

29 November 2019

European Crowdfunding Service Providers Regulation – Including lending platforms operating “discretionary models”

In light of the last trilogue discussions on 25th November and the ongoing discussions on the scope of the European Crowdfunding Service Providers Regulation (“Regulation”), the Association of German Lending Platforms (*Verband deutscher Kreditplattformen*) would like to take this opportunity to detail our position on the inclusion of discretionary services in loan agreements.

The Association of German Lending Platforms remains supportive of the objective to facilitate access to finance for SMEs by creating a pan-European framework for crowdfunding services, and has been throughout the legislative process. We understand that “discretionary services”, or more specifically “individual portfolio management of loan agreements” are now likely to be included under the scope of the Regulation. We would welcome the inclusion of such business models, which are common throughout the EU and in the interest of investors, if a number of crucial points for lending platforms can be addressed during trilogues.

Discretionary models

Under “discretionary models”, which are commonly called “autobid”, “autoinvest” or “portfolio builder”, platforms execute individual investment decisions of investors. Investors specify their investment decisions by certain criteria and details (e.g. based on risk bands and including the investment amount). Lending platforms execute these instructions when listing loans on their platforms. In contrast to the more traditional “pick and choose” features, these tools enable investors to spread relatively small amounts across a large number of projects. As an example, an investor might choose to invest EUR 2,000 in parts of EUR 20 across 100 loans. This would conveniently create a well-diversified portfolio that is much more likely to earn stable returns than large investments in a handful of projects. In addition to better diversification and user experience, autobid features allow investors to rely on a specific platform’s credit analysis, which is typically based on statistical risk models, manual underwriting and many more data points than can be shared with investors on an ongoing basis. Investors.

To ensure the Regulation provides workable rules for these features, we believe that further changes to certain provisions of the Regulation are necessary. Unless adequate rules for these models are introduced, the Regulation risks de facto prohibiting autobid features.

Recommended amendments

- **The KIIS (Art 16(4a) of the Parliament text):** We support the principle of the Key Investment Information Sheet (KIIS) as the way to provide investors with the necessary information to make informed decisions. **As already reflected in the Parliament text in Art 16(4a) for “intermediated services”, “discretionary” platforms should be obliged to provide a platform-focused KIIS instead of project-focused one.** Investors on discretionary platforms typically instruct platforms to place a high number of small investments (for example, of €20) in the projects

offered according to their instructions. This diversification is important to protect investor returns and therefore in the interest of investors. The crucial information for an investor, who uses such automated diversification tools, is not in the details of a project but instead the performance of a platform overall over time (the returns of the loans generated as well as default rates, collection strategies and credit risk management in general). We therefore strongly support a *platform-based* KIIS with this information instead of granular project-focused information. Platforms should of course provide information on individual projects to the investors but this should be part of the regular portfolio reporting which should allow investors to access specific information on individual projects if they want.

- **Ex-ante notification (Art 16(8) of the Council text¹):** We are of the opinion that the option of a notification requirement is an unnecessary burden. The delay in time (of seven working days) contradicts the Regulation's objective to provide accessible and fast financing to SMEs. For lending-based crowdfunding, speed is a crucial element to a good borrower experience and a differentiator with banks when arranging SME financing. We therefore believe that the notification requirement combined with a mandatory waiting period would have a very detrimental effect on platform lending in Germany.
- **Ex-ante notification (Art 16(8) of the Council text) and platform-focused KIIS:** In any event, an **ex-ante notification requirement cannot be reconciled with a platform-focused KIIS** and would therefore have to be limited to project-based KIIS (if at all). The reason is that the content of a platform-based KIIS would be identical for each investment over a certain time until updated in due course. Having a KIIS checked for each and any project would be an empty formality with the effect of delaying the funding process and creating administrative burden for platforms, borrowers and regulators.
- **Reflection period (Art 15b of the Council text):** Art 15b stipulates a period of seven calendar days before the investor's intention is deemed final. While we do not object to the idea of a revocation right (for example along the lines of § 2d *VermAnlG*), **Art 15b stipulates another waiting period of seven calendar days between investment by an investor decision and pay-out of a loan.** This provision forces platforms to freeze funds until the waiting period has run its course and would therefore slow down the pay-out of a loan without any apparent benefits for the investor. Combined with the seven working day waiting period of Art 16(8) of the Council text, it would lead to a waiting period of two and a half weeks and seriously impair the attractiveness of business loans offered by lending platforms. Especially in lending, investors will typically already have a two-week revocation right under the Distance Selling Directive (97/7/EC) which will overlap with this additional withdrawal right.
We suggest to instead include a revocation right similar to § 2d *VermAnlG* which would oblige platforms to reimburse investors should they make use such right but do not oblige platforms to freeze funds.
- **Reflection period and discretionary models:** In any event, a reflection period as stipulated in Art 15b of the Council text cannot be reconciled with discretionary models. We therefore strongly believe that Art 15b should not apply to discretionary models (unless remodelled into a traditional revocation right alike § 2d *VermAnlG*).

¹ File no 10557/19 (24 June 2019) – Interinstitutional File 2018/0048 (COD).

One way to achieve this might be a threshold below which this provision does not apply.

- **Transition period (Art 38a of the Council text): We fully support the Council addition of a 12-month transition period** during which crowdfunding service providers can continue to provide crowdfunding services in accordance with the applicable national law. Without these transitional arrangements, crowdfunding service providers will not have sufficient time to adapt their business operations to the rules provided by this Regulation and apply for an authorisation under this Regulation.
- **Platform-managed Bulletin Board (Art 17):** Art 17 establishing a Bulletin Board, as drafted in the Commission's proposal and the Parliament's report, would have a severe impact on the operations of lending platforms by preventing an organised and fully functioning secondary market. We therefore support the concept in Art 17 of the Parliament text. Whereas the Bulletin Board structure is appropriate for investment-based crowdfunding, it is impractical and does not reflect market practice of lending platforms. The ability to operate a platform-managed secondary market is essential; secondary markets currently organised and run by platforms are of proven benefit to retail investors as they add some necessary flexibility and reduce the risk of abuse. Using the platform, investors who would like to access their money early are able to sell their loan parts to other investors, subject to demand. Furthermore, these secondary markets operate according to strict internal rules in the interest of investor protection. For example, these rules could entail that loan parts, which are late or not performing cannot be sold and should be held to term. The purchase price of these loans eligible for the secondary market might be determined by the platform in order to balance out demand and offer and a random generator chooses the loans of a portfolio, which are sold. Such rules prevent a seller from using information about certain loans, which a purchaser may not have and prevent buyers from abusing a situation under which a seller is under pressure to sell.
- **Underwriting (Art 5(2a)(b) and Art 14(4a) of the Council text):** We welcome the credit risk management provisions introduced by the Council. However, platforms must be allowed to use innovative methods for credit analysis, and these will change as they develop. For this reason, requiring them to use "audited accounts covering the two latest financial years where available" and to disclose specifically if they cannot, would ignore the standard underwriting practices as far as small businesses are concerned. Moreover, investors might be misled by overstating the relevance of audited accounts. Information like payment history or credit bureau scores can be much more relevant for the purposes of credit analysis than audited accounts, which usually include only dated information at the time of the credit analysis. Furthermore, most small and micro enterprises are typically under no obligation to provide audited financial statements. Consequently, such documents are not available in the large majority of cases.
- **Customer Due Diligence (Art 5a(2a) of the Parliament text²):** We support robust customer due diligence and believe the Council text (Art 4(6)) provides proportionate rules. The provisions in Art 5a(2a) of the Parliament text however would be harmful to the operation of lending platforms: some of the checks would take weeks to complete and pose challenges in terms of privacy as they contain measures such as

² File no. A8-0364/2018 (8 November 2018).

checking criminal records or checking whether a project owner "effectively complies with internationally agreed tax standards".

In addition, there are a few issues regarding the existing national regulatory framework in Germany we would like to address. We are at your disposal should you have any questions and would like to discuss discretionary services in more detail.