

Crowdfunding Consultation

Financial Services Division

Department of Finance

Upper Merrion Street

Dublin 2, DO2 R583

16th May 2017

Re: Regulation of Crowdfunding

The Institute of Directors in Ireland (IoD) welcomes the opportunity to submit our views to the Department of Finance consultation on whether a regulatory regime would be appropriate for the crowdfunding sector in Ireland.

About The Institute of Directors in Ireland:

The Institute of Directors in Ireland is the representative body for over 2,600 directors and senior executives within the private, public and not-for-profit sectors. As the leading voice in the debate on improving corporate governance standards, the Institute of Directors is dedicated to developing and improving the effectiveness and performance of directors and boards throughout Ireland.

Response to consultation:

In consideration of Department of Finance's invitation for submissions on whether a regulatory regime would be appropriate for the crowdfunding sector in Ireland, which refers to the use of social media or other internet platforms to enable individuals or companies to raise funds, this consultation response focuses specifically on issues relating to oversight, risk and governance.

The IoD is proposing that there should be proportionate regulation of crowdfunding in Ireland.

The absence of any current crowdfunding regulation provides the opportunity for substantial risk to potential investors, and increases the opportunity for bad practice and ultimately could create serious reputational damage for this relatively new funding model in Ireland.

We believe that there is a clear distinction between the model of non-financial return crowdfunding, donation or reward-based crowdfunding, and financial return crowdfunding. The former is not considered to involve lending or investment-type activity and there is no expectation of financial return. Hence our remarks are confined exclusively to financial return crowdfunding, and will refer to three types of crowdfunding: peer-to-peer consumer, business lending and investment-based crowdfunding.

Part of the IoD International Network

Chief Executive: Maura Quinn. Company Secretary: Liam Daniel

Directors: D Lamont (President), E Coughlan, L Daniel, G D'Arcy, D Flinter, I Gibney,
H Lorton, HA McSharry, J Murphy, K Neary, M Somers

A company limited by guarantee, registered in Ireland number 197643

General Questions

Question 1: Should crowdfunding in Ireland be regulated?

Yes. The Institute of Directors believes that it would be important to consider a proportionate regulatory framework in Ireland in view of the fact that crowdfunding is already showing growth in Ireland, and is likely to emulate growth elsewhere, raising concerns about oversight, which would provide protection for potential investors and ensure that the sector develops in a regulated and structured way. With the growth of the investment model elsewhere and the fact that the EU Commission has no plans to introduce laws for crowdfunding, while continuing to keep the matter under review, the responsibility will remain with Ireland to introduce its own domestic regulatory regime similar to many other Member States.

Crowdfunding also comes under the category of 'shadow banking', or financial activities that go on outside banks. The Swiss-based Financial Stability Board states that Ireland is home to \$2.2 trillion (€2 trillion) of global shadow banking assets. Almost a third of Ireland's shadow-banking is subject to little or no regulation. Now is the time to devise and implement a proportionate regulatory framework in Ireland, which serves to adequately protect all involved.

2(a): What risks associated with crowdfunding should be considered and addressed in any potential regulatory regime? How could they be mitigated?

As crowdfunding is currently unregulated in Ireland, there is therefore no formal protection in place for consumers, investors or businesses. The IoD recognises that the crowdfunding model is still developing, and therefore any regulatory regime should not have a chilling effect on the industry. However, the IoD also believes that absence of regulation and oversight could have a detrimental effect on the evolution of a sustainable industry model.

A regulatory and oversight regime is therefore needed that protects the interests of all stakeholders while supporting the development of the industry in parallel.

We suggest that the following risks should be considered and weighted accordingly.

- Consumers may be attracted to crowdfunding without having a full understanding of how the model works, without understanding that it is wholly unregulated and without understanding that there are no guaranteed returns.
- Inexperienced consumers may not understand the range of other risks involved such as the extensive nature of cybercrime. The anonymity provided to unregulated technology platforms may also increase the risk of fraud.
- Data protection risks must also be considered.
- There is also a risk that the absence of regulatory oversight may mean that inadequate or misleading information may be provided to investors which may mean that they cannot make a fair and informed assessment of the risks involved in undertaking the investment.

- Contractual terms of an excessive or unfair nature may be imposed on unsuspecting investors who are unfamiliar with the terms usually offered for similar crowdfunding opportunities.
- With crowdfunding seen as an alternative source of funding for start-up businesses who may find traditional funding sources reluctant to invest, there is greater risk of business failure associated with these start-ups resulting in consequential losses for investors.
- If the platform itself fails, without any current prudential, client asset or business rules, this is a further risk for a potential investor.
- Return on investment (ROI) can also be less than what was expected and there is currently no mechanism for either dispute resolution or redress.
- Furthermore, it may not be possible for the investor to sell on shares or an equity interest due to the potential absence of a secondary market.
- With the potential risks outlined above, one may also add that the absence of any form of corporate governance or oversight may mean that the long-term best interests of the business and its stakeholders are also at risk.

2(a)b: How could these risks be mitigated?

There are clear and substantial risks evident in respect of crowdfunding from the outset. These risks require to be enumerated and categorised according to their complexity and likely incidence of occurring.

A proportionate regulatory framework must be considered to account for the range, size and complexity of an investment.

The framework would ensure that, at a minimum, investors are assured of basic standards with regard to the quality and accuracy of information provided on platforms seeking investors. There should be full disclosure of the risks involved for investors, allowing them to make informed decisions about the potential investment. The information provided would also include the returns expected and the means by which this will be discharged.

There must also be a complaints mechanism, which allows investors access to an independent party to hear about their concerns and a mechanism for redress.

In a regulatory regime, a risk management framework would safeguard the security, continuity, compliance and integrity of all crowdfunding operations in support of overall strategy and corporate objectives. The framework should apply to the three general types of crowdfunding in the financial return category.

Question 2(b): If regulation is to be introduced, should there be minimum standards of due diligence, disclosure and a process in the event of default, insolvency or bankruptcy? Should there be a standard suggested procedure or best practice outlined? If so, what should this include and what would best practice entail?

2(b) a: If regulation is to be introduced, should there be minimum standards of due diligence, disclosure and a process in the event of default, insolvency or bankruptcy?

Yes, we believe that minimum standards should form part of a proportionate regulatory framework for the crowdfunding industry. This would support the development of the industry by giving investors assurances that encourage other potential investors to come forward in greater numbers. The higher the degree of assurance around crowdfunding, the greater the opportunity for Irish enterprise. The evidence from other jurisdictions is that regulation has had no adverse impact on the growth of the crowdfunding industry.

The IoD also regards obligations around due diligence and disclosure, and robust protections for dealing with default, insolvency or bankruptcy as part of a minimum requirement for lending and investment-based crowdfunding.

There should be provision of information which is transparent and not misleading so that the investor is able to understand the nature of the risks involved and therefore make an informed decision. In terms of due diligence and disclosure, the types of information provided should include:

- Expected and actual default rates
- Reasonable description of likely return
- Details of loan risk assessment
- Details of lender protection
- Lender exit options

2(b) b: Should there be a standard suggested procedure or best practice outlined?

There should be a standard procedure available. The due diligence processes that firms should follow, and the level of diversification investors should seek to mitigate risks, should be outlined.

2(b) c: If so, what should this include and what would best practice entail?

The IoD believes that a regulatory regime that is alert to best practice, should be framed with foresight. Regarding crowdfunding, such is the pace of expansion in the fintech sector, it seems likely that far larger sums will change hands in the not-to-distant future, than is currently the case.

Furthermore, the potential for abuse of the crowdfunding model is considerable. If it develops without the proper regulatory oversight, there is a high risk of misapplication or fraud.

Steps need to be taken by the Department to aid regulatory oversight in order to ensure that crowdfunding enables enterprises to access capital and to guard against fraud. Such steps could create new opportunities for crowdfunding but establish basic regulatory oversight, liability, and disclosure rules. There is also a need to increase legal clarity on insolvency rules applicable in case the online platform fails, the funded enterprise is bogus or fails, anti-money laundering rules and intellectual property rights protection.

There is now considerable experience in other jurisdictions of how regulatory frameworks have developed over time, lessons learnt in terms of oversight and unintended consequences. This is all a valuable resource to Ireland. In addition, the European Union provides significant resources in this area which will be of assistance.

The various regulatory frameworks developed by the Central Bank of Ireland in the financial services sector, can provide significant assistance in the development of a proportionate regulatory framework.

Question 2(c): Should businesses be required to provide specific information when seeking funding on crowdfunding platforms? If so, should there be different requirements for loan-based and investment-based crowdfunding? What specific information should be provided?

2(c) a: Should businesses be required to provide specific information when seeking funding on crowdfunding platforms?

All the informational and disclosure requirements involved in conventional funding should apply to crowdfunding with further safeguards in relation to data security, location of the business and security of contract.

2(c) b: If so, should there be different requirements for loan-based and investment-based crowdfunding?

Yes, there should be different requirements for loan-based and investment-based crowdfunding as loan-based crowdfunding is seen as lower risk.

When devising the regulatory framework to generate conduct rules and guidance around crowdfunding, dividing 'loan-based crowdfunding platforms' from 'investment-based crowdfunding platforms', should be considered. Generally, loan-based crowdfunding is lower risk than investment-based crowdfunding and loan-based crowdfunding should be subject to 'softer' regulation on adequate disclosures to consumers.

2(c) c: What specific information should be provided?

The disclosure of expected and actual default rates, investment security mechanisms, comparative information and periodic reporting to clients, as well as the provision of information on the firm's position regarding taxation.

Question 2(d): Crowdfunding platforms in Ireland are not currently covered by prudential rules (including capital and liquidity requirements), by client asset rules or conduct of business rules. Should there be such standards for crowdfunding platforms in Ireland? If so, what should these standards include?

2(d) a Should there be such standards for crowdfunding platforms in Ireland?

Yes.

2(d) b If so, what should these standards include?

The standards should include obligations for crowdfunding platforms in respect of:

- Operational transparency including mandatory due diligence procedures to be carried out by the specific crowdfunding platform.
- A cap on platforms' interest rates and charges with clear, well-displayed information.

- Communication channels / direct contact facilitation between lender and borrower should be delivered by the platform. This should include a monitoring system to guard against false or unsubstantiated comments by either the lender or borrower.
- Security of information and payments should be paramount to the platforms' remit.
- Standardised restrictions on platforms providing credit facilities to lender or borrower.
- Total separation of lenders' funds from platforms' finances and a bar on the platform using funders' capital for investment or as collateral for borrowing.
- Loan contracts should be truly peer-to-peer borrowing.
- Demonstrate high standards of credit risk and operational risk management.
- Platform functionality.
- Operational procedures.
- Corporate governance information.

Question 2(e): Should the SME Regulations be applied to crowdfunding platforms?

Yes SME Regulations should be applied to crowdfunding platforms.

Question 2(f): Should there be a limit on the maximum level of investment in a 12 month period that an individual may invest in one or more crowdfunding projects/businesses that a crowdfunding platform can accept from an individual? Should there be other restrictions on retail investors before they can invest in both loan based and equity based crowdfunding?

2(f) a: Should there be a limit on the maximum level of investment in a 12 month period that an individual may invest in one or more crowdfunding projects/businesses that a crowdfunding platform can accept from an individual?

No, there should not be a limit on the maximum level of investment in a 12 month period that an individual may invest in one or more crowdfunding projects/businesses that a crowdfunding platform can accept from an individual.

2(f) b: Should there be other restrictions on retail investors before they can invest in both loan-based and equity-based crowdfunding?

The second part of the question in respect of retail investors, should be covered by transparency and right-to-contact rules. Lenders should have an entitlement to know if a retail investor has taken equity in, while also lending to a funding applicant. The size of the equity terms of any funding should be available to all potential funders.

Consultation Question 2(g): Are there any considerations that should be taken into account with respect to the cost of regulation or the cost of regulatory compliance?

The IoD suggests that the Central Bank of Ireland extends consumer and investor protection rules to cover the growing and relatively new crowdfunding technology. It should assume responsibility for the regulation of crowdfunding in order to take advantage of economies of scale and existing expertise.

Question 2(h): Should regulation address situations where there could be a potential conflict of interest, for example, where a crowdfunding platform, its shareholders, managers or key

employees can provide funds and potentially earn money from providing loans or having an equity share in enterprises through crowdfunding?

Yes, regulation should address situations where there could be a potential conflict of interest. Regulations should include references to licencing and employment contracts to counter incidences of conflict of interest.

Question 3: Should Ireland consider developing non-regulatory supports to encourage the development of crowdfunding?

The priority is to develop a proportionate regulatory framework for crowdfunding.

Conclusion

The IoD is firmly of the view that it would be important to consider a proportionate regulatory framework in Ireland for crowdfunding. This is to ensure that investor protections are appropriate for the risks in the crowdfunding industry while continuing to promote effective competition in the interest of consumers.

We appreciate the opportunity to present our views and would be delighted to discuss the issues raised in greater detail or to make any further contributions as necessary.

Yours sincerely



Maura Quinn

Chief Executive