

## **Requirements regarding applications for a licence to carry out Investment-based Crowdfunding under the Investment Services Act**

The Malta Financial Services Authority [the 'MFSA' or the 'Authority'] is hereby setting out Requirements regarding the circumstances under which a crowdfunding platform that plans to provide investment-based crowdfunding services shall be operating.

These Requirements set specific criteria that aim to ensure market integrity and protect investors from unwarranted risk. Given that the provisions of the Investment Services Act and Investment Services Rules are of general applicability and relevant to various types of Investment Services providers, the purpose of these Requirements is mainly to outline how certain provisions may apply to investment-based crowdfunding platforms that may be authorised under the Act.

The Requirements also seek to adopt a proportional approach by distinguishing between investment opportunities offered to retail and professional investors respectively, wherever this is permitted by the relevant rules.

These Requirements shall apply in addition to the 'Investment Services Rules' and 'Conduct of Business Rules' applicable to Investment Services Providers in terms of the Investment Services Act and any Regulations issued thereunder, and shall moreover be adhered to on an ongoing basis following the issue of the relevant approval.

These Requirements have been formulated in the light of the applicable frameworks including Markets in Financial Instruments Directive (MiFID) as well as feedback received in the course of public consultations following the publication of the MFSA Discussion Paper on Investment-Based Crowdfunding of 03/11/2016 and subsequent Feedback Statement published on 06/10/2017.

The Requirements shall be applicable to all applications submitted to the Authority for the relevant licence. Going forward the MFSA will issue Rules under the Investment Services Act for the better regulation of companies licensed in accordance with these Requirements.

When processing an application for a licence, the MFSA shall, *inter alia*, take into consideration the following:

### **Definitions:**

"Applicant" means the person applying for a licence when the investment crowdfunding service being provided results in an investment service in terms of the Investment Services Act;

"crowdfunding platform" means the medium through which the investment crowdfunding service or range of services falling within the scope of these Requirements is being provided;

"issuer" means the person issuing an instrument through a crowdfunding platform.

**Licensing requirements:** In order to provide investment-based crowdfunding services, a platform shall apply for a licence under the Investment Services Act. Given that business models for crowdfunding platforms may vary from one case to another, it is recommended that a detailed description of the nature of the services being provided by the platform and an overview of the proposed operational model is presented to the Authority at the pre-application stage. The latter should take into consideration the Requirements provided in this document.

The nature of the licence required will depend on the range of activities provided by the prospective licence holder, either on a stand-alone basis or as a part of a group of providers.

**The Application:** The relevant Application shall be submitted in accordance with Part A of the Investment Services Rules for Investment Services Providers and shall be accompanied by a detailed business plan as required under the said rules. The business plan shall, *inter alia*, set out in detail the nature and the manner in which the relevant activities will be carried out, aspects related to the handling of clients' money, any other investment activities that the Applicant may intend to carry out, and any intended outsourcing and/or delegation of any activities and processes. The Applicant would need to indicate whether the investment service being provided is that of reception and transmission of orders and/or handling of clients' money and/or any other investment service. Business plans submitted with an application for licensing of an investment crowdfunding platform will be reviewed on a case by case basis in terms of objectives and strategy, target market and customers, governance-management, key dependencies and business risks.

The MFSA understands that the operation of investment-based crowdfunding platforms would normally require the handling of clients' money for the purposes of placing orders according to the investors' investment decisions as well as the release of the committed amounts to the issuer of the relevant securities. The MFSA considers this type of activity as involving the holding and controlling of clients' money requiring that these cases be treated accordingly for licensing purposes.

**The MiFID Passport:** While investment services authorised in terms of the Investment Services Act are passportable under MiFID, there is currently no EU-level framework that would ensure the possibility of passporting crowdfunding activities throughout the internal market. Applicants should therefore verify the requirements applying to the carrying out of investment-based crowdfunding services in the EU Member State where they intend to provide such services.

**Capital Requirements:** The platform shall be subject to the capital requirements applicable to the relevant licence category. The required capital should be satisfied on an ongoing basis and not just at licensing stage.

**Segregation of activities:** Applicants that already hold an investment services licence and intend to provide investment-based crowdfunding services, shall consider this to be a material change in their business model and shall therefore need to seek MFSA approval in accordance with these Requirements. In their application, applicants shall clearly distinguish between services provided under their current business model and their crowdfunding business model, and shall demonstrate how, in addition to their current licence obligations, they would be capable of satisfying these Requirements with respect to the crowdfunding component of their business model.

In those cases where the Applicant is already licensed to provide an investment service, the Applicant shall also ensure that it shall distinguish clearly and on an ongoing basis, between the crowdfunding component in their business model and other investment services activities being performed by them as part of their original model. This demarcation should, *inter alia*, be reflected in the books of account, the relevant promotional material and website structure.

The requirements in respect of segregation of activities shall also apply to new Applicants who intend to provide investment-based crowdfunding services as well as other investment services.

#### **Disclosure requirements:**

##### **A. Issuer to disclose information to the Applicant and investors**

Applicants are required to demonstrate that businesses offering securities through the proposed crowdfunding platform would be subject to minimum disclosure requirements tailored to investments of this nature. In cases where the offer triggers application of the Prospectus Directive, the general EU requirements in this regard would be applicable.

Where no such Prospectus is required, the issuer is expected to provide the platform with an information document containing full details on the identity of the issuer, including full contact details, as well as all the relevant information on the business activity of the issuer, the project in relation to which the investment offer is being made as well as the potential risks and rewards associated with it.

The information document should contain information to help the investor understand the specific type of instrument that is being offered, and make investment decisions on an informed basis. The information disclosed must be meaningful, comprehensive, and sufficient enough to enable an informed investment decision. The information document must in addition disclose that the document has neither been verified nor approved by the MFSA.

Applicants shall have in place and apply adequate procedures to verify the completeness and the clarity of information contained in this information document.

#### **B. Obligation of the Applicant to disclose information on the proposed investment projects**

Applicants should make the information provided by the issuers directly available on their website. Applicants shall moreover provide details of procedures that the Applicants intend to adopt in order to ensure they meet their disclosure obligations.

Unless the applicant would be providing advisory or any other relevant investment service, it should be highlighted in the disclosures that it is not the responsibility of the provider to evaluate or guarantee the actual feasibility or viability of the issuer's project, either at initial or at later stage.

The Applicant shall moreover disclose whether and to what extent, based on the assessment carried out by the Applicant, the Applicant's activities would be covered by the Investor Compensation Scheme [S.L. 370.09] and the Depositor Compensation Scheme [S.L. 371.09]. A copy of the said assessment shall also be submitted to the Authority together with the business plan accompanying the application for licence.

#### **C. Disclosures about the treatment of client money**

Applicants are required to clearly disclose to investors on the platform the following information:

- (i) The name of the entity which will be entrusted with the safekeeping of their invested funds, pending the transfer to the issuer (if this is separate from the applicant itself);
- (ii) The manner and timing in which these funds will be transferred to the issuer. In this regard, applicants are to ensure that such funds are transferred without undue delay.
- (iii) The circumstances in which any funds held by the applicant or by a third party on its behalf (as the case may be) are to be returned to investors and manner in which such returns are to be made as well as the timing thereof. In this regard, applicants should ensure that such funds are refunded in a timely manner and without undue delay.

#### **D. Other disclosures and warnings**

The Applicant is expected to display, at all times and in a prominent place on the homepage of its website, information under the following sections: 1) general risk warnings in relation to the nature of the investment and the risks involved, including the fact that the platform does not undertake any responsibility regarding the feasibility of the project as presented; 2) a section on the services offered by the Licence Holder in relation to the instrument on offer, including the nature and risks of the investment service to be provided, and 3) the total amount to be charged to the investor.

With the exception of any additional obligations in relation to other investment services that the platform operator may be licensed to provide, prospective investors should be required to note that they are expected to read and assess the information provided in the platform's website in order to form their own investment decisions. It is the responsibility of the investors to read and assess at their own risk all the information provided taking into account the relevant warnings and disclosures, as well as carry out additional research, if necessary, in order to form their investment decision.

**Educational Material:** Investors should be encouraged to obtain information also on their own initiative. In order to facilitate this, it is advisable that platforms provide in a separate place on their website any additional educational material which is considered useful. The latter is not directly related to the investment projects themselves but is of a general educational nature and is aimed at guiding persons who are relatively unfamiliar with risks associated with investment in general and crowdfunding in particular. Such educational material could include investment guides and other aides such as learning videos, references to other educational websites that provide factual and technically correct information including explanation of risks, proposed strategies, ratings of the risk of the investments, aggregated data on successful or unsuccessful previous projects and other relevant information.

#### **Due-diligence requirements:**

##### **A. Project-related due-diligence requirements**

Applicants are expected to have in place adequate procedures to conduct due-diligence tests on the issuers and their business plans, in order to minimise the risk of fraud and investor detriment.

The main objective is to ensure integrity and competence of the persons involved and that the business proposal made by the issuer is in good faith.

The platform provider shall also verify the following:

- i. the issuer is duly incorporated or otherwise validly established or registered for business purposes according to the relevant laws of its place of incorporation or establishment;
- ii. the issuer is operating in conformity with its memorandum and articles of association or equivalent constitutional or registration documents;
- iii. the shares or debt securities are offered or being issued in conformity with the law of the issuer's place of incorporation and duly authorised according to the requirements of the issuer's memorandum and articles of association or equivalent constitutional document;
- iv. the creditworthiness of the issuer.

## **B. Anti-Money Laundering rules**

Investment services providers are subject to the applicable laws on the prevention of money laundering and terrorist financing.

In this regard, the Applicant shall as a minimum be required to identify and verify the identity of the issuer and the investors, and shall be subject to any other customer due diligence requirements as well as all other obligations arising out of the said legislation.

**Entry knowledge assessment:** The Applicant shall ensure a minimum level of protection for the investor. In respect of this, it shall carry out an online entry knowledge test, in order to determine whether the financial products and services envisaged are appropriate for the prospective investor. Applicants are therefore required to maintain procedures that enable them to assess prospective investors' investment experience, investment knowledge, and investment objectives. To this regard, Applicants shall obtain information such as the types of transactions prospective investors are familiar with, their level of education, frequency and volume of their transactions. Following the appropriate verifications, Applicants may assume that this test is satisfied if dealing with professional clients in terms of MiFID.

The business proposal submitted to the Authority shall include information as to how the knowledge test is to be carried out. Where prospective investors do not provide the information required above, or where the Applicant considers on the basis of the information received that prospective investors do not have sufficient knowledge, the Applicant shall be required to inform prospective investors that the services offered on the platform may be inappropriate for them and give them a risk warning.

**Instruments:** Instruments to be marketed on investment-based crowdfunding platforms should be non-complex instruments.

For the purposes of these Requirements only the following instruments shall be marketed on these platforms and be considered to be non-complex instruments:

- i. shares in companies, excluding convertible shares, shares in collective investment undertakings and shares that embed a derivative;
- ii. bonds or other debt instruments, excluding those that embed a derivative or incorporate a structure which makes it difficult for the client to understand the risk involved,

provided that there are no restrictions on the transferability of the instruments eligible under sub-paragraph (i) and (ii) of this paragraph.

### **Caps on investable amounts:**

The following limits shall apply with respect to issuers and investors as the case may be:

- i. a cap on maximum investable amount (allowable) per individual investor;
- ii. a cap on maximum project size in terms of total value of securities issued.

In particular the following limits shall apply:

- a) an investor cannot invest more than € 5,000 over a period of 12 months in any issuer listed on an investment-based crowdfunding platform; and
- b) an investor cannot invest more than 20% of their net annual income through an investment-based crowdfunding platform over a period of 12 months; and
- c) an offer of securities made on an investment-based crowdfunding platform cannot exceed the value of € 1,000,000 over a period of 12 months; and
- d) an issuer shall only be allowed to place a project on one crowdfunding platform.

Measures a) and b) above shall not apply to professional clients in terms of MiFID.

In addition to any verification that the Applicant shall make prior to enabling an issuer to place a project on the Applicant's platform, the Applicant shall require the issuer to submit a declaration undertaking that the project in question is not, and will not, be placed on another crowdfunding platform.

In addition to any verification that the Applicant shall make prior to allowing any investor to invest on their platform, the Applicant shall require the investor to submit a declaration undertaking that the particular investment, together with any other investment made on the Applicant's platform and any other investment crowdfunding platform, does not exceed 20% of their net annual income over the last 12 months.

**General Requirements:** The above factors should not be interpreted as an exhaustive list of aspects which may be taken into account by the MFSA in the process of evaluating the relevant applications for licence. The MFSA reserves the right to impose any special licence conditions envisaged by the relevant rules and regulations as may be deemed necessary in view of the particular business model adopted by the applicant and other relevant circumstances. Each application is assessed on its own merits.