



Crowdfunding: an alternative way of financing (Regulation (EU) 2020/1503)

Introduction

Crowdfunding is a way to facilitate the funding of a project by raising capital from a large number of people (each of whom typically contributes relatively small investment amounts), via online platforms.

On 3 March 2023, the Cyprus Securities and Exchange Commission (“**CySEC**”) published [Directive DI73-2009-02 for the Crowdfunding Service Providers](#), which relates to the application of articles 12, 13(1) and 15 of [Regulation \(EU\) 2020/1503 on European Crowdfunding Service Providers for Business](#) (the “**ECSP Regulation**”).

CySEC also published, on 13 March 2023, its [Policy Statement PS01-2023](#) informing prospective European Crowdfunding Service Providers (“**ECSPs**”) which intend to provide their services from Cyprus, and existing Crowdfunding Service Providers (“**CSPs**”) previously authorised under national law (i.e. as Cypriot Investment Firms – “**CIFs**”), of the next steps towards the full implementation of the ECSP Regulation.

Background

The ECSP Regulation entered into application on 10 November 2021; it lays down common rules across the EU for the provision of **investment-based** and **lending-based** crowdfunding services related to business financing. It allows online platforms to apply for an EU passport based on a single set of rules, which makes it easier for them to offer their services across the EU with a single authorisation.

Investors on ECSP platforms will benefit from an aligned and enhanced investor protection framework, based on:

- Clear rules on information disclosures for project owners and crowdfunding platforms.
- Rules on governance and risk management for crowdfunding platforms.
- Strong and harmonised supervisory powers for national authorities overseeing the functioning of crowdfunding platforms.

Prior to the entry into application of the ECSP Regulation, only the provision of investment-based crowdfunding was regulated at national level in Cyprus. Specifically, CySEC had issued [Directive DI87-10 on the provision of crowdfunding services in respect of transferable securities](#), and [Policy Statement PS-01-2020](#). Under the national framework, entities offering investment-based crowdfunding services were subject to authorisation and supervision by CySEC as CIFs.

Transitional Period

According to the ECSP Regulation, CSPs authorised under national frameworks, including CIFs in Cyprus, may continue to provide crowdfunding services that fall within the scope of the ECSP Regulation, until **10 November 2023** or until they receive authorisation as ECSPs under the ECSP Regulation, whichever comes first. However, these entities may not benefit from an EU passport until they receive their authorisation under the ECSP Regulation.

The ECSP Regulation

Key players

The provision of crowdfunding services generally involves three key players: the **project owner** that proposes the project to be funded, **investors** who fund the proposed project, and an intermediating organisation in the form of a **crowdfunding service provider** that brings together project owners and investors through an online platform.

“Crowdfunding services” under the ECSP Regulation

Under the ECSP Regulation, crowdfunding services shall mean the matching of business funding interests of investors and project owners through the use of a crowdfunding platform, and which consists of the following activities:

- (a) The facilitation of granting of loans.
- (b) The Placing, without a firm commitment basis¹, of transferable securities and admitted instruments for crowdfunding purposes issued by project owners or a special purpose vehicle, and the Reception and Transmission of client orders² in relation to those transferable securities and admitted instruments for crowdfunding purposes.

The **joint** provision of the MiFID services under point (b) above, is the key feature of crowdfunding services compared to certain investment services provided under Directive 2014/65/EU (MiFID II), even though individually those services match those

¹ As referred to in point (7) of Section A of Annex I to Directive 2014/65/EU (MiFID II).

² As referred to in point (1) of Section A of Annex I to Directive 2014/65/EU (MiFID II).

covered by that Directive. It is noted that legal persons authorised as **crowdfunding service providers under the ECSP Regulation are excluded**³ from the scope of Directive 2014/65/EU (MiFID II), meaning they should not obtain another authorisation under that Directive.

Lending-based crowdfunding

Lending-based crowdfunding is the activity where funds are raised from the crowd in the form of a loan agreement that entails interest payments and principal repayment over time. As stated above, the ECSP Regulation applies to the **facilitation of loans**, including services such as presenting crowdfunding offers to clients and pricing or assessing the credit risk of crowdfunding projects or crowdfunding owners.

It is clarified that the facilitation of granting of loans that falls within the scope of the ECSP Regulation is distinguished from the activity of a credit institution, which grants credits for its own account and takes deposits or other repayable funds from the public.

Investment-based crowdfunding

Investment-based crowdfunding is the activity where funds are raised from the crowd, in exchange for transferable securities⁴ or admitted instruments for crowdfunding purposes⁵. **Transferability** is an important safeguard in order for investors to be able to exit their investment since it provides the possibility for them to dispose of their interest on the capital markets. Shares of certain private limited liability companies, which are also **freely transferable**⁶ on the capital markets, are not prevented from being included in the scope of the ECSP Regulation.

Threshold for crowdfunding offers

The ECSP Regulation imposes a maximum threshold of **EUR 5.000.000** for a total consideration for crowdfunding offers made by a particular project owner.

Investor protection

In order to ensure adequate investor protection of different categories of investors participating in crowdfunding projects while facilitating investment flows, the ECSP Regulation distinguishes between **sophisticated** and **non-sophisticated** investors and introduces different levels of investor protection safeguards appropriate for each of those categories.

Similar to the requirement under MiFID for an 'appropriateness' and 'suitability' test, the ECSP Regulation imposes a requirement on crowdfunding service providers to run an '**entry knowledge test**' of prospective non-sophisticated investors, in order to ascertain their understanding of such investments. Where non-sophisticated investors have insufficient knowledge, skills and experience, crowdfunding service providers

³ [Law 78\(l\)/2021](#) transposing [EU Directive 2020/1504](#).

⁴ As defined under point (44) of Article 4(1) of Directive 2014/65/EU (MiFID II), 'transferable securities' means those classes of securities which are negotiable on the capital market, with the exception of instruments of payment, such as: shares in companies and depositary receipts in respect of shares, securitized debt (eg. Bonds) and despositary receipts in respect of such securities.

⁵ As defined under point (n) of Article 2(1) of the ECSP Regulation, 'admitted instruments for crowdfunding purposes' means shares of a private limited liability company that are not subject to restrictions that would effectively prevent them from being transferred, including restrictions to the way in which those shares are offered or advertised to the public.

⁶ It is doubtful whether shares of private Cypriot Limited Liability Companies could qualify as freely transferable.

should explicitly warn them that the crowdfunding services might be inappropriate for them.

The ECSP Regulation also provides for a **reflection period** during which a prospective **non-sophisticated investor** can revoke an offer to invest or an expression of interest in a particular crowdfunding offer, without giving a reason and without incurring a penalty. The reflection period shall start at the moment of the offer to invest or the expression of interest by the prospective non-sophisticated investor and shall **expire after four calendar days**.

Key Investment Information Sheet (“KIIS”)

Similar to other EU financial legislation, investors should be provided with a Key Investment Information Sheet, in order to make an informed investment decision. The KIIS should reflect the specific features of lending-based and investment-based crowdfunding and should take into account the **risks** associated with project owners, focus on material information about the project owners, the **investors' rights and fees**, and the type of **transferable securities**, admitted instruments for crowdfunding purposes and loans offered. The KIIS should be **drawn up by the project owners**, because the project owners are in the best position to provide the information required to be included therein. However, since it is the crowdfunding service providers that are responsible for providing the key investment information sheet to prospective investors, **it is the crowdfunding service providers that should ensure that the key investment information sheet is clear, correct and complete**. The KIIS should warn prospective investors that the investing environment they have entered into entails risks that are covered neither by deposit guarantee schemes⁷ nor by investor compensation schemes⁸.

National Competent Authority Discretions

While the majority of the provisions of the ECSP Regulation has a direct effect, there are a number of provisions in respect of which Member States and NCAs are given discretion.

KIIS officially accepted languages

CySEC has decided that the *officially accepted language* for the KIIS, where a ECSP promotes a crowdfunding offer through marketing communication in Cyprus, is **Greek** (and provided that the KIIS is drawn up in Greek, **English** would also be accepted).

Ex-ante notification of the KIIS

CySEC has decided to require the *ex-ante* notification of the KIIS at least **seven working days** before making it available to prospective investors, pursuant to Article 23(14) of the ECSP Regulation. It is clarified that CySEC will not review/approve the KIIS, but it will be used for future reference/potential ex-post analysis, if so needed.

⁷ Established in accordance with Directive 2014/49/EU.

⁸ Established in accordance with Directive 97/9/EC.

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