legal Certainty.
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(1) Standardised Disclosure Documents

Many of the jurisdictions examined require a standardised disclosure document.\(^{361}\) The UK considered using a standardised disclosure document but decided against a standardised disclosure document. The FCA stated that mandating standardised disclosure documents for crowdlending would be inappropriate because of the crowdlending market’s diverse business models.\(^{362}\)

This is not to say that the UK does not require any disclosures. The UK requires disclosures such as a risk warning,\(^{363}\) past performance publications\(^{364}\) and general for your information disclosures.\(^{365}\) The UK’s tools are examined in the next section.

Australia, and New Zealand both have a standardised disclosure document requirement. Australia’s standardised disclosure document is called a Product Disclosure Statement (‘PDS’).\(^{366}\) New Zealand’s standardised disclosure document is called a Service Disclosure Statement (‘SDS’).\(^{367}\) The US has a quasi-standardised disclosure document called a Form C.\(^{368}\)

When Australia’s PDS,\(^{369}\) New Zealand’s SDS\(^{370}\) and US’ Form C\(^{371}\) are compared, each evidence a different focus on the information disclosure requirements. All

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\(^{362}\) Financial Conduct Authority PS19/14 (n 336) 24.

\(^{363}\) For example, UK - FCA Handbook COBS 18.12.33R.

\(^{364}\) ibid.

\(^{365}\) For example, UK - FCA Handbook COBS 18.12.33R-40G.

\(^{366}\) Australia - Corporations Act 2001 Chapter 7 Part 7.9; Australia - Corporations Regulations 2001 Chapter 7 Part 7.9, Schedule 10.


\(^{369}\) Australia - Corporations Act 2001 Chapter 7 Part 7.9; Australia - Corporations Regulations 2001 Chapter 7 Part 7.9, Schedule 10.


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the standardised disclosure documents have basic information requirements such as name and contact details.\(^{372}\) All specify that the standardised disclosure documents must be delivered before the investor pays.\(^{373}\)

Australia’s PDS\(^ {374}\) and the US’ Form C\(^ {375}\) have a ‘catch all’ requirement to include any information that would be relevant.\(^ {376}\) The remainder of the detailed requirements\(^ {377}\) in Australia’s PDS,\(^ {378}\) New Zealand’s SDS\(^ {379}\) and the US’ Form C\(^ {380}\) each have a slightly different focus. New Zealand’s more detailed\(^ {381}\) disclosures focus on the information available on request and financials detailing how the investment is made, how money is dealt with, and the charges.\(^ {382}\) Australia similarly concentrates on where further information can be found\(^ {383}\) and financials in its disclosures.\(^ {384}\) Nevertheless, Australia’s financial disclosures focus on the significant benefits, tax implications, and financial returns.\(^ {385}\) The financial returns are delivered in a set table format outlining the fees when money is moved in or out and the fees and costs for

\(^{372}\) New Zealand - Financial Markets Conduct Regulations 2014 reg 215(1)(m); Australia - Corporations Act 2001 s 1013D(1)(a); US - Rule 201(a), (b) Regulation Crowdfunding, 17 CFR § 227.201(a), (b) (2021).


\(^{374}\) Australia - Corporations Act 2001 Chapter 7 Part 7.9; Australia - Corporations Regulations 2001 Chapter 7 Part 7.9, Schedule 10.


\(^{377}\) See further a) Theory of Legal Certainty.

\(^{378}\) Australia - Corporations Act 2001 Chapter 7 Part 7.9; Australia - Corporations Regulations 2001 Chapter 7 Part 7.9, Schedule 10.


\(^{381}\) See further a) Theory of Legal Certainty.

\(^{382}\) New Zealand - Financial Markets Conduct Regulations 2014 reg 215(1)(d), (e), (j), (o).

\(^{383}\) Australia - Corporations Act 2001 s 1013D(1)(j).

\(^{384}\) Australia - Corporations Act 2001 s 1013D(1)(b), (e), (h).

\(^{385}\) Australia - Corporations Act 2001 s 1013D(1)(b), (e), (h).
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managing the investment.\textsuperscript{386} Although, the US’ more detailed\textsuperscript{387} disclosures focus on where further information can be found, the information in any written communications or broadcasts, and the project owner itself.\textsuperscript{388} The disclosures about the project owner require information about (1) the number of employees of the project owner, (2) the project owner’s indebtedness including ‘the amount, interest rate, maturity date and any other material items’, (3) general financial condition including ‘to the extent material, liquidity, capital resources and historical results of operations’, (4) details about the project owner’s previous crowdlending offerings, and (5) any of the project owner’s transactions where the amount involved is over the 5% of the aggregate amount raised in reliance on Regulation Crowdfunding the past 12 months including the amount sought in the current loan.\textsuperscript{389}

Some of the disclosures in the standardised disclosure documents are more protective and paternalistic. New Zealand’s paternalistic disclosures concern checks and assessments, complaints procedures, whether the CSP or the project owner are subject to restrictions or prohibitions, conflicts of interest, and whether the CSP has the right to alter charges for the service.\textsuperscript{390} However, Australia’s paternalistic disclosures focus on details about dispute resolution, wording and clarity requirements, and associations with other persons’

\textsuperscript{386} Australia - Corporations Regulations 2001 reg 7.9.11W(2), Schedule 10E(3).

\textsuperscript{387} See further a) Theory of Legal Certainty.

\textsuperscript{388} US - Rule 201(e), (p), (q), (r), (s), (t), (w), (z) Regulation Crowdfunding, 17 CFR § 227.201(e), (p), (q), (r), (s), (t), (w), (z) (2021).

\textsuperscript{389} US - Rule 201(e), (p), (q), (r), (s), (t), (u), (w), (z) Regulation Crowdfunding, 17 CFR § 227.201(e), (p), (q), (r), (s), (t), (u), (w), (z) (2021).

\textsuperscript{390} New Zealand – Financial Markets Conduct Regulations 2014 reg 215(1)(f), (i), (k), (l), (n), (4).
disclosures. The US’s Form C is less focused on paternalistic disclosures. The US requires a discussion of the risky material factors, a statement that an investor must confirm the investment after a material change and any disqualification matters.

Australia is more prescriptive with its presentation requirements. Australia not only details a template but sets risk warnings, length requirements, examples of how fees would work in practice, which fees are negotiable, font size and more. In comparison, New Zealand makes significantly fewer presentation requirements. New Zealand requires that the standardised disclosure document is ‘worded and presented in a clear, concise, and effective manner’ and that the ‘format, font, and font size’ is easily readable. The US has more of a form with a set format without for example font size requirements.

The US has another disclosure document in the form of educational materials for the investor. CSPs in the US must provide educational materials when an account is established for investors. Furthermore, the CSP must obtain a representation from the investor that the investor has reviewed the educational materials, understands that the investment may be lost and can bear the loss of the investment. The educational materials have presentation requirements. The educational materials must explain everything in plain

391 Australia - Corporations Act 2001 ss 1013D(1)(g), 1013C(3), (4), (5), (6).
392 US - Rule 201(f), (k), (u), (x) Regulation Crowdfunding, 17 CFR § 227.201(f), (k), (u), (x) (2021).
393 Australia – Corporations Regulations 2001 Schedule 10E.
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language and must communicate effectively and accurately. The educational materials inform the investor at a general level. The materials provide basic information regarding the process, type of security, the information to be expected in Form C and details regarding the ongoing relationship with the project owner and continuing disclosure obligations. Some of the educational materials' disclosures are paternalistic. The educational materials disclosures inform the investor about their rights, investment limitations, and the need 'to consider whether [...the investment] is appropriate. While the disclosure document, which is provided by the project owner, is specific to the particular transaction. In effect the educational materials under Regulation Crowdfunding act as a standardised disclosure document. The different focuses in the standardised disclosure documents mean that each regulatory framework has a different idea of what information is key.

The EU's standardised disclosure document focuses on the delivery of basic information and information concerning funds, fees, and charges. The basic information informs the investor about the crowdlending service itself, contact details and information about the project owner’s business, The information concerning funds ranges from project owner financial statements, and the funding target, to fees and charges to financial

399 US - Rule 302(b)(1) (i), (ii), (iii), (iv), (viii), (ix) Regulation Crowdfunding, 17 CFR § 227.302(b)(1) (i), (ii), (iii), (iv), (vii), (ix) (2021).
401 ECSPR article 23(8), annex I part A(f), part G(a), (f), part H(b), part I(i)(g).
402 ECSPR article 24(1)(b), (c), annex I part A(a)-(c), part H(c), part I (a).
403 ECSPR annex I part A(d), (e).
404 ECSPR annex I part B(a)-(e).
405 ECSPR annex I part H(a), part G(b), part I(k).
returns. The EU is the only jurisdiction to differentiate its standardised disclosure document according to whether an individual portfolio management service is being availed of by the investor.

The EU focuses on the project owner in a slightly different way to the US. The EU’s standardised disclosure document discloses information about the project owners’ activities, services, products, financial figures, and descriptions of the business. The EU’s paternalistic disclosures about investor rights overlap with Australia and New Zealand. The EU’s fee disclosures overlap with New Zealand and Australia’s requirements also. Both Australia and the EU are quite prescriptive about the presentation requirements regarding fees and charges by specifying a set table to present the information that gives examples of how much the fees might be. Thus, it seems the EU has drawn inspiration from around the world. Although there is no evidence indicating this in the ECSPR’s policy documents.

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406 ECSPR annex I part G(d).
407 See further chapter 3.
408 US - Rule 201(e), (p), (q), (r), (s), (t), (w) Regulation Crowdfunding, 17 CFR § 227.201(e), (p), (q), (r), (s), (t), (w) (2021).
409 ECSPR annex I part A(c)-(f).
410 ECSPR annex I part F.
411 Australia - Corporations Act 2001 ss 1013D(1)(g), 1013C(3), (4), (5), (6).
412 New Zealand - Financial Markets Conduct Regulations 2014 reg 215(1)(f), (i), (k), (l), (n), (4).
413 ECSPR annex I part H.
414 New Zealand - Financial Markets Conduct Regulations 2014 reg 215(1)(d), (e), (j), (o).
415 Australia - Corporations Act 2001 s 1013D(1)(b), (e), (h).
416 Australia - Corporations Regulations 2001 reg 7.9.11W(2), Schedule 10E(3).
417 ECSPR annex I part H.
Despite the overlaps in approach, the EU’s standardised disclosure document is more targeted requiring information such as minimum target capital and maximum offer amount. Furthermore, the draft Delegated Regulation specifically outlines in a non-exhaustive list the risks that need to be described. The non-exhaustive list details for example default risk, platform failure, liquidity risk, and risk of no return.

The ECSPR has been described as having behavioural science ‘about human decision making clearly form’ its ‘theoretical building block[s]’. Because the EU leveraged behavioural science in its delivery of the information and Australia’s similar use of behavioural science-informed measures, the ECSPR is adequate in addressing inexperience and information asymmetry in its KIIS once the issues in chapter 3 have been remedied.

(2) The UK’s Information Asymmetry Tools

As stated at the beginning of this section the UK did not think that a standardised disclosure document was appropriate for crowdlending due to the diversity of business models in the market. The UK’s information disclosures
range from outlining the role of a crowdlending platform, disclosing that the investment is not covered by the financial services compensation scheme in the UK, platform failure, past performance details, secondary market disclosures, and information regarding contingency funds.

The UK’s disclosures are packaged in a few different ways. Some disclosures are in the form of lengthy reports or publications. Some disclosures are risk warnings in short paragraphs. Other disclosures do not have presentation requirements such as the ongoing disclosures requirement.

There is one part of the UK’s regulatory framework where CSPs are required to disclose the information set out in a non-exhaustive list that is very similar to the type of key information required in a standardised disclosure document. This information requirement is different where the investor and where the crowdlending platform selects the loan. The crowdlending platform must also keep the investor up to date regarding any material changes and is subject to various ongoing disclosures.

Where the investor selects the loan, the UK’s information disclosures give basic information about the (1) price, (2) annual percentage rate, (3) the date the
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loan will mature, and (4) the frequency, amounts and total amount of the repayments.\(^{439}\) The UK also requires more detailed requirements\(^{440}\) where the investor selects the loan which include:

- A fair description of the likely return which takes into account the likely fees, default rates, and taxes,
- If the CSP prices the loan, the CSP must disclose the credit risk assessment which was carried out,
- If the loan is backed by an asset,
- The fees paid by the project owner or investor ‘including any deduction from the interest to be paid by the’ project owner,
- If the CSP prices the loan, the CSP must disclose the risk categorisation of the loan by reference to the risk management framework, and
- If the loan price is set by an auction, the CSP must describe the auction process and how the terms are determined.\(^{441}\)

Where the CSP selects the loan, separate disclosures apply. The investor is given basic information about the minimum and maximum interest rates and maturity dates.\(^{442}\) The investor is also given details about the (1) range and distribution of risk categories which are explained by reference to the risk management framework, (2) the fees paid by the project owner and investor ‘including any deduction from the interest to be paid by the’ project owner,

\(^{440}\) See further a) Theory of Legal Certainty.
\(^{441}\) UK - FCA Handbook COBS 18.12.26R(7)-(12).
\(^{442}\) UK - FCA Handbook COBS 18.12.27R(1), (2).
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and (3) a fair description of the actual return taking into account fees, default rates, and taxes.\(^{443}\)

The UK discloses information about how the auctions set the price of a loan\(^{444}\) which is essential information that is lacking in the EU. The EU’s KiIS is only concerned with price information if the CSP has a role in pricing the loan.\(^{445}\) The risks are higher where the CSP prices the loan. The CSP takes on a position of trust where the investor and project owner rely on the CSP to price the loan honestly and fairly according to appropriate objective information. However, this does not negate the need for clear information on how auction-style pricing of loans works. As a result, an effort should be made in the EU to explain the auction to investors, particularly non-sophisticated investors.

The combination of the UK’s ongoing disclosures and loan agreement requirements together delivers the essential loan agreement information. The disclosures focus on matters relating to fees,\(^{446}\) payment,\(^{447}\) risk categorisation and assessment,\(^{448}\) pricing,\(^{449}\) and default.\(^{450}\) This monetary-oriented information is very similar to the information delivered by the EU’s standardised disclosure document.\(^{451}\) In loan agreements where the lender does not select the loan such as in the case of portfolio management, the CSP must provide

\(^{443}\) UK - FCA Handbook COBS 18.12.27R(3)-(5).
\(^{444}\) See further f) Pricing, Credit Risk Assessment, and Credit Scoring.
\(^{445}\) See further chapter 3.
\(^{446}\) UK - FCA Handbook COBS 18.12.26R(1), (10), 31R(1), (10).
\(^{448}\) UK - FCA Handbook COBS 18.12.26R(8), (11), 31R(8).
\(^{449}\) UK - FCA Handbook COBS 18.12.26R(12); See further f) Pricing, Credit Risk Assessment, and Credit Scoring.
\(^{450}\) UK - FCA Handbook COBS 18.12.31R(11), (12).
\(^{451}\) ECSPR annex I part H.
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information about payment,\textsuperscript{452} fees,\textsuperscript{453} and risk categorisation also.\textsuperscript{454} These disclosures in the case of portfolio management are the same as the disclosures the EU makes concerning portfolio management in its standardised disclosure document.\textsuperscript{455} Additionally, the UK disclosure requirement regarding loan servicing should the CSP fail is also required in the EU’s standardised disclosure document.\textsuperscript{456} It is unclear taking into account the considerable overlap in the type of disclosure requirements contained in the loan agreement and other disclosure mechanisms in the UK and the EU’s standardised disclosure document why the UK decided against the standardised disclosure document. The standardised disclosure document merely delivers information in a way that eases comparison for investors. The EU delivers the same information as the UK requirements in a more easily digested format.

Thus, the UK has favoured market facilitation in making it easier for CSPs to disclose information without the necessity of presentation requirements to the disadvantage of investor protection. The UK has favoured market facilitation despite research supporting the dissemination of information in formats that make it easier for clients to compare the information.\textsuperscript{457}

\textsuperscript{452} UK - FCA Handbook COB18.12.27R(1)-(3).
\textsuperscript{453} UK - FCA Handbook COBS 18.12.27R(4).
\textsuperscript{454} UK - FCA Handbook COBS 18.12.27R(5); See also (3) Individual Loan Portfolio Management.
\textsuperscript{455} ECSPR annex I part I; See further chapter 3.
\textsuperscript{456} ECSPR annex I part G(f), part l(i).
\textsuperscript{457} This study evidenced the effectiveness of colour coded comparison tables. Commission, ‘Behavioural Study on the Digitalisation of the Marketing and Distance Selling of Retail Financial Services Final Report’ (n 266) 129.
(3) Other Information Asymmetry Tools

Australia, New Zealand, the UK, and the US have used a variety of information asymmetry tools. For example, ongoing disclosure requirements, transaction confirmation requirements, advertising and promotions requirements, and risk warnings.

New Zealand uniquely has crowdlending client agreement requirements. The crowdlending client agreement must be given ‘before the investor applies for or acquires any financial products under the service’. The crowdlending client agreement must set out details of how the investment or loan will operate. New Zealand implies a term containing a duty to exercise care, diligence, and skill in the client agreements. It is unclear why the duty is imposed onto the CSP using an implied term in a client agreement rather than having a standalone provision that imposes a duty on the CSP. Because the term is implied in the client agreement it does not necessarily mean that it will be written out in the client agreement received by the client. Implying a term...

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461 Australia - Corporations Act 2001 ss 1013D(1)(d)(i), 1013D(1)(e); UK - FCA Handbook COBS 4.5.2R(2), 4.5.4G, 10.3.1R-3G, 18.12.33R
465 New Zealand - Financial Markets Conduct Act 2013 s 429(c); New Zealand - Financial Markets Conduct Regulations 2014 regs 223, 225(1).
containing a duty does not resolve any information asymmetries surrounding the matter as the client may not be expressly informed that such a duty applies in the client agreement. The EU’s approach in applying a best interests duty on CSPs is far more direct.\textsuperscript{466} It is unclear why New Zealand takes this path to apply this duty on CSPs.

Overall, New Zealand’s client agreements operate as a protection and disclosure measure. The client agreement informs the project owners and investors about the details of the loan while the implied terms protect the project owners and investors by ensuring due skill and care.

Another proven tool that improves inexperienced individuals’ selection of products is the provision of a colour-coded comparison table upfront and early in the process.\textsuperscript{467} The mandated use of early up-front colour-coded comparison tables is not found in any regulatory framework. The closest to requiring anything analogous to a colour-coded comparison table is the US’ search tool requirements for CSPs.\textsuperscript{468} The search tool requirement mandates filtering the offerings by set objective criteria. The US search tool requirement could be adopted and further developed by the EU incorporating the colour-coded comparison table element in the ECSPR.

(4) Gatekeeper

Similarly to the EU,\textsuperscript{469} both the regulator and the CSP have gatekeeper roles in Australia, New Zealand, the UK, and the US. The regulatory gatekeeper roles

\textsuperscript{466} ECSPR article 3(2). See further chapter 3 b) Clients.
\textsuperscript{467} Commission, ‘Behavioural Study on the Digitalisation of the Marketing and Distance Selling of Retail Financial Services Final Report’ (n 266) 129.
\textsuperscript{469} See further chapter 3.
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similar to the EU’s NCA gatekeeper roles concern authorisation. However, the authorisation process varies in its focus. The regulatory gatekeeper roles have a varying spectrum of micro to macro focus in the jurisdictions examined. Australia and the UK have a macro focus. Australia has a ‘single licensing regime for financial sales, advice, and dealings in relation to financial products’ which applies to crowdlending. The UK also has a single authorisation regime for regulated activities of which crowdlending is one. The EU leans towards the micro end of the focus spectrum as its authorisation process is solely for business crowdfunding. The EU’s focus is similar to the US where the US focuses on business crowdfunding. New Zealand’s regulatory gatekeeper role is difficult to classify as it has ‘additional’ crowdlending specific requirements and standard requirements. The additional crowdlending specific eligibility licence requirements are micro in their focus while the standard requirements are macro in their focus.

Interestingly in Australia, the regulatory gatekeeper role is in some instances calibrated according to the type of investor. Where CSPs deal with non-sophisticated investors additional registration requirements apply.

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470 See further a) Authorisation.
471 ibid.
474 See further a) Authorisation.
475 See further chapter 3.
478 New Zealand - Financial Markets Conduct Act 2013 s 396(a).
479 Australia - Corporations Act 2001 Chapter 5C.
additional registration requirements require the CSP to have a constitution, compliance plan, compliance committee and so on. In other words, the additional registration requirements place additional business conduct requirements and disclosure requirements on the CSP. Thus, CSPs dealing with non-sophisticated investors in Australia must meet more prescriptive standards than those CSPs that do not deal with non-sophisticated investors. The additional registration requirement where the CSP deals with non-sophisticated investors is not found in the other jurisdictions. It is one of the ways Australia addresses investor inexperience and information asymmetry.

All the jurisdictions ensure certain minimum standards are met before CSPs can access the market. Therefore, ensuring certain standards are reached before CSPs reach the market. All the jurisdictions place requirements upon the CSPs at the authorisation stage. Thus, requiring minimum standards before engaging with investors, project owners, and the market. Ultimately it is the CSP who gives the information, imposes the investment limits, and who conducts the knowledge tests. The investor self-responsibility principle is not relied upon. Except in Australia where sophisticated investors can deal with CSPs that have fewer registration requirements.

480 ibid.
483 See further (c) Investment Limits.
484 See also (a) Knowledge Tests
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In the EU, the CSPs’ gatekeeping role focused on client onboarding. Due to the interaction between MiFID II and the bulletin board, the CSPs’ role in facilitating early exits was limited to providing a space to advertise the interest to sell. All negotiations must take place outside of the CSP platform. This issue does not appear to arise in any of the comparator jurisdictions. Neither New Zealand nor the UK prescribes or limits the CSPs’ intermediary role in secondary markets. There are differences in the approaches. The UK takes an ‘inform the free market’ stance and focuses on disclosures to the investor and assessing the investor’s understanding of the liquidity risk in the appropriateness assessment. However, New Zealand is more paternalistic and requires the CSP to disclose the processes and procedures it will undertake to operate the secondary market as part of the authorisation process. This disclosure to the regulator indicates a more paternalistic position in New Zealand as it is possible that inadequate processes and procedures for the operation of a secondary market would result in the authorisation application being refused. The US is silent on secondary markets. Regulation Crowdfunding refers to the transfer of an investment in passing. Australia is the only jurisdiction to prescribe an intermediary role in CSP secondary markets. ASIC requires CSPs if they accept the request to exit the investment to satisfy the request generally within five

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485 See further chapter 3.
486 ibid.
487 See also b) Secondary Markets, a) Liquidity Risk.
488 See further a) Liquidity Risk.
491 See also b) Secondary Markets, a) Liquidity Risk.
493 See also b) Secondary Markets, a) Liquidity Risk.
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business days. Thus emphasising allocative market efficiency. However, none of the other jurisdictions addresses information asymmetry or inexperience in the context of the secondary market only the EU ensures that these matters are addressed.

(5) Conclusion
In conclusion, it appears that the EU’s standardised disclosure document combines a mix of the disclosure requirements from all the jurisdictions. The monetary information requirements from New Zealand and the UK’s disclosure requirements and project owner information disclosures in principle are like the US. Then the EU’s paternalistic disclosures about investor rights overlap with Australia and New Zealand. Thus, the EU’s standardised disclosure document combines the best qualities of all the jurisdictions. As a result, the EU’s standardised disclosure document is the most adequate in delivering a combination of the information that has been deemed key in all the comparator jurisdictions. It is unclear if this combination approach taken by the EU will saturate or adequately inform the investors to address information asymmetry and inexperience. This certainly is one of the few instances where the UK’s approach is not adequate at addressing the risk or

494 Australian Securities and Investment Commission REP 420 (n 80) 22.
495 See also b) Secondary Markets, a) Liquidity Risk.
496 See further chapter 3.
497 New Zealand - Financial Markets Conduct Regulations 2014 reg 215(1)(d), (e), (j), (o).
498 UK - FCA Handbook COBS 18.12.26R(1)-(8), (10)-(12), 31R(1)-(8), (10)-(12).
499 US - Rule 201(e), (p), (q), (r), (s), (t), (w) Regulation Crowdfunding, 17 CFR § 227.201(e), (p), (q), (r), (s), (t), (w) (2021).
500 ECSPR annex I part F; See further chapter 3.
502 New Zealand - Financial Markets Conduct Regulations 2014 reg 215(1)(f), (i), (k), (l), (n), (4).
goal examined. There is nothing to prevent the essential information from being delivered to investors in a large and difficult-to-navigate document.

**e) Fraud Risk**

All the jurisdictions examined addressed fraud by using their pre-existing fraud regulatory framework. There are some similarities in the tools employed across the jurisdictions. For example, Australia, New Zealand, the UK, and the US all have regulatory gatekeeper regimes (licences, authorisations etc...) the regulatory gatekeeper regimes all include for example a conflict-of-interest requirement and there are also disclosure requirements tackling fraud.

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506 See further (4) Gatekeeper.

507 Australia - Corporations Act 2001 s 912A(1)(aa); New Zealand - Financial Markets Conduct Regulations 2014 reg 186(h); UK - FCA Handbook SYSC 10.; US - Rule 300(b) Regulation Crowdfunding, 17 CFR § 227.300(b) (2021); See further (a) Conflicts of Interest.

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Business conduct requirements are a recurring feature in the regulatory response to fraud risk in Australia, New Zealand, the UK, and the US. An example of a business conduct requirement in Australia, New Zealand and the UK is the requirement for risk management systems to control for anti-money laundering and fraud. Another example is a requirement for certain levels of employee education and skills in the CSPs. Better equipping employees with education and skills hopefully enables them to identify fraud more adequately.

The US’ focus is slightly different. The US requires criminal history and background checks. Uniquely the US has a communication channel requirement which provides a space where offerings can be discussed. The CSP must have guidelines for communications and remove abusive or potentially fraudulent comments. The communication channel requirement is a business conduct mechanism used to limit fraud in the US. Australia comes closest to addressing cyber fraud risk in crowdlending’s specific context by stating that cyber risks may need to be included in a compliance plan.

As explored earlier in this chapter, all the comparator jurisdictions place ex-ante controls on natural persons who constitute the management of the CSP.

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513 Australian Securities and Investments Commission REP 429 (n 296) 41.
514 See further (b) Ex-Ante Controls on Access to Management.
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All apart from the US require information about the person’s experience\(^ {515}\) and all require information about criminal history.\(^ {516}\) The EU has similar ex-ante controls but as the analysis found there are some measures that the EU could use to make the ECSPR more adequate namely (1) an examination of the organisational competence, and (2) a requirement for CSPs to establish recruitment and HR processes to ensure the right skills and experience are recruited.

Fraud risk is one of the few areas where the EU has mirrored the approach in the other jurisdictions by applying its pre-existing fraud regulatory framework to crowdlending. CSPs must undertake a minimum level of due diligence in project owner investigations. The project owner’s due diligence investigations must find there is no criminal record and that the project owner is not established in non-cooperative jurisdiction outside the EU as per AMLD V.\(^ {517}\) Furthermore, any payment services conducted by the CSP or by a third party must comply with PSD II.\(^ {518}\) Payment service providers authorised under PSD II

\(^{515}\) Australia - Corporations Act 2001 s 921A(1)(e), (f); UK - FCA Handbook FIT 1-2, SUP 10.A; Australian Securities and Investments Commission RG 105 (n 186) 4; Financial Markets Authority, ‘Licensing Application Guide: Peer-to-Peer Lending Part B2’ (n 9) 10, 11.


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must comply with AMLD V. All in all AMLD V applies to CSPs meaning that the EU’s pre-existing fraud regulatory framework applies.

To conclude, all the jurisdictions have applied their pre-existing fraud regulatory frameworks. One implication is that each jurisdiction feels that fraud risks are adequately addressed in its pre-existing fraud regulatory framework. Another implication is that fraud risk is a very complex area and is difficult to regulate. Thus, fraud risk merits individual attention in a fraud-specific regulatory framework rather than addressing fraud risk within a CSP regulatory framework.

New Zealand and the UK require disclosures to the investor about the due diligence in project owner selection. There is no explicit mention of this type of requirement in Australia. Nevertheless, in ASIC’s information documents, ASIC suggests that disclosing the project owner selection policies and procedures on the website is a good practice requirement. However, in the US some project owner selection due diligence may be implied from the anti-fraud requirements. The EU makes a tangential reference to requiring disclosure of project owner selection criteria to clients. The EU also requires a minimum level of due diligence to ensure the project owners have no

521 Australian Securities and Investments Commission INFO 213 (n 29).
523 ECSPR article 19(1); See further chapter 3.
524 ECSPR article 5; See further chapter 3.
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criminal record and the project owner is not established in a non-cooperative jurisdiction or high-risk third country under article 9(2) of AMLD V.

The investor self-responsibility principle can be seen in project owner selection requirements. Project owner selection is an important part of crowdlending. The information used to screen project owners and conduct the credit risk assessment is lengthy and complex. Technology can speed up this process but comes with its risks. The EU, it seems, is the only jurisdiction that has responded to the potential fraud and other risks associated with using automated models.

The comparator jurisdictions and the EU agree that fraud should have a singular response that remains the same despite the context. It indicated that there is a market facilitatory response to fraud combined with paternalism. It is market facilitatory because despite the context the fraud regulatory framework remains the same. Thus, it reduces the regulatory burden as practitioners for


526 See further chapter 3.
example will be well-versed in the regulatory requirements. However, the EU was the only jurisdiction to address the risk of fraud and bias that comes with automated models. As the EU was the only jurisdiction to respond to automated models, it indicates that the EU has carefully considered the crowdlending business model. However, there are measures that the EU could include in its ex-ante management controls that could improve their adequacy.

\section*{f) Pricing, Credit Risk Assessment, and Credit Scoring}

All the jurisdictions have addressed pricing in some shape or form. Pricing has been addressed with varying degrees of detail. All the comparator jurisdictions have for example used pricing disclosure requirements. Some jurisdictions have been more prescriptive, detailing the information that must be taken into account when CSPs make their pricing or credit risk assessment.

In Australia, there is no explicit reference to pricing in chapter 5C of the Corporations Act 2001. There is a requirement to set out in the registered managed investment scheme’s constitution the consideration that is payable to acquire an interest in the scheme. The rest of the pricing requirements are disclosure requirements in the standardised disclosure document. The pricing part of the standardised disclosure document follows strict requirements in the Corporations Regulations 2001. The pricing part of the standardised disclosure document follows strict requirements in the Corporations Regulations 2001.

\begin{footnotesize}
\begin{itemize}
\item[527] See further (b) Ex-Ante Controls on Access to Management.
\item[528] See further a) Theory of Legal Certainty.
\item[529] ibid.
\item[530] Australia – Corporations Act 2001 s 601GA(1)(a).
\item[531] Australia – Corporations Act 2001 s 1013D(1)(d)(i), 1013D(1)(e); See further (1) Standardised Disclosure Document.
\item[532] See further (1) Standardised Disclosure Document.
\end{itemize}
\end{footnotesize}
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disclosure document must use the templates specified, and the information must be delivered in a certain order.\textsuperscript{533} The standardised disclosure document must contain details about the fees and costs summary, examples of annual fees and costs, product cost information, additional explanation of fees and costs and a standardised risk warning for consumers.\textsuperscript{534} The standardised disclosure document must also disclose how the creditworthiness of the project owners is assessed.\textsuperscript{535} In summary, several detailed disclosures,\textsuperscript{536} examples and risk warnings are used to address pricing in the standardised disclosure document.\textsuperscript{537}

New Zealand by contrast has few pricing requirements. The Financial Markets Conduct Regulations 2014 requires disclosure of the CSP’s charges.\textsuperscript{538} The charges disclosures must be included in the standardised disclosure document.\textsuperscript{539} The disclosures provide details for both the investor and project owner outlining when the charges must be paid and the rights to alter the charges. Nevertheless, the FMA’s licencing process requires CSPs to describe the processes and controls to conduct project owner creditworthiness assessments.\textsuperscript{540}

\textsuperscript{533} Australia - Corporations Regulations 2001 Schedule 10E Part 2; See further (1) Standardised Disclosure Document.
\textsuperscript{535} Australian Securities and Investments Commission INFO 213 (n 29); See further (1) Standardised Disclosure Document.
\textsuperscript{536} See further a) Theory of Legal Certainty.
\textsuperscript{537} See further (1) Standardised Disclosure Document.
\textsuperscript{538} New Zealand - Financial Markets Conduct Regulations 2014 reg 215(1)(h)-(j).
\textsuperscript{539} See further (1) Standardised Disclosure Document
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The UK has extensive pricing and credit risk assessment requirements in COBS 18.12 of the FCA Handbook. Overall, the UK requires that pricing, and credit risk assessments are fair, reasonable, and based on sufficient information. The UK uses a mix of business conduct requirements and disclosure requirements. The business conduct requirements take two approaches: a risk management framework requirement and stipulating where pricing must be reviewed. A price valuation must be reviewed upon origination, where there is a risk of non-payment, after default and in the case of an investor’s early exit. The UK has a variety of pricing disclosures. Some disclosures are required on an ongoing basis and others are triggered by events such as the end of the financial year. Some disclosures specifically inform investors about pricing and the CSP’s role in pricing.

The US uses a mix of measures to address pricing. The US uses disclosure requirements, advertising requirements, and requirements outlining timing and the price must be included in the confirmation of the transaction.

542 UK - FCA Handbook COBS 18.12.18R.
543 UK - FCA Handbook COBS 18.12.16R, 17R.
544 UK - FCA Handbook COBS 18.12.31R.
545 UK - FCA Handbook COBS 18.12.21R-23R.
546 UK - FCA Handbook COBS 18.12.24R.
548 US - Rule 204 Regulation Crowdfunding, 17 CFR § 227.204 (2021); See further b) Marketing Communications.
The EU’s pricing requirements are far more detailed than the UK. Yet overall, the EU and UK’s pricing requirements are very similar. Both the EU and the UK focus on disclosures and business conduct requirements. However, as explored in chapter 3 the EU’s requirements on methodology, governance, disclosures, and factors are significantly more detailed. The requirements specify that the CSP’s management must have a good understanding of automated models and when and how they are used. The EU also sets out how governance arrangements should be designed what factors should be used, information and outputs. On the other hand, Australia emphasises disclosures with presentation requirements, and specific ordering of information. Australia’s disclosures focus on details about fees, cost summaries and standardised risk warnings. Yet, Australia’s broad strokes cover most of the pricing risks crowdlending presents.

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551 See further chapter 3.
552 See further a) Theory of Legal Certainty.
553 ECSPR article 4(4).
554 See further chapter 3.
557 ECSPR article 19(6).
558 ECSPR article 4(4).
559 See further a) Theory of Legal Certainty.
561 Delegated Regulation [2022] OJ L287/50 (n 304) article 6(2).
563 Australia - Corporations Regulations 2001 regs 7.9.11S, 7.9.16N, Schedule 10 Part 2. See also Australian Securities and Investments Commission RG 97 (n 535); See further a) Theory of Legal Certainty.
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The US’s pricing requirements are not as detailed as Australia, the UK, and the EU. However, the US disclosures address more than the New Zealand disclosure requirements which only address the CSP’s charges.

Only the UK and the EU have specific requirements on what should be taken into account in pricing or credit risk assessments. Placing requirements on the pricing or credit risk assessments themselves addresses the risk investors may not get remunerated fairly. However, the EU addresses pricing in the secondary market where the other jurisdictions have been silent. Furthermore, the draft regulatory technical standards spin an intricate web of requirements in the EU. This raises questions about whether the level of detail in the EU’s regulatory framework is appropriate. By comparison, the level of detail required is significantly greater than in the other jurisdictions. Will this raise the regulatory burden too far and too high for crowdlending? Or if these detailed requirements have a positive impact on the EU business crowdlending market are the comparator jurisdictions rife with mispriced crowdlending loans? These questions will only be answered once the ECSPR’s Level 2 measures are all finalised.

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564 See further a) Theory of Legal Certainty.
565 See further chapter 3.
566 ECSPR article 25; See further chapter 3.
568 See further a) Theory of Legal Certainty.
569 ibid.
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\( g) \text{ Systemic Risk} \)

Most of the jurisdictions have placed some prudential or capital requirements on CSPs. The US does not. Australia, New Zealand, and the UK have all addressed systemic risk in their regulatory frameworks.

The UK imposes financial resource requirements.\(^{570}\) The UK also has significant credit risk assessment requirements such as what information can be taken into account in the assessment.\(^{571}\) Australia and New Zealand take different approaches. New Zealand requires the CSP to inform the FMA about the measures being taken regarding financial resources. New Zealand requires various reports such as audited financial statements, cash flow forecasting, and details on systems policies and controls.\(^{572}\) Australia places sui generis financial resource requirements on CSPs and a requirement to have adequate risk management systems.\(^{573}\) The sui generis financial resource requirements depend on reports drafted by the CSPs themselves. ASIC also require that the constitution outline the contingency fund obligations, procedures, and rights.\(^{574}\)

The disadvantage of the Australian and New Zealand approach is that it relies on the CSP’s honesty. Honesty is not a concern in the UK as the regulatory framework has set financial resource requirements. Nevertheless, the

\(^{570}\) UK – FCA Handbook IPRU-INV 12.

\(^{571}\) UK – FCA Handbook CONC 5.5A.


\(^{574}\) Australian Securities and Investments Commission REP 435 (n 275) 19-20.
Australian and New Zealand approach is more flexible than the UK requirements.

In comparison, the EU has struck a balance between flexibility and specificity for the prudential capital requirements. Under the ECSPR, CSPs must set aside an amount ‘of at least the higher of’ €25,000.00 ‘and’ a quarter of the preceding year’s fixed overheads. The EU has achieved this balance by requiring the amount to be constituted of own funds and/or an insurance policy requirement. The EU has also targeted areas of specific concern with indirect prudential requirements namely credit risk assessments and contingency fund plans. Both the EU and the UK are quite prescriptive in the information that should be taken into account for credit risk assessment. Although the others mainly rely on disclosures. However, the EU goes beyond and provides greater detail on contingency fund plans. The UK by comparison relies on disclosures and prescribes when the price must be re-evaluated. As a result, it appears that systemic risk is of greater concern for the EU legislators than in Australia, New Zealand, the UK and the US. The only jurisdiction that takes similar steps to the EU is the UK. At the outset, the prudential capital requirements position in the EU and UK would imply that the UK is taking a

575 See further chapter 3.
576 ECSPR article 11(1); See further chapter 3.
577 ECSPR article 11; See further chapter 3.
578 ECSPR article 4(4), annex I part I(e); European Banking Authority, ‘Final Report Draft Regulatory Technical Standards on Credit Scoring and Pricing Disclosure, Credit Risk Assessment and Risk Management Requirements for Crowdfunding Service Providers under Article 19(7) Regulation (EU) 2020/1503’ (n 235) 12-26; See further chapter 3.
579 ECSPR article 6(5), (6); See further chapter 3.
580 See further chapter 3.
582 UK - FCA Handbook COBS 18.12.16R; See further f) Pricing, Credit Risk Assessment, and Credit Scoring.
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stricter position on prudential requirements. However, the EU is more prescriptive in the other areas and goes into greater detail.583

h) Conclusion
By comparison with the comparator jurisdictions, it is unclear whether the ECSPR is the most adequate risk-based regulatory model. Several factors inform this conclusion. One reason is owing to differences in nature between the comparator jurisdictions. Another is due to legal traditions. Jurisdictions like Australia and New Zealand tend to take a general principles approach. Another factor is that the ECSPR is not a pure risk-based regulatory model it has features of a business conduct regulatory model.

Furthermore, the analysis of the ECSPR’s response to the risks found that by comparison there are some improvements to be made. For example, the analysis of default risk584 found that the limited scope of the contingency fund requirements leaves investors exposed to inadequate contingency funds or none. However, there were other instances where the ECSPR’s response is more adequate comparatively such as systemic risk.585

Overall, the ECSPR needs to address five key areas:

1. Credit agreement definition in the KIIS,
2. Prescribe the risks to be assessed in the knowledge assessment,
3. Liquidity risk warning that explains the opportunity to exit,

583 See further chapter 3.
584 See further b) Default Risk.
585 See further g) Systemic Risk.
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4. Apply the contingency fund requirements to all contexts not solely individual portfolio management, and
5. Clearly state that the business continuity plan should be used where the CSP chooses to cease its services.

D. Regulatory Goals
This section provides the regulatory theory analysis of legal certainty.

1. Legal Certainty
In chapter 3 it was found that the ECSPR made a significant positive impact in addressing legal certainty in the EU crowdlending market. However, problems were noted with the ECSPR’s scope. The primary concern raised was that the ECSPR focused solely on business crowdlending. At present, there is no pan-EU regulatory response to consumer crowdlending. The EU is developing a regulatory response to consumer crowdlending however it will be some time before it reaches full legal effect across the EU. As a result, legal uncertainty pervades the pan-EU consumer crowdlending market.

   a) Theory of Legal Certainty
In chapter 3, it was found that the ECSPR was detail-oriented in its rules. This aligned with Braithwaite’s theory of legal certainty that in the beginning, the EU legislators will need to use specific detailed rules.586

Throughout the comparative analysis, it was frequently found that the ECSPR’s requirements are significantly more detailed than the other jurisdictions. The analysis of default risk587 demonstrated that the EU has the most detailed and

586 Braithwaite, ‘Rules and Principles: A Theory of Legal Certainty’ (n 270) 47.
587 See b) Default Risk.
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prescriptive requirements on default risk and contingency funds. Both the UK and the EU have detailed continuity of business plan requirements. The EU is more detailed on pricing credit risk assessments and credit scoring and systemic risk. One possible meaning is that each legislative culture has a different idea of what constitutes a detailed regulatory framework. This possible meaning may hold for jurisdictions with a sui generis regulatory framework such as New Zealand, the UK, and the US. Each of these sui generis regulatory frameworks were designed with the task of regulating crowdlending for the first time and evidence differing levels of detail. Although it does not make sense for Australia as a pre-existing regulatory framework was used which was not specifically designed with crowdlending in mind. By comparison to the EU, Australia is generally not as detailed. Another possible meaning is that some legislators may be concerned with the potential future changes in crowdlending meaning that detailed rules may quickly become obsolete.

b) Cross-Border
The EU’s success in addressing legal certainty relates in part to its enabling of a pan-EU business crowdlending market and levelling the playing field across the EU. The cross-border issue is something that is a challenge that is generally

589 Delegated Regulation [2022] OJ L287/50 (n 304) chapter IV.
590 UK - FCA Handbook SYSC 4.1.8AR-ER.
591 ECSPR article 12(2)(j).
592 See further c) CSP Failure.
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unique to the EU and does not arise in Australia, New Zealand, and the UK. However, the US faced similar cross-border issues before the SEC finalised the rules for Regulation Crowdfunding. There was almost a three-year delay in the SEC finalising rules for Regulation Crowdfunding. In these intervening three years, many States in the US created their own individual regulatory framework for crowdfunding. The States relied on the intrastate exemption which allows unregistered securities to be sold within a state so long as the securities are sold to that State’s residents and the project owner does business within that same state. While Regulation crowdfunding resolves the internal cross-border issue in the US, the regulatory market fragmentation issues remain. It is still possible for a State’s regulatory framework to continue as it relies on the intrastate exemption.

A separate type of cross-border issue, however, may arise in all the jurisdictions examined. This cross-border issue relates to a CSP from outside the jurisdiction trying to provide services while based outside of the desired jurisdiction or a

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CSP moving to a different jurisdiction. The US makes provisions for non-resident CSPs.\(^599\) Australia allows for the passporting of foreign financial service providers of some types from certain jurisdictions however, the passporting requirements are likely to be prohibitive to CSPs.\(^600\) For example, the assets under management must have a total value of at least $500 million (USD).\(^601\) New Zealand and the UK do not seem to have cross-border specific provisions for crowdlending.\(^602\) Nevertheless, both allow foreign financial service providers to apply for authorisation in their respective jurisdictions. The appropriateness of allowing CSPs established outside of the EU is under review under the ECSPR.\(^603\) As a result, the cross-border issue for third countries is not clear in the EU.

c) Business and Consumer Crowdlending

Another issue arising from the analysis of the ECSPR in chapter 3 was the ECSPR’s limited focus on business crowdlending.\(^604\)

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\(^{600}\) Memorandum of Cooperation on the Establishment and Implementation of the Asia Region Funds Passport 2016.
\(^{601}\) ibid Annex 2 Section 3.
\(^{602}\) Although, New Zealand applies its regulatory framework regardless of where the CSP is based. If the CSP is providing a service to a client or investor as a person resident, incorporated or carrying on a business in New Zealand. New Zealand – Financial Markets Conduct Act 2013 s 387.
\(^{603}\) ECSPR article 45(2)(q).
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All the jurisdictions (Australia, New Zealand, the UK, and the US) examined have addressed consumer project owner protection under a different regulatory regime. Some of the jurisdictions tailored parts of their pre-existing consumer project owner regulatory framework to consumer crowdlending. Such as the UK. In the UK crowdlending consumer project owners are protected under the Consumer Credit sourcebook with parts of the Consumer Credit sourcebook specifically addressing crowdlending issues. The other jurisdictions applied their pre-existing consumer project owner regulatory framework to consumer crowdlending. No jurisdiction has completely re-drafted its consumer project owner protections.

The US is perhaps the most challenging jurisdiction for consumer crowdlending. Many different federal and state regulatory frameworks apply in the consumer crowdlending context. The myriad of regulatory frameworks means that there is no ‘one-stop shop’ for consumer crowdlending regulation in the US. This maze in no way assists efforts towards legal certainty in the US. A maze makes it easy to go down the wrong regulatory path.

d) Signals - Titles and Definitions

A final aspect of this legal certainty examination is regulatory signalling. At a very basic level regulatory signalling comes from the name of the regulatory

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606 UK - FCA Handbook CONC 4.3.4.
607 Australia - National Consumer Credit Protection Act 2009; New Zealand - Credit Contracts and Consumer Finance Act 2003; In the US there is a swathe of laws applicable to consumer project owners. An example is US - Truth in Lending Act.
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framework. Is it clear from the name of the regulatory framework that crowdlending is regulated? Before exploring this point, it is necessary to spend a moment outlining the regulatory styles in the comparator jurisdictions. The regulatory style in Australia, New Zealand, the UK, and the US is to have large documents that contain the majority if not all the financial regulation of that jurisdiction in one document. The one document preference means that these documents are incredibly large. In Australia and New Zealand, their Act is a single document containing most of the financial regulations for their jurisdiction.\(^{608}\) Australia applies a pre-existing regulatory framework to crowdlending. The disadvantage to this approach is that it is not immediately clear that the pre-existing regulatory framework for Managed Investment Schemes\(^{609}\) applies to crowdlending. It is only where secondary sources such as information documents\(^ {610}\) on the Australian financial regulator’s website are examined that it is clear that the Managed Investment Scheme Framework applies to crowdlending.

Contrastingly New Zealand has specifically designed parts of its regulatory framework crowdlending which are in the main scattered across Part 6 of the Financial Markets Conduct Regulations 2014 along with the regulatory requirements for other market services. Thus, reducing clarity as to what is applicable to crowdlending in New Zealand. However, the financial regulator

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\(^{609}\) Australia - Corporations Act 2001 Chapter 5C.  
\(^{610}\) Australian Securities and Investments Commission INFO 213 (n 29).
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in New Zealand also uses a suite of secondary materials on its website to explain the regulatory framework.\(^{611}\)

On the other hand, the UK has the FCA Handbook which itself is not legislation, it is a document that collates and organises the financial Acts in the UK into one document that is organised into chapters. Some of these Chapters are specifically designed for crowdlending and others which are either applied to crowdlending or crowdlending are exempted from their application. The UK also has significantly detailed secondary documents called Policy Statements\(^{612}\) and Consultation Papers\(^{613}\) which describe and explain the applicable regulatory framework and some focus on crowdlending. The use of secondary documents alongside the FCA Handbook considerably adds to legal certainty. Thus, making it easier to navigate and understand what is inside and outside the scope.

The US has a different structure where the core Act is continually amended by subsequent Acts. In the case of crowdlending Title III of the Jumpstart Our Businesses Act or the CROWDFUND Act or Capital Raising Online While Deterring Fraud and Unethical Non-Disclosure Act of 2012 or also known as Regulation Crowdfunding amends the Securities Act of 1933. Thus, the US signals that


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crowdfunding is regulated. Nevertheless, the text of Regulation Crowdfunding only makes it clear that crowdequity for business is regulated. To find out whether crowdlending comes within the remit of Regulation Crowdfunding it is necessary to look at the SEC’s Cease and Desist Order. As was explored in chapter 1, the SEC’s Cease and Desist Order interprets crowdlending as dealing with a security and therefore comes within the remit of Regulation Crowdfunding.

Of all the comparator jurisdictions the US and the EU are the only jurisdictions that make it clear in the title of their regulatory frameworks that crowdlending might be within their scope. Therefore, both gain from signalling in their title that crowdlending might be within its scope aiding legal certainty. The UK, New Zealand, and Australia to varying extents rely on secondary materials to communicate that crowdlending is addressed in its regulatory framework. As a result, Australia, New Zealand, and the UK do not benefit from any legal certainty signalling from the name of their regulatory frameworks. However, both send some signalling in other less obvious ways.

e) Conclusion

In conclusion, it can be said that by comparison, the EU is largely adequate in achieving its regulatory goal of legal certainty. There are concerns that the ECSPR’s focus on detail may result in a regulatory maze that is too difficult to


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navigate. There are also some areas where the EU can improve and further clarify its position as highlighted in chapter 3.

E. Conclusion

Using the findings from chapter 3, this chapter explored the regulatory responses to crowdlending across Australia, New Zealand, the UK, and the US. Chapter 5 will discuss in detail the findings of this chapter, make recommendations, and propose a way forward.

Chapter 3 found that the ECSPR’s passporting mechanism is an adequate way to address its competition goal. However, this chapter finds that the ECSPR’s penalty sanctions\(^{616}\) and marketing communications requirements mean that the ECSPR is not entirely adequate in its harmonisation efforts under its competition goal.\(^ {617}\)

The market efficiency analysis found that there is an argument for removing the upper €5 million 12-month limits for crowdfunding offers from the ECSPR. The argument is particularly persuasive because Australia and the UK do not prescribe an upper limit in their regulatory frameworks.\(^ {618}\)

The investor protection and other users investigation found that the ECSPR’s focus on enabling wise decision-making through defaults and behavioural-science-informed investor self-responsibility echoes the measures in the UK.\(^ {619}\)

\(^{616}\) ECSPR article 39; See further chapter 3.

\(^{617}\) See further a) Enforcement.

\(^{618}\) The US has raised its limit to match the EU’s limit and New Zealand has a significantly lower limit.

\(^{619}\) For example, UK - FCA Handbook COBS 4.7.7R-13G, 10.2.9G(1), CONC 11.2.3R.
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Australia and New Zealand rely on disclosures. The US is somewhere between the other four jurisdictions as it uses standardised disclosure documents and a knowledge assessment.

The client protection inquiry found that the EU’s client protection measures often detailed prescribing for example methodologies that should be used by the CSP so that clients would be protected. However, Australia, New Zealand, and the UK took a general principles approach bolstered by business conduct requirements.

The risk-based regulatory analysis found the ECSPR has addressed the risks in more detail than most of the jurisdictions examined in this chapter apart from the UK. Generally, the UK matched the ECSPR’s detail. Sometimes the UK surpassed the ECSPR’s detail and in some instances, the UK provided fewer details than the ECSPR.

The legal certainty examination found that the ECSPR is largely adequate in achieving its regulatory goal of legal certainty. However, there are areas where

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620 Australia - Corporations Act 2001 Chapter 7 Part 7.9; Australia - Corporations Regulations 2001 Chapter 7 Part 7.9, Schedule 10.
623 US - Rule 303(b)(2) Regulation Crowdfunding, 17 CFR § 227.303(b)(2) (2021); See further (a) Knowledge Tests.
625 See for example ; New Zealand - Financial Markets Conduct Regulations 2014 reg 215(1)(h)-(j); UK - FCA Handbook COBS 18.12.8R.
626 See for example chapter 4 CSP Failure the discussion on business continuity plans.
627 See for example chapter 4 Information Asymmetry the discussion on knowledge assessments.
628 See for example chapter 4 Information Asymmetry the discussion on standardised disclosure documents and the simulation of loss analysis.
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the ECSPR could be more adequate and these will be explored in chapter 5. The next chapter discusses the findings of this chapter.
CHAPTER V. THE WAY FORWARD

A. Introduction
Using the findings from chapters 3 and 4, this chapter explores the way forward for the EU and the ECSPR. Section B sets out the current position of the ECSPR. Section C explores the way forward for the ECSPR and the EU is outlined. Section D provides some discussion. Section E investigates future possibilities. Section F provides conclusions.

B. The ECSPR’s Current Position
This section explores (1) the ECSPR’s implementation in the Member States, (2) the ECSPR’s application in practice, (3) a discussion of the ECSPR itself and whether it achieves its regulatory goals adequately for crowdlending, and (4) a comparison of the ECSPR’s goals with the goals initially put forward in the proposal that formed the basis of the ECSPR.

1. The ECSPR’s Implementation in the Member States
At the time of writing, the ECSPR has not yet been fully implemented across the 27 Member States. As of 4 October 2022, 12 of the 27 Member States have published national provisions concerning the marketing requirements in the ECSPR. As of 4 October 2022, 19 of the 27 Member States have established

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national competent authorities' (‘NCAs’) complaints mechanisms.\(^4\) Many of the Member States have fulfilled their obligations under article 39 of the ECSPR in setting down national rules on penalties under the ECSPR such as Finland, France, Germany, Hungary, Ireland, Latvia, Lithuania, Luxembourg, Malta, Poland, Portugal, Romania, Slovenia, Spain, and Sweden.\(^5\) It is difficult to source definite figures on the status of Member States’ implementation of penalties under the ECSPR as ESMA does not publicly share the information collated under article 39 of the ECSPR.

It is unclear why the EU legislators decided against an ESMA reporting mechanism for penalties\(^6\) while providing for such a reporting mechanism for advertising requirements.\(^7\) It could indicate that there is a real concern that crowdfunding service providers (‘CSPs’) will ‘jurisdiction shop’ according to whether a jurisdiction has the least onerous sanctions. However, a report

\(^4\) ECSPR article 38(2); European Securities and Markets Authority, ‘European Crowdfunding Service Providers for Business Regulation (2020/1503) Miscellaneous Reporting to ESMA’ (n 2) 27-29.
\(^5\) Finland - Laki joukkorahoituspalvelun tarjoamisesta 203/2022; France - ordonnance n° 2021-1735 du 22 décembre 2021; Germany - Gesetz zur begleitenden Ausführung der Verordnung (EU) 20201503 und der Umsetzung der Richtlinie EU 20201504 zur Regelung von Schwarmfinanzierungsdienstleistern (Schwarmfinanzierung-Begleitgesetz) und anderer europarechtlicher Finanzmarktvorschriften; Hungary - Nyolcadika. Rész A Közösségi Finanszírozásra Vonatkozó Szabályok of 2001. évi CXX. Törvény a tőkepiacról; Ireland - European Union (Crowdfunding) Regulations 2021 SI No 702 of 2021; Malta - Crowdfunding Rules; Latvia - Kolektīvās finansēšanas pakalpojumu likumam 202276.2; Lithuania - Sutelktinio Finansavimo Įstatymo Nr. XII-2690 Pripažinimo Netekusiu Galios Įstatymas; Luxembourg - Loi du 25 février 2022 portant no 84 du 4 mars 2022; Poland - USTAWA z dnia 7 lipca 2022 r. o finansowaniu społecznościowym dla przedsięwzięć gospodarczych i pomocy kredytobiorcom Dz. U. 2022 poz. 1488; Romania - Legea nr. 2442022 privind stabilirea unor măsuri de punere în aplicare a Regulamentului (UE) 2020/1.503 al Parlamentului European și al Consiliului din 7 octombrie 2020 privind furnizorii europeni de servicii de finanţare participativă pentru afaceri și de modificare a Regulamentului (UE) 2017/1.129 și a Directivei (UE) 2019/1.937; Portugal - Lei n. 3/2018, de 9 de fevereiro; Slovenia - č. 4832001 Z. z. o bankách a o zmene a doplnení niektorých zákonov v znení neskorších predpisov a ktorým sa menia a doplňujú niektoré zákony; Spain - Título V de la Ley 52015, de 27 de abril, de fomento de la financiación empresarial; Sweden - Lag (2021899) med kompletterande bestämmelser till EUs förordning om gräsrotsfinansiering.
\(^6\) ECSPR article 39.
\(^7\) ECSPR article 28.
collating information on Member States’ sanctions under article 39 of the ECSPR could accidentally assist CSPs in this jurisdiction shopping endeavour. The lack of a reporting mechanism could also mean that EU legislators prefer to communicate information that assists CSPs with their compliance endeavours rather than collating and reporting the Member States’ sanctions. Although informing CSPs about the threat of potential sanctions could also achieve this end. The threat of possible sanctions may be sufficient to achieve compliance and allow the regulator to whisper\(^8\) its other regulatory requirements such as advertising requirements.\(^9\)

2. The ECSPR’s Application in Practice

As of 7 March 2023, 21 CSPs are authorised under the ECSPR.\(^10\) Twelve CSPs have received authorisation to operate within one Member State.\(^11\) Five CSPs have availed of passporting possibilities under the ECSPR and informed their home NCA that they wish to provide services across the 27 Member States.\(^12\) Four CSPs have received authorisation that have indicated that they wish to provide their services in a select number of Member States.\(^13\)

The ECSPR’s transitional period has been extended to 10 November 2023.\(^14\) This extension was much to the relief of the CSPs who had previously stated that if

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\(^8\) Ian Ayres and John Braithwaite, *Responsive Regulation: Transcending the Deregulation Debate* (Oxford University Press 1995) ch 2.
\(^9\) ECSPR article 28.
\(^11\) Ibid.
\(^12\) Ibid.
\(^13\) Ibid.
\(^14\) ECSPR article 51; Commission Delegated Regulation (EU) 2022/1988 of 12 July 2022 extending the transitional period for continuing to provide crowdfunding services in accordance with
the transitional period was not extended many CSPs would be ‘out of business’ as they had not yet sought authorisation under the ECSPR. As explored in chapter 3, ESMA in its technical advice to the Commission on the extension of the transitional period under article 48(3) of the ECSPR shared insights as to why CSPs had not yet sought authorisation. One of the reasons cited was that the CSPs were waiting for the draft Delegated Regulations to be finalised which are not expected to be finalised before the end of 2022.

NCAs are already showing differences in their approaches to the ECSPR. Thus adding to the market fragmentation evidenced by the penalties and marketing communications requirements. Some NCAs have indicated that there is a national law as referred to in Article 48(1) of Regulation (EU) 2020/1503 of the European Parliament and of the Council [2022] OJ L273/3 (‘Delegated Regulation [2022] OJ L 227/3’).

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18 ECSPR articles 28, 39; See further 1. The ECSPR’s Implementation in the Member States; chapter 3.
streamlined authorisation process for CSPs that are already authorised within their national regulatory frameworks such as France, Netherlands, and Spain. Some NCAs, such as Malta and Sweden, are charging an authorisation application fee. In a survey conducted by Eurocrowd, more than two-thirds of the respondents had not found an insurance provider for the prudential requirements under article 11 of the ECSPR. This indicates a gap in the insurance market that may not have been foreseen by the EU legislators. However, if no insurance provider can be found, the CSP must comply with the prudential requirements using their own funds. Thus further exacerbating the initial regulatory compliance costs which are estimated to range from €15,000 to €50,000. Eurocrowd has stepped in to fill the gap in the market. On 21 December 2022, Eurocrowd announced an insurance policy in line with article

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22 ECSPR article 11.


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11 of the ECSPR.\textsuperscript{25} Eurocrowd paired with UK insurance broker Protean Risk to develop the solution.\textsuperscript{26} Unfortunately, the insurance product is only available for CSPs based in Ireland, Malta, Luxembourg, Denmark, Finland, Norway, Sweden, the Netherlands, and Belgium.\textsuperscript{27}

There have been some attempted mergers in the UK in response to the new opportunities under the ECSPR: there was an ‘attempted merger of Crowdcube and Seedrs’ and the acquisition of Seedrs by Republic from the US.\textsuperscript{28} This raises the question as to whether there will be further mergers in the future and whether more US actors will purchase EU CSPs to gain a foothold in the EU market.

3. Discussion of the ECSPR
The ECSPR can be classified in many ways. It is a \textit{sui generis} regulatory framework. The ECSPR is targeted in its approach by incorporating flexibility and defaults. It relies on an investor self-responsibility principle using measures that combine optional law elements and behavioural-science-informed tools.\textsuperscript{29}

The ECSPR’s framework is a risk-based regulatory framework that also has some features of principles-based and business-conduct-based regulatory frameworks.\textsuperscript{30}

\textsuperscript{25} ibid.
\textsuperscript{26} ibid.
\textsuperscript{27} ibid.
\textsuperscript{28} Daniel Thomas, ‘Seedrs Bought by US Group after Merger of UK Rivals was Blocked’ \textit{Financial Times} (London, 1 December 2021); Thistle, ‘New EU Regulation sees European Market Open to UK P2P Lenders’ (Thistle, 28 February 2022) \texttt{<www.thistleinitiatives.co.uk/newsletter-credit/new-eu-regulation-sees-european-market-open-to-uk-p2p-lenders/>} accessed 7 March 2023.
\textsuperscript{29} See chapter 3.
\textsuperscript{30} ibid.
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It also uses a calibrated precautionary approach as, in contrast to the US, the ECSPR addresses risks that are currently low in the market such as systemic risk. Additionally, there have not yet been reports of mass frauds, money-laundering scandals, or cyber risk in the EU business crowdlending market. Yet, the ECSPR has developed business conduct requirements to counter fraud, applied the pre-existing EU regulatory frameworks on anti-money laundering or payment services, and the EU regulatory framework on cyber-risk will apply to crowdlending from 17 January 2025 too. It is therefore active in addressing the areas it wishes to take precautionary measures while also using pre-existing or, in this instance, specifically designed regulatory frameworks to address the areas it wishes to take precautionary measures.

a) Competition
Chapter 4 found parts of the EU’s regulatory requirements that are set out in the comparator jurisdictions’ requirements. The EU is similar to Australia as both require marketing communications that are not misleading and that the marketing communications are consistent with the standardised disclosure

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31 See chapter 3 Systemic Risk.
32 See for example ECSPR article 5.
36 Australia - Australian Securities and Investments Commission Act 2001 s 12DA, 12DB; Australia - Corporations Act 2001 s 1041H; ECSPR article 27(2).
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document. However, the EU’s duty that ‘marketing communications shall be fair, clear and not misleading’ is very similar to the UK’s requirement that financial promotions must be fair, clear, and not misleading.

Taking the international approach into context, the EU is unusual in setting out crowd-lending-specific enforcement measures. Greater harmonisation is achieved in the comparator jurisdictions on penalties. As outlined in chapter 3, it remains to be seen whether the balance struck in relation to penalties and marketing communications requirements will be adequate despite the lack of harmonisation. The ECSPR proceeded under Article 114 of the Treaty on the Functioning of the European Union which allows for harmonised legislation in the EU. The EU may have struck the right balance between respect for Member State sovereignty and its efforts for harmonisation for penalties. However, further harmonisation may be needed for marketing communications.

The analysis under this financial regulatory goal highlights the differences in the comparator jurisdictions. The comparator jurisdictions, Australia, New Zealand, the UK, and the US, are all jurisdictions with more legislative autonomy than the EU. In future research, an evaluation of the ECSPR’s adequacy in achieving its competition financial regulatory goal could be conducted on a comparative basis against either (1) other EU financial regulatory frameworks or (2) a Member State’s enforcement and marketing

37 Australia - Corporations Act 2001 s 734; ECSPR article 27(2).
38 ECSPR article 27(2); See further chapter 3.
39 UK - FCA Handbook COBS 4.2.1R(2)(c); See further chapter 4.
40 ECSPR article 39.
41 ibid.
42 ECSPR article 28.
communications mechanisms under the ECSPR against the comparator jurisdictions in this thesis. For example, Ireland has applied its pre-existing enforcement framework as its enforcement mechanism under the ECSPR. 

\textbf{b) Market Efficiency}

In chapter 3, three mechanisms were considered under the framework of market adequacy or more specifically allocative efficiency: 1 authorisation and passporting, 2 bulletin boards, and 3 the €5 million limit. The authorisation, passporting and bulletin board provisions under the ECSPR significantly add to the ECSPR’s attainment of allocative efficiency. Bulletin boards’ allocative efficiency could be increased if the CSP was allowed to intermediate the transaction. In Australia, the CSP must have an active role in facilitating the early exit from the investment if the CSP is granted permission to operate the secondary market. An option for the EU to action would be to allow CSPs to intermediate on bulletin boards as an exception to multilateral trading facility requirements under MiFID II. This is not a perfect option. It raises possible regulatory arbitrage concerns where MiFID II operators might evolve into CSPs purely to circumvent the more onerous requirements under MiFID II.

\begin{itemize}
\item[Ireland - European Union (Crowdfunding) Regulations 2021, SI 2021/702 regulation 9.]
\item[ECSPR articles 3(1), 12, 13, 17.]
\item[ECSPR articles 18, 12(12).]
\item[ECSPR article 25.]
\item[ECSPR article 1(2)(c).]
\item[MiFID II article 4(1)(22).]
\end{itemize}
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From an allocative efficiency perspective, there is an argument for removing the upper €5 million 12-month limits for crowdfunding offers from the ECSPR. The argument is particularly persuasive considering Australia’s and the UK’s positions where neither prescribes an upper limit in their regulatory frameworks.\(^{51}\) Admittedly the EU must balance the same activity same rules considerations in light of the EU’s prospectus requirements\(^{52}\) and the ECSPR’s goal to enable SMEs to access capital markets. The EU must also consider the potential harms and benefits of raising or removing the limit and upon whom or what the effects would be felt.

In summary, there is no clear path forward for the ECSPR to further improve allocative efficiency. Having no upper limit, such as in the UK, may not be a solution for the EU. Regulatory arbitrage concerns would remain for the EU owing to the interaction between the ECSPR and the Prospectus Regulation. A possible intermediary solution would be to raise the ECSPR’s limit to €8 million by increasing harmonisation on the threshold requirement for a prospectus in the EU. Current feedback from CSPs in the EU market may however mean that the EU will have no choice but to address the €5 million limit.\(^{53}\) The ECSPR has not yet reached full legal effect across the EU and CSPs are already raising the issue of the €5 million limits and the challenges it causes for their business.\(^{54}\)

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\(^{51}\) The US has raised its limit to match the EU’s limit and New Zealand has a significantly lower limit; See further chapter 4.

\(^{52}\) ECSPR recital 16; Parliament and Council Regulation (EU) 2017/1129 of the of 14 June 2017 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market, and repealing Directive 2003/71/EC [2017] OJ L168/12 (‘Prospectus Regulation’); See further chapter 3.

\(^{53}\) European Securities and Markets Authority, ‘Final Report: ESMA’s Technical Advice to the Commission on the Possibility to Extend the Transitional Period Pursuant to Article 48(3) of Regulation (EU) 2020/1503’ (n 15) 7.

\(^{54}\) ibid.
c) Investor Protection and Other Users

(1) Investor Protection

The shift to consumerisation in investor protection since the Global Financial Crisis, noted in chapter 2, is seen in the ECSPR.\(^{55}\) A precautionary theme comes through in the ECSPR’s stance on investor protection.\(^{56}\) Although the precautionary theme is at loggerheads with the evident self-responsibility principle seen for investor protection in the ECSPR.\(^{57}\) The focus of the ECSPR’s investor protection is on enabling informed decision-making through defaults, behavioural-science-informed measures and a strong emphasis on investor self-responsibility.\(^{58}\) The only other jurisdiction with a similarly strong emphasis on enabling wise decision-making through a variety of measures is the UK.\(^{59}\) Although the UK decided against using standardised disclosure documents for crowdlending. There is less diversity in the investor protection measures seen in Australia and New Zealand with their reliance on standardised disclosure documents.\(^{60}\) However, the US sits halfway between Australia and New Zealand at one end and the UK and the EU at the other, using standardised disclosure documents\(^{61}\) and a knowledge assessment.\(^{62}\)

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\(^{55}\) See further chapter 3.
\(^{56}\) ibid.
\(^{57}\) ibid.
\(^{58}\) ibid.
\(^{59}\) See further chapter 4.
\(^{60}\) Australia - Corporations Act 2001 Chapter 7 Part 7.9; Australia - Corporations Regulations 2001 Chapter 7 Part 7.9, Schedule 10; New Zealand - Financial Markets Conduct Regulations 2014 regs 213-218; See further chapter 4.
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The comparison in chapter 4 found the UK specifically outlines the risks that must form part of the knowledge assessment\(^63\) while the ECSPR does not. This is an area where improvements could be made.\(^64\)

(2) Client Protection

Australia, New Zealand, and the UK take similar approaches to client protection. In general, the UK is the most prescriptive combining its detailed requirements with general principles.\(^65\) Although, Australia, New Zealand, and the UK in the main take a general principles approach bolstered by business conduct requirements by asking the CSP to demonstrate compliance with a principle or requirement.\(^66\) Contrastingly, the EU instead tells the CSP how to comply with the regulatory framework by setting out a specific methodology.\(^67\)

The US is an outlier in its approach to client protection. The US focuses more on disclosures and the risks that might flow from the project owner’s business rather than the CSPs’ business. The US, instead of requiring the CSP to put in

\(^{63}\) UK - FCA Handbook COBS 10.2.9G(j).
\(^{64}\) See further 3. Prescribe Risks to be Assessed in the Knowledge Assessment.
\(^{65}\) See for example the factors that must be taken into account in a credit risk assessment UK - FCA Handbook COBS 18.12.8R (3). Whereas Australia takes the disclosure approach and New Zealand asks for policies in the licence application. Australia - Corporations Act 2001 s 1013D(1)(d)(i), 1013D(1)(e); New Zealand - Financial Markets Conduct Regulations 2014 reg 215(1)(h)-(j); See further chapter 4.
\(^{66}\) See for example; New Zealand - Financial Markets Conduct Regulations 2014 reg 215(1)(h)-(j); UK - FCA Handbook COBS 18.12.8R; See further chapter 4.
place procedures to account for the risk, requires the project owner to disclose information.\textsuperscript{68}

There are some measures that the EU could use to improve the ECSPR’s adequacy in protecting clients namely (1) an examination of the organisational competence, and (2) requiring CSPs to establish recruitment and human resources processes to ensure the right skills and experience are recruited. The EU could also consider at some point in the future using some form of periodic NCA review clause to ensure continuous compliance with the capability requirements in the ECSPR. A periodic NCA review mechanism would be useful if it is found that there is widespread non-compliance with the capability requirements in the future.

d) Risk-Based Regulatory Model

The ECSPR has addressed the risks in more detail than most of the jurisdictions examined in chapter 4 except the UK. In the main, the UK matched the ECSPR’s detail.\textsuperscript{69} Sometimes the UK surpassed the ECSPR’s detail\textsuperscript{70} and in some instances, the UK provided fewer details than the ECSPR.\textsuperscript{71}

While systemic risk is low in the EU business crowdlending market,\textsuperscript{72} the ECSPR has put in place prudential measures. This is a very forward-looking position for

\textsuperscript{68} See discussion in chapter 4 on client protection regarding the disclosure of a discussion of the project owner’s financial condition. US - Rule 201(s) Regulation Crowdfunding, 17 CFR § 227.201(s) (2021); See further chapter 4.

\textsuperscript{69} See for example chapter 4 CSP Failure the discussion on business continuity plans.

\textsuperscript{70} See for example chapter 4 Information Asymmetry the discussion on knowledge assessments.

\textsuperscript{71} See for example chapter 4 Information Asymmetry the discussion on standardised disclosure documents and the simulation of loss analysis.

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the EU to take on systemic risk. In chapter 4 it was found that the ECSPR is the most adequate in addressing systemic risk. The measures that the ECSPR puts in place are a mix of prescriptive requirements and flexible requirements. The prudential measures target areas that the EU is concerned about such as contingency fund plans.

By comparison, the ECSPR is adequate at achieving its regulatory goals. The ECSPR’s response is a good beginning. However, the risks in the EU crowd-lending market will evolve. Systemic risk might become more prevalent in the future. As a result, a gap in the ECSPR’s response to risk is that it needs a mechanism that allows the ECSPR to adapt in the future to changing markets. The below analysis explores the risks where the ECSPR could be more adequate in responding to those risks.

(1) Liquidity Risk
The analysis in chapter 4 found that by comparison, the ECSPR was inadequate in addressing liquidity risk. Currently, liquidity risk is addressed in the standardised disclosure document the Key Investment Information Sheet (‘KIIS’)


74 ECSPR article 25(3); See further chapter 3.

Reintermediation? in Emiliou Avgouleas and Heikki Marjosola (eds), Digital Finance in Europe: Law, Regulation, and Governance (De Gruyter 2022) 51 Macchiavello; See further chapter 3.
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to liquidity risk in crowdlending.\textsuperscript{75} Australia among other obligations requires the CSP to prominently place information on the website about the secondary market.\textsuperscript{76} However, the UK explicitly requires CSPs to assess a non-sophisticated investor’s understanding of liquidity risk in the knowledge assessment.\textsuperscript{77}

\textbf{(2) Default Risk}

Despite the EU having very detailed requirements to address both default risk and contingency funds, the EU is exposed in a key area.\textsuperscript{78} The EU’s requirements for contingency funds only apply where the CSP selects the loans as part of its portfolio management services.\textsuperscript{79} Why the policy decision was made to apply regulatory requirements to contingency funds only in the case of portfolio management of loans is unclear. Contingency funds can be used by CSPs where the investor has selected the loan. The ECSPR’s position goes against the same activity same rules principle. The same activity same rules principle was highly influential for the EU’s bulletin boards. Nonetheless, the principle is all but disregarded in the context of contingency funds. Notably, the UK’s requirements for contingency funds apply regardless of whether the investor or the CSP selects the loans.\textsuperscript{80}

In relation to buy-back obligations, Australia is possibly the only jurisdiction with a regulatory requirement that might cover this new development.\textsuperscript{81} This

\textsuperscript{75} See further 4. Liquidity Risk.
\textsuperscript{76} Australian Securities and Investment Commission REP 420 (n 48) 22; See further chapter 4.
\textsuperscript{77} UK - FCA Handbook COBS 10.2.9G(j); See further chapter 4.
\textsuperscript{78} See further chapter 3.
\textsuperscript{79} ibid.
\textsuperscript{80} See further chapter 4.
\textsuperscript{81} Australia - Corporations Act 2001 Part 7.9; Australian Securities and Investment Commission, ‘Information Sheet 213 Marketplace Lending (Peer-to-Peer Lending) Products’ (INFO 213, March
demonstrates the benefits of having a general principles approach as it can sometimes include new developments that are outside the scope of detailed requirements.

(3) CSP Failure
Chapter 4 found that the EU, New Zealand, and the UK were the only jurisdictions with a business continuity plan requirement. The EU and UK have highly detailed requirements. However, New Zealand has a broad general principle requirement that a CSP should have a plan for the continuity of services should the CSP’s services cease with some additional detail.\(^{82}\)

It was found in chapter 4 that on balance detailed requirements were the more adequate approach for the EU. It is unclear at this point whether the significantly more detailed requirements in the UK will be necessary for the EU.\(^{83}\) Increasing regulatory requirements generally increase regulatory costs. Currently, it has been indicated that CSPs will have to crowdfund the costs of initial regulatory compliance.\(^{84}\) Perhaps it is something for the EU to consider if the risk of CSP failure increases in the future. Although it is not a point that is included in the review in article 45 of the ECSPR.

However, the EU’s approach could be made more adequate in its aims to address CSP failure by mirroring New Zealand in one area. New Zealand applies business continuity plans where the CSP ceases to provide its services.\(^{85}\) On

\(^{82}\) New Zealand - Financial Markets Conduct Regulations 2014 reg 187(f); See further chapter 4.
\(^{83}\) UK - FCA Handbook CASS 10, SYSC 4.1.8AR-DDR; See further chapter 4.
\(^{84}\) Eurocrowd, ‘Insights on the ECSPR Licensing Process’ (n 18).
\(^{85}\) New Zealand - Financial Markets Conduct Regulations 2014 reg 187(f); See further chapter 4.
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close inspection of the scope of the business continuity plan, it could be interpreted to apply to situations where a CSP ceases its services. However, considering the ECSPR’s legal certainty goal, it should be made clear that the business continuity plan applies to CSPs who choose to cease their services like in New Zealand.\(^\text{86}\)

(4) Information Asymmetry and Inexperience
The ECSPR is by comparison the most adequate of the regulatory regimes examined in delivering the essential information in a standardised disclosure document. Thus, by comparison, the ECSPR is adequate in addressing information asymmetry and inexperience. What remains to be seen is whether the delivery of the comparator jurisdiction’s combined ideas on what constitutes essential information will result in oversaturating the investor. Nevertheless, the ECSPR’s standardised disclosure document - the KIIS - is hampered by the issues raised in chapter 3. These issues concern the credit agreement definition and information about exiting the investment. It is hoped that the split approach by ESMA and EBA to the credit agreement definition and information about exiting the investment will be remedied by the EU before all the draft regulatory technical standards become delegated acts.

In conclusion, the EU’s standardised disclosure document combines a mix of disclosure requirements from all jurisdictions. The ECSPR’s monetary information requirements\(^\text{87}\) are similar to those in New Zealand\(^\text{88}\) and the UK’s

\(^{86}\) ibid.
\(^{87}\) ECSPR annex I part H.
\(^{88}\) New Zealand - Financial Markets Conduct Regulations 2014 reg 215(1)(d), (e), (j), (o); See further chapter 4.
disclosure requirements\textsuperscript{89} and the project owner information disclosures are similar to those in the US.\textsuperscript{90} Then the EU’s paternalistic disclosures\textsuperscript{91} about investor rights overlap with Australia\textsuperscript{92} and New Zealand.\textsuperscript{93} Thus, the EU’s standardised disclosure document combines the best qualities of all the jurisdictions. As a result, the EU’s standardised disclosure document is adequate in delivering a combination of the information that has been deemed key in all the comparator jurisdictions. It is unclear whether this combination approach taken by the EU will saturate investors with too much information or adequately inform the investors to address information asymmetry and inexperience. This certainly is one of the few instances where the UK’s approach does not address information asymmetry and inexperience adequately. There is nothing to prevent the essential information from being delivered to investors in a large and difficult-to-navigate document.

The Australian approach to secondary markets is adequate. Australia requires CSPs if they accept the request to exit to satisfy the request generally within five business days.\textsuperscript{94} New Zealand and the UK all leave the degree of intermediation on secondary markets for the market to decide. While the US regulatory framework is silent on the operation of secondary markets. The EU’s

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\textsuperscript{89} UK – FCA Handbook COBS 18.12.26R(1)-(8), (10)-(12), 31R(1)-(8), (10)-(12); See further chapter 4.

\textsuperscript{90} US - Rule 201(e), (p), (q), (r), (s), (t), (w) Regulation Crowdfunding, 17 CFR § 227.201(e), (p), (q), (r), (s), (t), (w) (2021); See further chapter 4.

\textsuperscript{91} ECSPR annex I part F.

\textsuperscript{92} Australia - Corporations Act 2001 ss 1013D(1)(g), 1013C(3), (4), (5), (6); See further chapter 4.

\textsuperscript{93} New Zealand - Financial Markets Conduct Regulations 2014 reg 215(1)(f), (i), (k), (l), (n), (4); See further chapter 4.

\textsuperscript{94} Australian Securities and Investment Commission REP 420 (n 48) 22; See further chapter 4.
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requirements\(^{95}\) impede adequacy as the transaction must be negotiated outside of the CSP’s platform and possibly negatively impact the bulletin board’s capacity to respond to the liquidity risk to which investors are exposed.

However, the EU is the most adequate by comparison in addressing information asymmetry and inexperience on its bulletin board. The EU allows a reference price to be suggested and requires the KIIS to be shared and the risk warning to be passed on.\(^{96}\)

\((5)\) Fraud Risk

All the jurisdictions used their pre-existing regulatory frameworks to respond to fraud risk in crowdlending. This agreement indicates that fraud requires one single regulatory response despite even the new context of crowdlending. It indicates that a market facilitatory but at the same time paternalistic stance is taken to fraud. By comparison, the EU is the most adequate in addressing fraud risk. This is however solely because the EU is the only jurisdiction of the jurisdictions compared to respond to automated models.\(^{97}\) It indicates that the EU has carefully considered the crowdlending business model. It also indicates that the EU is consistently applying the same activities same rules and principles as the EU has applied a single specialised regulatory framework to specific fraud risks regardless of the context in which it occurs. This indicates that the EU has carefully considered the crowdlending business model and the use of automated models in the market.

\(^{95}\) See further chapter 3.
\(^{96}\) ECSPR article 25(3)(b); See further chapter 3.
\(^{97}\) See further chapter 3.
(6) Pricing, Credit Risk Assessment, and Credit Scoring
The EU’s regulatory response to pricing, credit risk assessment and credit scoring is incredibly detailed, perhaps excessively so. The ECSPR’s regulatory requirements for pricing, credit risk assessment and credit scoring focus on legal certainty and investor protection and other users goals rather than its allocative efficiency goal to place capital in the hands of SMEs. This is likely because non-sophisticated investors rely on the CSP’s competency as it is unlikely that a non-sophisticated investor will be sufficiently competent to conduct their assessment. This reliance means that there is a potential risk for CSPs to abuse their position of trust which could result in non-sophisticated investors losing their investment.

(7) Systemic Risk
The comparative analysis found that the EU has struck a balance between flexibility and specificity for the prudential capital requirements. The EU achieved balance through a set monetary requirement or an insurance policy requirement. The EU has also targeted areas of specific concern with indirect prudential requirements namely credit risk assessments and contingency fund plans. The EU’s regulatory response to systemic risk is by comparison more detailed than the responses in the other jurisdictions. Although, it is the flexibility of the regulatory requirements that by comparison, that means that

98 See further chapter 4.
99 ibid.
100 ECSPR article 11; See further chapter 4.
102 ECSPR article 6(5), (6); See further chapter 4.
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the EU’s regulatory requirements addressing systemic risk are more adequate. This flexibility allows CSPs to respond to systemic risk in a way that suits the size of their business model.

(8) Other Issues
Challenges that were specifically flagged in chapter 4 were: 1 self-responsibility principles for investor protection, 2 ambiguities regarding the CSP’s role in verifying the KIIS, 3 the extent of the CSP’s responsibility in selecting the project owners, 4 consumer project owners and 5 the €5 million aggregate limit for project owners.103

On some of the issues, the other jurisdictions have taken the same approach as the ECSPR for example, consumer project owners. All the other jurisdictions (Australia, New Zealand, the UK, and the US) have addressed consumer project owner protection under a different regulatory regime. Some of the jurisdictions tailored parts of their pre-existing consumer project owner regulatory framework to crowdlending such as the UK.104 Nevertheless, the other jurisdictions applied their pre-existing consumer project owner regulatory framework to crowdlending.105 No jurisdiction has completely re-drafted its consumer project owner protections.

The other issues are either not mentioned, not an issue or have a similar approach such as standardised disclosure document verification, and project

103 Macchiavello and Sciarrone Alibrandi, ‘Marketplace Lending as a New Means of Raising Capital in the Internal Market: True Disintermediation or Reintermediation?’ (n 71) 25, 36 Sciarrone.
104 UK - FCA Handbook CONC 4.3.4.
105 Australia - National Consumer Credit Protection Act 2009; New Zealand - Credit Contracts and Consumer Finance Act 2003; In the US there is a swathe of laws applicable to consumer project owners. An example is US - Truth in Lending Act.
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owner selection responsibility. The €5 million aggregate limit is comparable to the limit found in the US. However, Australia and the UK do not use an aggregate 12-month borrowing limit. This issue is explored further under the heading of Market Efficiency.

First, the issues surrounding CSP’s responsibility for verifying the standardised disclosure document are unclear in the regulatory frameworks in Australia, New Zealand, the UK, and the US. In Australia, the CSP would be responsible for meeting the standard disclosure document requirements. Nevertheless, it is unclear about the CSP’s role in verifying the information.

Second, regarding the CSP’s responsibility in selecting project owners in Australia, ASIC suggests as a good practice requirement that CSPs should disclose their policies and procedures for managing project owner selection. Contrastingly, New Zealand requires disclosures about the project owner’s due diligence procedures. The UK requires disclosures about due diligence and sets out assessment criteria. However, the closest the US comes to detailing project owner selection responsibility is its fraud requirements. Nevertheless, none of these measures specifically address responsibility for project owner selection. Project owner selection responsibility is even more important where individual loan portfolio management services are provided. The UK is the only regulatory framework to specifically address individual loan

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107 See further chapter 4.
108 Australian Securities and Investment Commission INFO 213 (n 80).
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portfolio management. The closest the UK comes to elaborating on project owner selection responsibility is a requirement for the CSP to disclose its role.\textsuperscript{112} However, the analysis of pricing, credit risk assessment, and credit scoring in chapter 4 shows the extent of the CSP’s responsibilities when pricing loans. As a result, the EU’s approach to project owner selection is comparable to the other jurisdictions. Although, its adequacy is still questionable. Time will tell if the EU’s measures are adequate in these circumstances.

e) Legal Certainty

In chapter 4, it was found that the ECSPR is adequate in achieving its regulatory goal of legal certainty. It is clear from the title of the ECSPR and the scope of the ECSPR that crowdlending is regulated by the ECSPR. This creates significant signalling to the market about crowdlending’s regulatory position in the EU and adds to the EU’s regulatory goal of legal certainty.

There are areas where the ECSPR has not been adequate in addressing legal certainty. Thus undermining the ECSPR’s contribution to a single market objective and means that regulatory fragmentation remains.

One such area is consumer crowdlending because it falls outside the scope of the ECSPR. As was explored in chapter 3, consumer crowdlending is a large market in the region of Europe. Furthermore, consumer loans are a frequent form of financing business\textsuperscript{113} at the embryonic stages of development. At

\textsuperscript{112} UK - FCA Handbook COBS 18.12.24R.
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present, the consumer crowdlending market cannot operate under the same regime across the EU.

Another area where market fragmentation remains is the fact that Member States are required to have their own rules about penalties and marketing communications. It is unclear why a margin of appreciation is afforded to Member States on both penalties and marketing communications. There are parts of the marketing communication and penalties requirements that mirror MiFID II. The ECSPR is similar to MiFID II as both require marketing communications to be ‘fair, clear and not misleading’. The ECSPR is also similar to MiFID II in that both leave it to the Member State to decide whether to impose criminal sanctions. Regardless, it reduces ECSPR’s adequacy in addressing legal uncertainty. It remains to be seen whether the marketing requirements will be further harmonised under the ECSPR. However, it is unlikely that the ECSPR will further harmonise penalties as this may be deemed as the EU not respecting Member State sovereignty. The fact that MiFID II also has minimum sanctions and leaves it to Member States to decide to criminalise sanctions makes it less likely that there will be harmonisation in the EU on this point.

\[\text{References}\]

114 ECSPR article 39(1)-(3).
115 ECSPR article 28.
116 Catalina Goanta and others, ‘Marketing Communications and the Digital Single Market’ in Marije Louise and Pietro Ortolani (eds), Crowdfunding and the Law (Oxford University Press 2021) 293 citing ECSPR article 27(2); MiFID II article 24(3).
117 ECSPR article 39; MiFID II article 70.
118 Goanta and others (n 118) 298.
119 MiFID II article 70(6); See further Christos V Gortsos, ‘Public Enforcement of MiFID II’ in Danny Busch and Guido Ferrarini (eds), Regulation of the EU Financial Markets: MiFID II and MiFIR (Oxford University Press 2017).
4. Comparison with the Original Commission Proposal for the ECSPR

The final text of the ECSPR has changed significantly from the Commission’s proposal for the ECSPR. At a basic level, the number of recitals increased significantly between the Commission Proposal (46 recitals) and the ECSPR (79 recitals). Some of the recitals in the Commission Proposal were completely removed such as recital 10 of the Commission Proposal regarding different crowdlending business models which should be accommodated with the law. Overall, the Commission Proposal and the ECSPR have very similar goals. However, the balance struck between the competing goals is different. The Commission Proposal seeks to reduce risk for example. This part will examine some of the salient differences between the Commission Proposal and the ECSPR.

The Commission Proposal had a different thrust to its protection efforts which overtly focused on investor protection. Any reference to clients in the Commission Proposal’s recitals focused on transparency and fairness rather than protection. The ECSPR includes a recital regarding the protection of clients which includes investors but also includes project owners. With this broader focus comes a mention of prudential requirements. As explored in chapter 2, the ECSPR does not have a financial stability goal. However, an addressal of systemic risk comes within the guise of protecting clients.

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120 Commission Proposal recitals 12, 15, 18, 23, 24, 29, 31, 32.
121 Commission Proposal recitals 6, 11, 12, 15, 17, 23, 27, 29-32, 37, 41, 43.
122 Commission Proposal recitals 15, 29, 35, 36.
123 ECSPR recital 24.
124 ECSPR article 11; See further chapter 3.
The Commission Proposal had a competition goal but sought to harmonise the market and balance Member State sovereignty differently. The Commission Proposal envisioned ESMA with a gatekeeper role that went beyond encouraging information sharing and collaboration.\textsuperscript{125} ESMA under the Commission Proposal had an authorisation, monitoring and supervisory role which included sanctioning.\textsuperscript{126} Furthermore, the enforcement component was not left to the Member States as it is under the now ECSPR.\textsuperscript{127} Under the Commission Proposal, the enforcement component was significantly more harmonised.\textsuperscript{128} This demonstrates a different balance between harmonisation under the competition goal and respect for Member State sovereignty. The Commission Proposal balanced respect for Member State sovereignty by making the proposal optional for CSPs.\textsuperscript{129} CSPs could choose to operate on a national basis only within the national regulatory framework or comply with the Commission Proposal and avail of passporting opportunities.\textsuperscript{130}

There are a few factors to take into account to ascertain whether the Commission Proposal or the ECSPR is more adequate in meeting the goals. The shift to a more overt emphasis on client protection encompassing prudential requirements appears to indicate a shift in thinking by the EU. Perhaps the EU considers that crowdlending will eventually become sufficiently large and

\begin{footnotes}
\item[125] See further chapter 3.  
\item[126] Commission Proposal recitals 40-42, Chapter II. 
\item[127] See further chapter 3.  
\item[128] Commission Proposal articles 28-33. 
\item[129] Commission Proposal recital 14, article 2(2)(c). 
\item[130] Commission Proposal recital 14, article 2(2)(c). 
\end{footnotes}
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interconnected to pose a systemic risk that warrants anticipatory measures such as the prudential requirements in the ECSPR.\textsuperscript{131}

Currently, CSPs are still adjusting to the new regulatory burdens and compliance costs under the ECSPR.\textsuperscript{132} It is worth questioning whether in hindsight it would have been better to retain the optional element for CSPs providing their services on a national basis only. This would have provided small CSPs with an opportunity to scale on a national basis before seeking to comply with the ECSPR. However, this line of reasoning would have only been beneficial to CSPs in Member States with a national regulatory framework with a lower regulatory burden and compliance costs than the ECSPR. Such CSPs would have had a competitive advantage over CSPs in Member States with less clear or more onerous national regulatory frameworks. As a result, the optional regulatory framework would not have been conducive to a level playing field. Furthermore, it would have been contrary to the same-activity same-rules principle.

This being said the ECSPR will be attractive and beneficial for larger CSPs who because of economies of scale may be better equipped to manage the new regulatory burdens and compliance costs. Perhaps this will mean that small CSPs will either close or be acquired by larger CSPs. If this is the case, and taken to the extreme, the market might become an oligopoly. An oligopoly might not be in the interests of SMEs and start-ups. CSPs in an oligopoly might collude and participate in cartel behaviour resulting in more expensive credit

\textsuperscript{131} ECSPR article 11; See further chapter 3.
\textsuperscript{132} Eurocrowd, ‘Insights on the ECSPR Licensing Process’ (n 18).
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for SMEs and start-ups. Or, as seen in the UK, EU CSPs may begin to be acquired by US CSPs or investors.

As a result, it remains to be seen whether the ECSPR or the Commission Proposal’s approaches would have been more adequate. There are strengths and weaknesses to each approach. It will depend on how the market reacts to the ECSPR. However, the precautionary approach taken by the ECSPR to systemic risk and prudential requirements might on balance be more adequate. This is particularly the case when the investor protection and other users, risk-based regulatory model and competition goals of the ECSPR are taken into account.

C. The Way Forward for the ECSPR and the EU

This section sets out the way forward for the EU and the ECSPR. The way forward has been informed by the research in chapter 4.

1. Client Protection

There are two measures that the ECSPR could mirror from New Zealand and Australia. The first measure is from New Zealand and it requires CSPs to set out their recruitment and HR processes will ensure the management team has the right skills and experience. The second measure is found in both Australia and New Zealand where organisational competence is assessed as well as an

133 Thomas D (n 27); Thistle (n 27).
134 See also (2) Client Protection.
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individual’s capability. An examination of the organisation’s competence would ensure that the organisation as a system has the competence to engage in crowdlending. The recruitment and HR processes would further ensure and make it clear that continuous compliance is necessary with the capability requirements. Both measures would make the ECSPR more adequate in protecting clients. The EU could also consider at some point in the future using some form of periodic NCA review clause to ensure continuous compliance with the capability requirements in the ECSPR. As set out above, a periodic NCA review mechanism would be useful if it is found that there is widespread non-compliance with the capability requirements in the future.

2. Standardised Disclosure Document - KIIS
The ECSPR is by comparison the most adequate in delivering the essential information in a standardised disclosure document. Nevertheless, there are issues with the ECSPR’s standardised disclosure document. These issues concern the credit agreement definition and information about exiting the investment. These issues should be addressed by the EU before the draft regulatory technical standards and draft Delegated Regulations are finalised. EBA’s credit agreement definition should be used across the entirety of the ECSPR. Currently, EBA’s credit agreement definition is limited to chapter III of the EBA’s draft regulatory technical standards. In other words, EBA’s

137 See also (4) Information Asymmetry and Inexperience.
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definition only applies in the context of individual loan portfolio management under article 6(4)(f) of the ECSPR. However, ESMA’s position that credit agreements need no definition applies to the KIIS. The EU needs to rectify these issues. The EBA’s definition of credit agreements should be used across the entirety of the ECSPR rather than being limited in its application.

3. Prescribe Risks to be Assessed in the Knowledge Assessment
The ECSPR could mirror the UK’s approach of setting a non-exhaustive risk list for the knowledge assessment. The comparison in chapter 4 found the UK specifically outlines the risks that must form part of the knowledge assessment. The Delegated Regulations do not list the risks to be included in the knowledge assessment. The Delegated Regulations should set out a non-exhaustive list of risks to be included in the knowledge assessment. The main risk types from the KIIS could be listed namely: (1) project risk, (2) sector risk, (3) default risk, (4) risk of lower, delayed or no returns, (5) CSP failure risk, and (6) liquidity risk. However, the UK’s knowledge assessment is well-developed and should be looked at also. The UK’s knowledge assessment tests:

1. that returns may vary over time,
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2. that there are no government-backed guarantee schemes that apply to
crowdlending,
3. risk diversification strategies,
4. the risk mitigation measures adopted,
5. that crowdlending is not comparable to a savings account,
6. the characteristics of insurances or guarantees,
7. the contingency fund,
8. outlines that there are no risk mitigation measures that losses are more
likely, and
9. the CSPs role and scope of its services.\textsuperscript{144}

The list must be non-exhaustive as it provides room for responsible CSPs to add
risks to the knowledge assessment as needed. A non-exhaustive list allows for
flexibility while also ensuring that specific known risks are addressed. The
ECSPR’s knowledge assessment should test the six risks from the KIIS and the
nine areas that the UK knowledge assessment targets.

4. Liquidity Risk

It is recommended that the ECSPR should take inspiration from Australia’s
prominent website risk warning requirement\textsuperscript{145} and copy the UK’s explicit
inclusion of liquidity risk in the knowledge assessment.\textsuperscript{146} This recommendation
is despite the research carried out by the Dutch and Australian regulators\textsuperscript{147}

\textsuperscript{144} UK - FCA Handbook COBS 10.2.9G.
\textsuperscript{145} Australian Securities and Investment Commission REP 420 (n 48) 22.
\textsuperscript{146} UK - FCA Handbook COBS 10.2.9G(j); See also (1) Liquidity Risk.
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about the weaknesses of risk warnings and instead relies on the upfront and early in the process finding of the Commission. The ECSPR should have a prominent risk warning requirement for the CSP’s website. The prominent risk warning should address the liquidity risk rather than the secondary market. In a similar way to the risk warning required under article 21(4) of the ECSPR that an investor may lose the entirety of the investment. The key information that must be passed to the investor is that the investor may not be able to exit the investment early. Liquidating the investment depends on free-market considerations. For example, whether there is interest in purchasing the investment. As set out in chapter 4, a key component to improving choices is delivering information upfront and early in the process. There should be a risk warning outlining the liquidity risk on the website rather than being disclosed later in the KIIS.

5. Default Risk
The contingency fund regulatory requirements should apply in all contexts and not solely where portfolio management services are provided. It is unclear why the policy decision was made to apply regulatory disclosure and business conduct requirements to contingency funds only in the case of portfolio management of loans. However, this position needs to be remedied. It exposes

150 Commission, ‘Behavioural Study on the Digitalisation of the Marketing and Distance Selling of Retail Financial Services Final Report’ (n 151) 130.
151 See also (2) Default Risk.
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investors to the poor business management of contingency funds and allows a poor calibre CSP to offer their services to the market.

The contingency fund requirements should not have been placed within article 6 of the ECSPR. Article 6 of the ECSPR solely applies to individual portfolio management of loans. The contingency funds requirements should be placed in a standalone article with no mention of portfolio management of loans to ensure the application of the contingency fund requirements across the board.

Next, there are two potential responses to buy-back obligations. One, the ECSPR could incorporate a broad general principle disclosure requirement in its KIIS to disclose the risks associated with a source of protection for investor losses, how it is funded, and accessed. Two, the ECSPR could include the buy-obligation in the risk warning set out in article 6(5)(a) of the ECSPR. Both would achieve the aim of informing the investor about the possible risks associated with a buy-back obligation. However, the first option would provide the investor with more information. It will also be worth considering whether to ban the practice if it is seen that the practice is too risky. The EU could also consider detailed requirements as per the methodology requirements in the Delegated Regulation.

152 Australia - Corporations Act 2001 Part 7.9; Australian Securities and Investments Commission INFO 213 (n 80).

153 Commission Delegated Regulation (EU) 2022/2118 of 13 July 2022 supplementing Regulation (EU) 2020/1503 of the European Parliament and of the Council with regard to regulatory technical standards on individual portfolio management of loans by crowdfunding service providers, specifying the elements of the method to assess credit risk, the information on each individual portfolio to be disclosed to investors, and the policies and procedures required in relation to contingency funds C/2022/4841 [2022] OJ L287/50 chapter IV.
6. CSP Failure
The EU’s approach to CSP failure could be made more adequate by mirroring New Zealand’s scope of application of the business continuity plan.\textsuperscript{154} New Zealand applies business continuity plans where the CSP ceases to provide its services. Considering the ECSPR’s legal certainty goal, it should be made clear that the business continuity plan applies to CSPs who choose to cease their services.

D. Discussion
Regulators internationally have developed diverse and unique responses to the challenges raised by crowdlending. To varying degrees, some jurisdictions have developed \textit{sui generis} legislation and others have applied existing legislation to crowdlending.\textsuperscript{155}

1. One-Size vs Sui Generis
A \textit{sui generis} regime (New Zealand, UK) is more likely to specifically address the risks in the EU business crowdlending market. However, the US \textit{sui generis} regime does not address a number of the risks in the business crowdlending market such as default risk, CSP failure, liquidity risk and systemic risk. The US regulatory framework has a markedly different approach to crowdlending. The US is unique in its focus on the project owner and in some instances, the focus on the project owner is to the exclusion of attention being paid to the CSP. For example, the US places regulatory reporting responsibilities to the SEC on the project owner concerning information such as the income of the persons

\textsuperscript{154} See also (3) CSP Failure.
\textsuperscript{155} Kevin Davis, ‘Peer-to-Peer Lending: Structures, Risks and Regulation’ (2016) 3 JASSA 37, 11.
controlling the project owner.\textsuperscript{156} The US also requires the project owner to disclose its business plan\textsuperscript{157} while making no requirement for a business continuity plan should the CSP fail. The US is unique in requiring the CSP to report on an ongoing basis on the project owner’s progress in achieving its funding goal and whether or not the goal will be exceeded.\textsuperscript{158} As a result, it comes as no surprise that the data in the US shows that the majority of CSPs do not seek Regulation Crowdfunding authorisation but instead seek authorisation under Regulation D a different regulatory framework in the US.\textsuperscript{159} However, under Regulation D, CSPs may only offer investments to sophisticated investors and there are ‘few investor protections and disclosure requirements’.\textsuperscript{160}

The one-size-fits-all regime (Australia) can specifically address the ECSPR’s regulatory goals and provides lessons for the ECSPR. Crucial to the functioning of the one-size-fits-all regime (Australia) is a regulator that engages in a dialogue with the regulated and equips the regulator with an exemption power\textsuperscript{161} that is actively used. For example, in Australia, the regulatory framework is unclear as to whether the provision for withdrawal rights means that CSPs can operate in a secondary market.\textsuperscript{162} It is in these moments of ambiguity that ASIC flexes its muscles and makes use of its exemption

\textsuperscript{157} US - Rule 201(d) Regulation Crowdfunding, 17 CFR § 227.201(d) (2021).
\textsuperscript{161} Australia - Corporations Act 2001 s 601QA.
\textsuperscript{162} Australia - Corporations Act 2001 s 601KA.
powers.\textsuperscript{163} ASIC’s exemption power\textsuperscript{164} is the saving grace of the Australian regulatory framework. ASIC’s exemption powers allow the regulatory framework to be calibrated to respond to the specific contexts the regulatory framework is being applied in. ASIC made an exemption in the context of the withdrawal rights for the operation of a secondary market.\textsuperscript{165}

Similar features were also found in the UK’s \textit{sui generis} regime which specifically addresses most of the risks in the business crowdlending market. Nevertheless, the UK takes its willingness to engage in dialogue with the regulated a few steps further than Australia. In the case of crowdlending, the FCA conducted extensive consultations and policy statements on crowdlending regulation.\textsuperscript{166} Instead of issuing individual exemptions like in Australia,\textsuperscript{167} the

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\textsuperscript{163} Australia - Corporations Act 2001 s 601QA.
\textsuperscript{164} Australia - Corporations Act 2001 s 601QA.
\textsuperscript{165} Australian Securities and Investment Commission REP 420 (n 48) 21.
\textsuperscript{167} Australia - Corporations Act 2001 s 601QA.
\end{flushleft}
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UK calibrated the regulatory regime to target the areas that were not previously addressed by its regulatory framework.

This means that there is greater legal certainty found at the outset in UK’s regulatory framework than in the Australian regulatory framework. It is easier at first glance to determine whether crowdlending is regulated in the UK than in Australia. It is also easier to determine what type of crowdlending business model is appropriate within the UK’s regulatory framework than in Australia. Both achieve similar ends in that crowdlending is regulated in both jurisdictions but there is greater legal certainty in the UK. Thus, the UK achieves more legal certainty than Australia.

Much of the discussion thus far has focused on Australia and the UK. This is not to say that New Zealand’s regulatory framework is lacking. The value of New Zealand’s regulatory framework is the simplicity of its solutions. For example, New Zealand includes the operation of an ancillary market in their definition of crowdlending.\textsuperscript{168} At first glance, the New Zealand regulatory framework may seem to rely on general principles, but the New Zealand regulator’s guidance documents provide the details of the regulatory framework. For example, one of the client protection measures is that CSPs are required to have ‘fair, orderly, and transparent systems and procedures for providing the service’.\textsuperscript{169} New Zealand’s guidance material fleshes this general principle out and interprets the fair, orderly and transparent requirement into 19 minimum

\textsuperscript{168} New Zealand - Financial Markets Conduct Regulations 2014 reg 185(2)(b).
\textsuperscript{169} New Zealand - Financial Markets Conduct Regulations 2014 reg 187 (a).
requirements.170 These 19 requirements range from requirements that the directors and senior managers must be fit and proper171 to conflict-of-interest requirements.172 This elaboration on general principles is also seen in the context of default and liquidity risk in New Zealand.173

The US regulatory response cannot be completely explained by the difference in the business model. It is not only this risk-based analysis that finds the US regulatory approach lacking. While some commentary positively reviewed the US’ regulatory approach174 many voiced negative views.175 The Regulation

Crowdfunding critics noted the financial burden imposed by Regulation Crowdfunding,176 how CSPs have used other legal frameworks in the US177 and that securities regulation of crowdlending is inappropriate.178 Regulation Crowdfunding was amended in November 2020 increasing the limit from $1.07 million to $5 million, removing accredited investor investment limits, and increasing non-accredited investors’ limits to the greater of their annual income or net worth.179 Yet industry forums hosted by the SEC have also noted a need to reduce regulatory burden180 and set out secondary market pre-emptions.181

Little change has been actioned on these points. This is unsurprising considering it took four years for Regulation Crowdfunding to be implemented.182 In addition, the US shows reluctance to bolster, change, or amend its information

176 Won (n 163) 1411.
177 Franson and Manbeck (n 178).
178 Verstein (n 178).
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exchange tools\textsuperscript{183} in line with Australia or the UK.\textsuperscript{184} The US’ reluctance\textsuperscript{185} means that any changes will be far down the line as the US leans towards the ‘single-shot design’ approach to regulation.\textsuperscript{186}

The US faces challenges that the UK and Australia do not face to the same extent. The financial regulatory system in the US is a behemoth with a minimum of twelve federal regulators and innumerable state regulators to coordinate.\textsuperscript{187} By comparison, Australia and the UK have significantly fewer regulators to coordinate on matters such as information exchange and exemption tools.

What does this all mean for the ECSPR? It means that a one-size fits all regulatory framework can adequately respond to the risks crowdlending presents if it is equipped with an ad hoc exemption tool and the regulator can issue guidance materials to explain the regulatory requirements. The UK also demonstrates that a \textit{sui generis} regulatory framework can also adequately respond to the risks crowdlending presents. Nevertheless, it is uncertain if ad hoc exemption tools would be a viable option for the EU and the ECSPR. The EU

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is a very different legal system which has a very different legislative process. The creation of an ad hoc exemption tool would have been contrary to the EU’s harmonisation efforts in the ECSPR.

2. Detailed Requirements vs Broad Principles
The analysis in this chapter repeatedly returned to a question that contrasted detailed requirements against broad principles. Are detailed requirements as evidenced repeatedly in the EU and UK more adequate in achieving the regulatory goal or addressing the risk in question than the broad principles approach evidenced in Australia, New Zealand, and the US? The general principle approach in New Zealand demonstrates a market facilitatory approach and allows greater flexibility on what compliance might look like. However, the UK and EU demonstrate more paternalistic motivations towards their investors ultimately underpinning the detailed business conduct requirements.

The issue arose in the context of the risk of CSP failure. The analysis found that it was difficult to say which approach is by comparison the most adequate. Whether a detailed prescription or general principles approach is considered to be more adequate in addressing CSP failure depends on a variety of factors. It depends on whether legal certainty is valued. Detailed regulatory requirements tend to increase legal certainty when an area is first regulated as is the case for crowdlending. As legal certainty is one of the regulatory goals of the

188 See further chapter 4.
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ECSPR, more detailed regulatory requirements would be considered by the EU to be a more adequate regulatory response.

3. Market Impact

The UK has one of the largest crowdlending markets in the region of Europe and the world. However, the UK’s increased investor protection measures in 2019 resulted in some market actors closing their non-sophisticated investor side of the business. The size of the UK’s crowdlending market and the closure of retail investment services may be prophetic for the EU owing to the considerable similarities between the two crowdlending regulatory frameworks’ approaches to investor protection. As the ECSPR has not reached full legal effect, it is difficult to say what kind of impact the ECSPR has had on the market. On 22 March 2022, ESMA found in an informal survey that 94.5% of CSPs surveyed had not applied for authorisation. The ECSPR’s level 2 measures have not been confirmed although they are available in draft form. Also, the ECSPR’s transitional period has been extended until November 2023.

The UK leans towards market facilitation rather than the prescriptive regulatory requirements approach seen in the EU. It is difficult to state whether the market facilitatory approach also seen in Australia, New Zealand and the UK is

191 Siddharth Venkataramakrishnan, ‘Funding Circle Exits Peer-to-Peer Lending for Non-sophisticated investors’ Financial Times (London, 10 March 2022).
192 See further chapter 4.
193 European Securities and Markets Authority, ‘Final Report: ESMA’s Technical Advice to the Commission on the Possibility to Extend the Transitional Period Pursuant to Article 48(3) of Regulation (EU) 2020/1503’ (n 15) 6.
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more adequate than the prescriptive approach in the EU. The UK market is strong at present however it will be interesting to see once the ECSPR reaches full legal effect whether its prescriptive approach is more adequate at protecting the market and achieving its primary goal.

E. Future Possibilities
As previously explored, in the UK, some CSPs are evolving away from providing services to non-sophisticated investors since the increased investor protections in 2019.\textsuperscript{196} While crowdlending may have had its roots in ideas of democratised finance and enabled one person to lend to another or peer-to-peer this narrative no longer appears to describe what is happening in the market.\textsuperscript{197} It is no longer peer-to-peer as set out in the UK and New Zealand regulatory frameworks; it is shifting to institutional-crowd lending. The word institutional can be interchanged with professional but both communicate a similar idea. Crowdlending appears to be moving towards putting businesses in touch with other businesses for funding purposes. This development will come within the scope of the ECSPR. It will however come as a disadvantage to non-sophisticated investors if CSPs choose to only provide their services to sophisticated investors. It would also limit investor diversification benefits for CSPs and project owners.

\textsuperscript{196} Venkataramakrishnan, ‘Funding Circle Exits Peer-to-Peer Lending for Retail Investors’ (n 194); See further 3. Market Impact.
\textsuperscript{197} For analysis in the wider crowdsourcing sector see Arun Sundararajan, \textit{The Sharing Economy: The End of Employment and the Rise of Crowd-Based Capitalism} (MIT Press 2017).
A curious shift that is happening in both the UK and the US is that LendingClub (US)\(^{198}\) and Zopa (UK)\(^{199}\) have successfully received banking licences. Both jurisdictions have markedly different regulatory styles and have demonstrated different understandings of crowdlending. It is interesting to see similar developments happening in jurisdictions with such different approaches to crowdlending regulation. One market actor in each jurisdiction changing its business model to a bank is insufficient for any real conclusions. However, it is an area to monitor in the future. Perhaps CSPs will begin to seek e-money licences.\(^{200}\)

The immediate concerns before the ECSPR were raised by individual portfolio management of loans were whether this practice constituted investment advice as regulated under MiFID II. The ECSPR recognises the similarities between individual portfolio management of loans and the ‘similar services’ under MiFID II as posing a challenge to the same activity same rules principles.\(^{201}\) This issue among others will be explored in the Commission’s report before 10 November 2023 as to whether the measures in the ECSPR are appropriate.\(^{202}\) Therefore, individual portfolio management of loans could well be construed as investment

\(^{198}\) Miles Kruppa and Robert Armstrong, ‘FinTechs Take on Banks at their Own Game’ Financial Times (London, 3 November 2020); Robert Armstrong, ‘Investors Warm to Lending Club, the Fintech that Became a Bank’ Financial Times (London, 17 March 2021).

\(^{199}\) Zopa, ‘We’ve Received our Banking Licence – What Happens Next?’ (Zopa, 4 December 2018) [https://blog.zopa.com/2018/12/04/weve-received-banking-licence-happens-next/] accessed 7 March 2023.


\(^{202}\) ECSPR article 45(2)(f).
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advice within the scope of MiFID II. This change would significantly impact CSPs’ regulatory burden and cost of compliance.

The ECSPR has lessened the potential for market fragmentation in the EU. There is still a possibility for market fragmentation because each Member State can goldplate the sanctions for breaching the ECSPR.

F. Conclusion
This chapter proposes a way forward for the ECSPR that takes into account the comparative analysis in chapter 4. There are some key areas where improvements are necessary in relation to (1) client protection and competencies, (2) the KIIS and credit agreements, (3) the knowledge assessment and prescribing risks, (4) liquidity risk and a prominent risk warning, (5) default risk and contingency fund regulatory requirements and (6) CSP failure and a broader application of the continuity of business plan requirement. These findings will inform the conclusions that are made in chapter 6 as to whether the ECSPR is adequate in addressing its regulatory goals for crowdlending.
CHAPTER VI. CONCLUSION

A. Introduction
The EU made its first foray into crowdlending regulation with the ECSPR in late 2020.1 This thesis critically examined the ECSPR by conducting an international comparative study. This thesis compared the ECSPR to the crowdlending regulatory frameworks in four jurisdictions. The four jurisdictions were: Australia, New Zealand, the UK, and the US.

Section B outlines the objectives of this research. Then the key findings are summarised in Section C. Next, in Section D, a call for future research is set out. Followed by an exploration in Section E of the limitations of this research. Section F explores the research contribution of this thesis. Finally, conclusions are given in Section G.

B. Research Objectives
The objective of this research2 contained a series of linked questions:

- How do the ECSPR’s goals align with those in financial regulatory theory and regulatory theory?
- How does the ECSPR act upon its goals?
- What are the comparator jurisdictions’ goals? Are they similar to the ECSPR’s goals?

2 See also chapter 1.
Conclusion

- Is there an overlap between the ECSPR’s goals and the comparator jurisdictions’ goals?
- How do the comparator jurisdictions act upon the goals?
- Is the ECSPR by comparison adequate in addressing its goals?
- What are the risks that the ECSPR intends to reduce and protect investors and clients from?

These questions lead to the central research question of this thesis, which is to examine whether the ECSPR is adequate in achieving its regulatory goals for crowdlending. The ECSPR’s regulatory goal is to ensure seamless and expedient access to capital markets for start-ups and SMEs, reduce financing costs and avoid delays and costs for crowdlending (‘primary goal’). The ECSPR aims to achieve its primary goal by (1) enabling the cross-border provision of services by harmonising rules, (2) protecting investors and clients, (3) providing legal certainty, and (4) reducing risk.

C. Summary of Key Findings

Chapter 1 set out the central research question of this thesis: whether the ECSPR is adequate in achieving its regulatory goals for crowdlending. The framework of analysis of this thesis was established in chapter 2 by matching the ECSPR’s goals and the comparator jurisdictions’ goals with those in regulatory theory and financial regulatory theory. The ECSPR’s primary goal is

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4 ECSPR recitals 3, 27, 54, 60.
5 ECSPR recitals 6, 8, 18, 30, 33, 58, 61-66.
6 ECSPR recitals 7, 16, 18, 24, 36, 42-47, 50-54, 56.
7 ECSPR recitals 58, 76.
8 ECSPR recitals 18, 23, 30, 24.
Conclusion

to ensure seamless and expedient access to capital markets, reduce financing costs and avoid delays and costs for crowdlending. The ECSPR aims to achieve this primary goal by (1) enabling the cross-border provision of services by harmonising rules, (2) protecting investors and clients, (3) providing legal certainty, and (4) reducing risk. When the ECSPR’s goals and the comparator jurisdictions’ goals were matched with financial regulatory theory and regulatory theory and a list of similar goals were identified. This informed the framework of analysis of this thesis. The framework of analysis was used to examine the ECSPR and the comparator jurisdictions under the headings of competition, market efficiency, investor protection and other users, legal certainty, and risk-based regulatory model.

There is no clear yes or no answer as to whether the ECSPR is adequate in addressing its regulatory goals for crowdlending. Where the ECSPR is adequate, this means that the ECSPR is more likely to achieve its regulatory goals for crowdlending. It means that crowdlending is now supported by a pan-EU regulatory framework where previously there was none. It means that crowdlending now has the opportunity to deliver FinTech leveraged business lending to the entire EU market. The EU will have to wait and see whether crowdlending can deliver finance to SMEs.

Chapter 6 outlined that there are some key areas where improvement is needed for (1) client protection and competencies, (2) the KIIS and credit agreements,

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9 ECSPR recitals 3, 27, 54, 60.
10 ECSPR recitals 6, 8, 18, 30, 33, 58, 61-66.
11 ECSPR recitals 7, 16, 18, 24, 36, 42-47, 50-54, 56.
12 ECSPR recitals 58, 76.
13 ECSPR recitals 18, 23, 30, 24.
Conclusion

(3) the knowledge assessment and prescribing risks, (4) liquidity risk and a prominent risk warning, (5) default risk and contingency fund regulatory requirements and (6) CSP failure and a broader application of the continuity of business plan requirement. The answer to the central research question will be explored in this section by setting out whether the ECSPR is adequate in achieving its primary goal and then the secondary goals for crowdlending are considered.

1. Primary Goal
Is the ECSPR adequate in ensuring seamless and expedient access to capital markets, reducing financing costs and avoiding delays and costs for crowdlending? This goal was examined as a competition and allocative market adequacy goal.

The analysis in chapters 3 and 4 found that ECSPR is somewhat adequate in addressing market efficiency and competition. Therefore, the ECSPR is somewhat adequate in addressing its goal to ensure seamless and expedient access to capital markets for SMEs, reducing financing costs and avoiding delays and costs for crowdlending. The ECSPR is adequate in ensuring seamless and expedient access to capital markets for SMEs through the ECSPR’s passporting and authorisation mechanisms. 

Before the ECSPR, the pan-EU business crowdlending market was hampered by a lack of a single authorisation mechanism that allowed passporting through the entire EU. Previously it was expensive to seek to provide crowdlending services in more than one Member

14 ECSPR articles 18, 12(12).
15 ECSPR articles 3(1), 12, 13, 17.
16 See further chapters 3 and 4 the analysis under Competition and Market Efficiency.
Conclusion

State. There were significant costs to establish whether there was a
crowdlending regulatory framework and how they could comply with the
regulatory framework if there was one. By having established an authorisation\(^{17}\) and passporting\(^{18}\) mechanism the ECSPR has reduced financing costs and
avoided delays and costs for crowdlending.

Some of the ECSPR’s measures are not as adequate in addressing the ECSPR’s
primary goal. The measures taken in relation to secondary markets\(^{19}\) and the
€5 million limit\(^{20}\) reduce the ECSPR’s adequacy in ensuring seamless and
expedient access to capital, reducing financing costs and avoiding delays and
costs for crowdlending.\(^{21}\) However, the reasons for this conclusion are outside
the scope of the ECSPR. The ECSPR is not adequate because of Member State
implementation of the EU prospectus requirements\(^{22}\) and MiFID II\(^{23,24}\). This
reduction in adequacy has the potential to increase financing costs for SMEs. If
for example, the bulletin boards\(^{25}\) do not prove to be allocatively efficient,
investors may decide against investing using crowdlending because the liquidity
risk is too great. This in turn may reduce the amount of capital available to
SMEs through crowdlending and SMEs may seek funding from other sources. The

\(^{17}\) ECSPR articles 3(1), 12, 13, 17.
\(^{18}\) ECSPR articles 18, 12(12).
\(^{19}\) ECSPR article 25.
\(^{20}\) ECSPR article 1(2)(c).
\(^{21}\) See further chapter 4.
\(^{22}\) ECSPR recital 16; Parliament and Council Regulation (EU) 2017/1129 of the of 14 June 2017
on the prospectus to be published when securities are offered to the public or admitted to
(‘Prospectus Regulation’).
L173/349 (‘MiFID II’).
\(^{24}\) See further chapter 3 for the analysis of b) Secondary Market and 3. €5 Million Limit.
\(^{25}\) ECSPR article 25.
Conclusion

ECSPR’s adequacy is reduced by the €5 million limit.26 The limit has already been subject to critique by CSPs as it limits their capacity to attract larger projects.27 There is little that can be done to address the matter while also respecting the same activity same rules principle unless the EU’s prospectus requirements28 are harmonised further to only apply to amounts over €8 million.29

2. Secondary Goals

a) Enabling Cross-Border Provision of Services by Harmonising Rules

This goal was examined under the heading of a competition goal. The ECSPR is adequate in enabling the cross-border provision of services by harmonising rules through its passporting30 mechanism. However, full harmonisation was not achieved regarding enforcement and marketing requirements. The ECSPR sets minimum standards for enforcement sanctions under the ECSPR which Member States can goldplate.31 The analysis in chapter 4 indicated that harmonisation

26 ECSPR article 1(2)(c).
30 ECSPR articles 18, 12(12).
31 ECSPR article 39; See further chapter 3.
Conclusion

of enforcement sanctions is unlikely because MiFID II takes a similar stance.\textsuperscript{32} The ECSPR provides general principle requirements for marketing communications and national competent authorities (‘NCAs’) are in general required to publish the national laws on marketing communications on their websites.\textsuperscript{33} Thus the ECSPR is not completely adequate in addressing its cross-border/harmonising rules goal. As explored in chapter 3, this may encourage some element of jurisdiction shopping and regulatory arbitrage according to which Member State has the least onerous sanctions and marketing communications requirements.

\textit{b) Legal Certainty}

There were three faces to the legal certainty analysis in chapter 3, (1) Braithwaite’s theory of legal certainty,\textsuperscript{34} (2) uncertainties remaining within the ECSPR and (3) uncertainties remaining within the EU crowdlending market.

According to Braithwaite’s theory of legal certainty,\textsuperscript{35} chapters 3 and 4 found that the ECSPR is relatively adequate in addressing legal uncertainty. Throughout the entire examination of the ECSPR, it was found that the ECSPR is a highly detailed regulatory framework. Although the other jurisdictions do not appear to endorse the same level of detail as found in the ECSPR.

It is worth noting that there is a point where detail becomes too much and clouds legal certainty making it difficult for market actors such as CSPs,

\textsuperscript{32} MiFID II article 70(6); See further Christos V Gortsos, ‘Public Enforcement of MiFID II’ in Danny Busch and Guido Ferrarini (eds), \textit{Regulation of the EU Financial Markets: MiFID II and MiFIR} (Oxford University Press 2017).
\textsuperscript{33} ECSPR articles 27, 28.
\textsuperscript{34} Ibid.
\textsuperscript{35} Ibid.
Conclusion

investors, and project owners to navigate the regulatory framework. This is a concern for the ECSPR because of how much more detail is seen in the ECSPR in comparison to the other jurisdictions. The conclusion here is couched in caution with a warning to ‘wait and see’ what impact the ECSPR has on the market. Yet the cost of complying with the draft regulatory technical standards has been cited as a reason for the lack of applications for authorisation in the EU.\textsuperscript{36} The CSPs were waiting for the draft regulatory technical standards and draft Delegated Regulations to be finalised before they commenced their applications.

The examination in chapter 3 found that five areas within the ECSPR are not clear: (1) the risk awareness requirement for sophisticated investors,\textsuperscript{37} (2) the definition of credit agreements,\textsuperscript{38} (3) the contingency fund requirements\textsuperscript{39} and buy-back obligations,\textsuperscript{40} (4) sanctions as these are not harmonised under the

\begin{footnotesize}
\begin{enumerate}
\item European Securities and Markets Authority, ‘Final Report: ESMA’s Technical Advice to the Commission on the Possibility to Extend the Transitional Period Pursuant to Article 48(3) of Regulation (EU) 2020/1503’ (n 29) 7.
\item ECSPR annex II(I).
\item ECSPR article 6; Commission Delegated Regulation (EU) 2022/2118 of 13 July 2022 supplementing Regulation (EU) 2020/1503 of the European Parliament and of the Council with regard to regulatory technical standards on individual portfolio management of loans by crowdfunding service providers, specifying the elements of the method to assess credit risk, the information on each individual portfolio to be disclosed to investors, and the policies and procedures required in relation to contingency funds C/2022/4841 [2022] OJ L287/50 (‘Commission Delegated Regulation [2022] OJ L287/50’) chapter IV.
\item See further chapter 3.
\end{enumerate}
\end{footnotesize}
Conclusion

ECSPR,\(^{41}\) and (5) marketing communications requirements are subject to national laws under the ECSPR.\(^{42}\) The legal uncertainty about the risk awareness requirement\(^{43}\) is unlikely to be critical as it relates to sophisticated investors who generally require fewer protection measures than non-sophisticated investors. The legal uncertainties relating to the definition of credit agreements,\(^{44}\) contingency fund requirements,\(^{45}\) and buy-back obligations\(^{46}\) are concerning. As such, these legal uncertainties form the basis of the recommendations in chapter 6 for the way forward for the ECSPR. The legal uncertainties caused by the lack of harmonisation on sanctions\(^{47}\) and marketing communications\(^{48}\) negatively impact the ECSPR’s efforts in creating a pan-EU market. It remains to be seen whether these legal uncertainties will be fatal to the adequacy of the ECSPR or simply an inconvenience for CSPs to navigate as they seek to provide their services on a cross-border basis.

It was found that in the main the ECSPR’s scope is certain.\(^{49}\) In the examination of the ECSPR’s scope, it was acknowledged that businesses also use personal finance to fund their business in the embryonic stages. As a result, until there

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\(^{41}\) ECSPR article 39; See further chapter 3.
\(^{42}\) ECSPR articles 27, 28; See further chapter 3.
\(^{43}\) ECSPR annex II(l).
\(^{45}\) ECSPR article 6; Commission Delegated Regulation [2022] OJ L287/50 (n 42) chapter IV.
\(^{46}\) See further chapter 3.
\(^{47}\) ECSPR article 39; See further chapter 3.
\(^{48}\) ECSPR articles 27, 28; See further chapter 3.
\(^{49}\) See further chapter 3.
Conclusion

is a pan-EU response to consumer crowdlending the ECSPR alone falters in completely achieving its primary goal.

c) Reducing Risk

It is difficult to say whether the ECSPR is an adequate risk-based regulatory model. The analysis of the ECSPR’s response to the risks found there are some improvements to be made.\textsuperscript{50} For example, the analysis of default risk found that the limited scope of the contingency fund requirements leaves investors exposed to poorly maintained contingency funds.\textsuperscript{51} The lack of a response to buy-back obligations\textsuperscript{52} is concerning also as the analysis showed in chapter 3 it likely falls outside the scope of the requirements in the ECSPR. The EU should monitor this development closely and at least mandate disclosures in relation to buy-back obligations.\textsuperscript{53} There were other instances where the ECSPR’s response is adequate such as systemic risk.\textsuperscript{54} However, this evaluation was predicated upon the availability of insurance providers to offer the requisite coverage. The current market evidence indicates that this service is not being provided in the market.\textsuperscript{55} As explored in chapter 3, the insurance market may respond and provide the necessary insurance coverage to CSPs for their prudential requirement needs. Another possibility is that the EU may have to rethink its prudential requirements under the ECSPR.

\textsuperscript{50} See further chapters 3, 5.
\textsuperscript{51} ECSPR article 6; Commission Delegated Regulation [2022] OJ L287/50 (n 42) chapter IV.
\textsuperscript{52} See further chapter 3.
\textsuperscript{53} Ibid.
\textsuperscript{54} ECSPR article 11; See further chapter 3.
Conclusion

The comparative analysis in chapter 4 frequently returned to the challenge of comparing jurisdictions that favour broad principles against jurisdictions that favour detailed requirements. However, for the EU, a detailed response is the ‘right’ response.56

A conclusion that can be reached is that the ECSPR responds to liquidity risk, default risk, CSP failure, information asymmetry, inexperience, fraud risk, pricing risk and systemic risk. However, the ECSPR’s adequacy can be improved in six key areas:

1. Credit agreement definition in the KIIS,
2. Prescribe the risks to be assessed in the knowledge assessment,
3. An early liquidity risk warning that explains the opportunity to exit,
4. Apply the contingency fund requirements to all contexts not solely individual portfolio management,
5. Require disclosures regarding buy-back obligations with a view to possible further measures in the future, and
6. Clearly state that the business continuity plan should also be used where the CSP chooses to cease its services.

**d) Protecting Investors and Clients**
The analysis in Chapters 3 and 4 on this point is interesting. The ECSPR protects investors using behavioural-science-informed57 default measures. The ECSPR

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56 See further chapters 3, 4.
Conclusion

uses a self-responsibility principle\textsuperscript{58} for direct investor protection measures. Strict paternalism does not feature heavily in the ECSPR’s investor protection measures. The ECSPR demonstrates ‘an approach that preserves freedom of choice but [...] steer[s] people in directions that will promote their welfare’.\textsuperscript{59} The degree of paternalism is somewhat increased for non-sophisticated investors. However, these measures are generally optional default protections. The degree of paternalism is increased when the CSP provides more services for the investor the ECSPR’s regulatory response is more detailed and more paternalistic.

Australia, New Zealand, and the US all rely on an investor self-responsibility principle with less behavioural-science-informed measures. Yet the UK is very similar to the EU in its approach to investor and client protection. The UK has very similar tools although the EU generally employs those tools with more detailed requirements.

The UK is one of the largest business crowdlending markets in the world. However, market actors have recently begun closing their services for non-sophisticated investors because of the greater regulatory requirements that come with providing services to non-sophisticated investors. This is interesting because the current thinking found in Chapter 2 on investor protection is that paternalism can be market-making. In providing a safe environment for investment, more investors might participate. However, a perhaps unintended


Conclusion

Consequence of the behavioural-science-informed investor protection in the UK is that CSPs no longer wish to engage with non-sophisticated investors. Thus, reducing the pool of capital for SMEs to access in the capital market.

It is unclear whether the behavioural science-informed self-responsibility investor protection measures will have a similar market impact in the EU. The answer will depend on a variety of factors including for example the appetite for crowdlending across the EU and the cost of compliance with the investor protection measures. Market actors in the EU have cited that the ECSPR has increased operational costs. However, this was about their delay in applying for authorisation not that the increased costs were too much.

For now, the ECSPR is adequate in protecting investors because of the ECSPR’s primary goal. The influence of the primary goal means that market-making investor protection or behavioural science-informed self-responsibility investor protection is more adequate than a regime that sought to completely insulate investors from risk.

The ECSPR is by and large adequate in protecting clients also. The ECSPR uses indirect measures combined with a self-responsibility principle to protect clients. In the main, the indirect client protection measures are highly detailed business conduct requirements. However, two improvements could be made. First CSPs should set out how their recruitment and HR processes will ensure

60 European Securities and Markets Authority, ‘Final Report: ESMA’s Technical Advice to the Commission on the Possibility to Extend the Transitional Period Pursuant to Article 48(3) of Regulation (EU) 2020/1503’ (n 29) 7.
the management team has the right skills and experience.\textsuperscript{61} The second measure requires the organisational competence to be assessed as well as an individual’s capability.\textsuperscript{62} An examination of the organisation’s competence ensures that the entire system has the competence to engage in crowdlending. The recruitment and HR processes emphasise that continuous compliance with the capability requirements is necessary. Both measures would make the ECSPR more adequate in protecting clients. The EU could also consider at some point in the future using some form of periodic NCA review clause to ensure continuous compliance with the capability requirements in the ECSPR. A periodic NCA review mechanism would be useful if it is found that there is widespread non-compliance with the capability requirements in the future.

**D. Future Research**

This section sets out other questions as a call to action for future research.

1. **Consumer Borrowers**

Most of the jurisdictions examined in this thesis applied their pre-existing consumer borrower regulatory framework to crowdlending.\textsuperscript{63} In some instances, the pre-existing consumer borrower regulatory framework was tailored to crowdlending.\textsuperscript{64} An area for future research would be to compare the approaches taken in these jurisdictions on consumer crowdlending to the


\textsuperscript{62} Australia - Corporations Act 2001 s 921A(1)(e), (f); Financial Markets Authority, ‘Licensing Application Guide: Peer-to-Peer Lending Part B2’ (n 64) 10, 11.

\textsuperscript{63} Australia - National Consumer Credit Protection Act 2009; New Zealand - Credit Contracts and Consumer Finance Act 2003; In the US there is a swathe of lathe were applicable to consumer borrowers. An example is US - Truth in Lending Act.

\textsuperscript{64} UK - FCA Handbook CONC 4.3.4.
Conclusion


2. Green Policy
With the slow recognition that climate change has an impact on every part of human existence including on the financial systems, there is a growing field discussing how to create a financial policy that encourages green goals that assist in a transition to a low-carbon economy. The ECSPR signals the EU’s interest in using CSPs in the future to fund green initiatives. The partnerships will in and of themselves present new regulatory challenges and risks which will need research. Recent research has highlighted the potential for crowdlending to pair with public authorities to distribute funding. However, the efficacy of delivering funds to green projects requires research.


Conclusion

3. Future Developments

One of the focuses of the Digital Sandbox Pilot run by the FCA was on Improving SME Access to Finance. This pilot attracted many innovative businesses. One company, for example, Fluence provides natural language processing AI that interprets complex documentation based on the business’s values and preferences. Natural language processing AI could be used to reduce the bias in lending, promote financial inclusion and tap into previously underserved market segments. Another participant, Company Watch Limited, enables businesses to accurately predict their exposure to financial risk by using risk analysis and data modelling tools. Thus there is massive potential for the future of lending to make it easier to highlight worthy borrowers and new market segments.

Further future development according to the industry is personalisation and how lending firms can leverage data to the lending firm’s advantage. The combination of data and personalisation will allow future loans to be priced more closely to the borrower’s risks. Furthermore, the advent of increased

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75 Ibid.
Conclusion

Personalisation and use of data will allow lenders to quickly detect if a borrower is approaching financial difficulties.\(^{76}\) The lender will then be able to personalise a plan for the borrower.\(^ {77}\) These future developments leveraging data and AI are not without risk. For example, the risk of bias in AI is well documented.\(^ {78}\) Research is needed to examine the risks and the measures that can be taken to mitigate them.

4. Information Disclosure Regulatory Tool

Further work is needed on the different ways to deliver information and implement the new methods. A positive development was the standardised disclosure documents.

However, further developing the pre-existing comparison and consumer product testing agencies to provide an easy comparison of financial products would be another step in the right direction. There are already consumer agencies that do great work testing and comparing consumer products such as Consumer Reports in the US and Which? in the UK. An EU response is needed.

\(^ {76}\) ibid.

\(^ {77}\) ibid.

Conclusion

The umbrella organisation International Consumer Research and Testing coordinates consumer testing agencies in individual jurisdictions and is not limited to EU member states. Ideally, an EU comparison website of financial products would be combined with the push for financial education\textsuperscript{79} by the EU Portuguese Presidency.\textsuperscript{80} Aiding comparison of EU consumer financial products should go hand in hand with any efforts to passport financial services and products including crowdlending.

5. Classification Challenges
As explored in chapter 3, there are significant similarities between crowdlending and other investment services and asset classes. These similarities and differences are highlighted by the varying regulatory treatment of crowdlending internationally.\textsuperscript{81} Some jurisdictions classified crowdlending as dealing with a security.\textsuperscript{82} Others created a \textit{sui generis} category\textsuperscript{83} and others used other classifications.\textsuperscript{84} These classification challenges merit further future research to clarify the nature of investment services and asset classes.

\textsuperscript{79} See further on the importance of financial education in investor protection SM Solaiman, ‘Revisiting Securities Regulation in the Aftermath of the Global Financial Crisis: Disclosure - Panacea or Pandora’s Box’ (2013) 14 Journal of World Investment and Trade 646, 670.
\textsuperscript{80} João Nuno Mendes, ‘Introducing the Program of the Portuguese Government for the EU Presidency in the Field of Banking and Financial Market’ (EBI 4th Policy Series, Webinar, 14 January 2021).
\textsuperscript{81} See further chapter 3.
\textsuperscript{83} ECSPR article 2(1)(b); See further chapter 3.
\textsuperscript{84} Australia – Corporations Act 2001 s 9.
Conclusion

E. Limitations

This research is not without its limitations. First, the EU is a different type of legal system in comparison to its comparator jurisdictions. The comparator jurisdictions were all national jurisdictions rather than international jurisdictions. There were times in the comparative analysis when the EU would have to respect Member State sovereignty and allow each Member State to have their position on the matter. However, the comparator jurisdictions could address the issue directly.

Second, this thesis’ examination is also qualified by the limited comparison of the ECSPR to other EU regulatory frameworks. Some comparisons were made between the ECSPR and for example MiFID II, EMIR, or the Prospectus Regulation in chapter 3 in particular. The ECSPR has been termed by Macchiavello as MiFID II lite. Both the ECSPR and EMIR deal with the similar context of default risk and contingency funds. This analysis is touched upon in chapter 3 about legal uncertainty which demonstrated that the ECSPR has more detailed requirements for contingency funds than EMIR’s default fund

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Conclusion

It would have been informative to compare the ECSPR to the Prospectus Regulation\textsuperscript{91} to investigate whether the ECSPR echoed the approach in the Prospectus Regulation. CSPs should they wish to intermediate larger sums would be subject to the Prospectus Regulation. A detailed intra-EU comparison was outside the scope of this thesis. The purpose of this thesis was to compare the ECSPR to the approach taken internationally. It is one of the first studies of this kind.

Third, this thesis does not compare the ECSPR to Regulation D\textsuperscript{92} the crowdlending regulatory framework that many CSPs in the US operate within, and the analysis does not take into account Financial Industry Regulatory Authority’s (‘FINRA’) rules that relate to crowdlending. The comparison to Regulation Crowdfunding in this thesis is also a strength because it demonstrates why Regulation Crowdfunding is not used by CSPs in the US.

F. Research Contribution

This research fills a pressing gap in scholarship on crowdlending regulation. Crowdlending regulation in the academy is still in its infancy. Scholars have only begun exploring crowdlending regulation’s nuance. Academics are building

\begin{footnotesize}
\textsuperscript{91} For some examination see Serdaris (n 60).
\end{footnotesize}
Conclusion

research by applying, adapting, and amending financial regulation theory and regulatory theory more broadly to crowdlending’s context.

This is the first study to compare the ECSPR to the approaches taken in the four other jurisdictions. Most of the limited literature has focused on Regulation Crowdfunding in the US with some discussion on the UK and the EU’s potential regulatory approaches to crowdlending. This research can be used to inform future crowdlending regulation and assist in the understanding of the New Zealand and Australian crowdlending regulatory frameworks.

This research is significant because it is one of the first to conclude an examination comparing the EU to Australia, New Zealand, the UK, and the US. The significant conclusions were that the EU is one of the leading lights in the world on crowdlending regulation when examined on a risk addressal basis. The EU leverages the most behavioural-science-informed investor protection. The EU also mirrors the international approach of mixed disclosure and a business-conduct-based regulatory framework for crowdlending. The other approaches found were an exemptions-based approach and the silent treatment.

This research is also one of the first to provide suggestions to improve the ECSPR.

G. Conclusion
This thesis critically examined the EU’s first foray into crowdlending regulation, the ECSPR by conducting an international comparative study on a regulatory goal and financial regulatory goal basis. The international comparative study examined four jurisdictions: Australia, New Zealand, the UK, and the US.
Conclusion

As the ECSPR currently stands, some improvements can be made to the ECSPR regarding:

1. The credit agreement definition in the KIIS,
2. Prescribe the risks to be assessed in the knowledge assessment,
3. Liquidity risk warning that explains the opportunity to exit,
4. Apply the contingency fund requirements to all contexts not solely individual portfolio management,
5. Require disclosures regarding buy-back obligations with a view to possible further measures in the future,
6. Clearly state that the business continuity plan should be used where the CSP chooses to cease its services,
7. Require CSPs to set out how their recruitment and HR processes ensure the management team has the right skills and experience, and
8. Assess the CSP’s organisational competence.

The ECSPR is a combined disclosure and business conduct regulatory framework that leverages behavioural-science-informed investor protection. The ECSPR addresses most of the risks in the EU crowdlending market before the ECSPR. In the main, the ECSPR is adequate in achieving its regulatory goals. Questions are raised as to whether the level of detail in the ECSPR will allow the EU business crowdlending market to soar to new heights and truly be unleashed or become captured in the net of a detailed regulatory framework.

Unleashing crowdlending’s potential will rely on Member States and their respective NCAs as parts of the ECSPR are left to Member State responses. Some NCAs could be very active in offering guidance material on how to navigate the
Conclusion

ECSPR. This guidance would assist in further creating an environment that is conducive to crowdlending. Some NCAs might take a minimal compliance option and solely fulfil the ECSPR’s requirements without engaging with the market further. It could potentially be the case that the general public in Member States might not have any appetite to invest in crowdlending which could lead to crowdlending foundering in those Member States.

The research found the ECSPR is a good beginning, a start of the discussion on EU crowdlending regulation. The ECSPR is at times adequate in achieving its goals. However, as demonstrated by the seven points above, some matters need to be addressed to improve the ECSPR’s adequacy in addressing these goals.


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