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Is regulating crowdfunding missing the point?

Jeremy Glen explains how the rise in popularity of crowdfunding has led to financial regulation

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In April 2014, the Financial Conduct Authority (FCA) published rules and guidelines for UK crowdfunding platforms. Though designed to protect investors, there are concerns that these rules will force a growing industry back into the box.

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Crowdfunding is the online process of raising finance from lots of people who each give small amounts of money and which grew from a gap in the market for alternatives to traditional funding.

There are three types of crowdfunding, each giving investors something different for their money. While some will get nothing in return (donation crowdfunding), others can expect to receive their money returned with interest (debt crowdfunding) and there is even scope to receive shares in the company (equity crowdfunding – a model made popular by Brewdog).

Despite its popularity, crowdfunding is risky. Start-ups and early-stage businesses have no trading history so accurately predicting the return on an investment is nearly impossible. An investor isn't guaranteed dividends or the return of their investment. If a project goes viral, shareholding can easily become diluted meaning you might not get what you were expecting.

These concerns prompted the FCA's intervention and now debt crowdfunding and equity crowdfunding are more closely regulated. Donation crowdfunding is not covered by the rules so well-known platforms like Kickstarter and Indiegogo have been unaffected.


Jeremy Glen

Some of the FCA's rules have been welcomed as they are unlikely create a huge burden. Debt crowdfunding platforms must be clearer about crucial information, like who the borrower behind the project is and whether there are any risks associated with the loan. Any promotions or interest rates must not be misleading and investors must be given 14 days to cancel.

That said, the requirement for platforms to have back up plans (to secure the loan structure and ensure that loan repayments from the borrowers to investors will continue even if the platform ceases to exist) will require a huge effort on the part of the platform and could be off-putting.

The final sting in the tail is the intervention into the use of social media

The rules for equity crowdfunding platforms have been more controversial. The 10% Rule requires anyone buying shares via crowdfunding to certify that they are not committing more than 10% of their Net Investible Assets (i.e. their home, pensions and life insurance). However, this doesn't apply to so-called sophisticated investors, who either have past experience of investing or can afford any losses. This risks equity crowdfunding becoming the reserve of traditional investors.

The final sting in the tail is the intervention into the use of social media. This has been particularly controversial as crowdfunding often relies on social media to make projects go viral. Now adverts must explain the risks associated with crowdfunding. While this might work for larger adverts on sites like Facebook, the FCA also suggests that Tweets should contain these warnings - a challenge considering the 140 character limit!

Overall, while the motives behind the rules are understandable, the FCA have shown a lack of engagement with the ethos of crowdfunding and there are concerns that the rules will stifle a model which was intended to be an informal alternative to traditional funding. It remains to be seen what effect the FCA rules (and any new social media rules) will have on crowdfunding in the long term.

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