Bitkom represents more than 2,500 companies of the digital economy, including 1,700 direct members. Through IT- and communication services only, our members generate a domestic turnover of 190 billion Euros per year, including 50 billion Euros in exports. Members of Bitkom employ more than 2 million people in Germany. Among the members are 1,000 small and medium-sized businesses, over 400 startups and nearly all global players. They offer a wide range of software technologies, IT-services, and telecommunications or internet services, produce hardware and consumer electronics, operate in the sectors of digital media or are in other ways affiliated to the digital economy. 80 percent of the companies’ headquarters are located in Germany with an additional 8 percent each in the EU and the USA, as well as 4 percent in other regions. Bitkom supports the digital transformation of the German economy and advocates a broad participation in the digital progression of society. The aim is to establish Germany as globally leading location of the digital economy.

1 The benefits of European regulation

We strongly believe in the benefit of European regulation for crowdfunding services.

We agree with the European Commission’s analysis that an EU-wide regulation can significantly improve the economic conditions for small and medium-sized enterprises (SMEs) and startups. In particular, small businesses and startups are still underserved when it comes to accessing finance, even though SMEs are the lifeblood of the German and European economy. In many European markets SMEs are traditionally underserved by banks; and we see no improvement in this regard. While banks turn away from small business loans for economic reasons, credit platforms can connect investors and borrowers.

EU-wide regulation will help to create a level playing field and allow platforms to expand within the Single Market. We agree that European rules are the next and vital step for the industry. We also believe that only a harmonised European set of rules can create high and robust standards for investor protection and risk management.
2 Executive summary

In our assessment, the European Crowdfunding Service Providers Regulation ("ECSPR") in its current form will not be attractive for the vast majority of the crowdlending industry and does not provide adequate investor protection. The ECSPR impedes the development of innovative and customer-friendly products which are already today offered by leading credit platforms and which investors expect. In our opinion, it also falls short in terms of customer protection and requirements for risk management and market integrity.

We believe that the ECSPR could be a big success for all stakeholders if these issues are addressed. We also believe that this will be possible in the legislative process even though we acknowledge the ambitious timeline.

We would like to highlight the following shortcomings of the current ECSPR draft (further details being given in the remainder of this paper):

- The ECSPR is drafted for equity-based crowdinvesting and to some extent unsuitable for the area of crowdlending.

- The restriction to “transferable securities” and loans is problematic.

- The information requirements on individual projects are not suitable for crowdlending.

- Several provisions impede useful product innovations.

- Supervision by ESMA and the legal recourse to the ECJ overlap with national regulators in payment services and result in unnecessary complexity.

- Several relevant topics are neglected, such as risk management and transparency of loan book performance.

- The regulatory implications on investors and borrowers in Germany need to be clarified.

3 Our analysis of the ECSPR

In its current form, the ESCPR does not provide an attractive licensing option for most crowdfunding service providers, and in particular not for platforms domiciled in Germany. The reasons are shortcomings in its scope, general design flaws and a high degree of uncertainty in relevant questions for the German industry. It also neglects key safeguards for
the responsible growth of the industry and for investor protection. Only if these matters are addressed, will the ECSPR offer a viable solution for German credit platforms.

3.1 The impact on regulatory requirements applying to borrowers and lenders – Will this allow direct lending in Germany?

Looking at crowdfunding models in Germany, the first and most relevant question for our assessment is the impact of the ECSPR not only on credit platforms but also on the borrowers and investors involved. It is our understanding that the ECSPR would not leave any room within its scope for national license requirements (around credit business for investors and deposit taking for borrowers which currently rule out most direct lending models in Germany). We strongly support the concept of allowing direct SME lending in Germany under the ECSPR provided that it introduces adequate regulation in the interests of all parties involved.

While the ECSPR would have implications on the current legal framework in Germany beyond crowdfunding service providers only, we strongly believe that such change is vital to provide German credit platforms with an option to grow, compete and to build scalable business models. It is also a good opportunity to introduce the direct lending model in a very small area and assess its consequences.

Looking at the workarounds, which some credit platforms use in Germany to bypass the existing banking monopoly, we believe that investors, borrowers and credit platforms would benefit from this new concept. The current situation has given rise to questionable developments within the German crowdlending landscape at the expense of investor protection. In order to rule out any credit business on behalf of investors and deposit taking on behalf of borrowers, several platforms resort to subordinated loans which do allow direct lending. We feel that this is a hybrid product between equity and debt financing with a significantly higher risk profile and that its use is not in the interest of investor protection.

Bitkom’s crowdlending platforms work on the basis of regular loan agreements, even though we are aware that the use of a cooperation bank, respective fees, cost for borrowers and the regulatory burden under outsourcing arrangements do not provide a competitive basis for international growth. This German peculiarity constitutes a major obstacle to German credit platforms in a critical phase and time for the industry. We strongly advocate a balanced European approach which achieves investor protection and high risk management and transparency standards by other means than these license requirements, which we feel are prohibitive.
We suggest

- to clarify that additional national license requirements for investors and borrowers in the context of loan origination do not apply in the context of the ECSPR;

- to include minimum requirements for credit platforms in order to ensure professional credit analysis and a professional management of credit risks and operational risks.

3.2 The distinction between crowdlending and equity-based crowdfunding

We do not agree with the assumption in the ECSPR that “it is appropriate to include in the scope of this Regulation both lending-based crowdfunding and investment-based crowdfunding, since they are comparable business funding alternatives” (Recital 1 of the ECSPR). Instead, we strongly believe that the ECSPR needs to distinguish between crowdlending and equity-based crowdfunding to provide an attractive and robust regulation which is adequate for both industries. The reason is that these are different asset classes and business models – both in terms of the financial assets concerned and in terms of investor protection, inherent risks, repayment profiles and product requirements. We note that countries with a successful crowdlending industry that has managed to scale, such as the UK, have bespoke regulation for credit platforms and distinguish between crowdlending and equity-based crowdfunding. Unsurprisingly, these countries point out that the ECSPR falls short in not making this distinction.

Crowdfunding typically promotes investments in start-ups or significant business expansions. Investors participate in the equity of these businesses. Due to their financing purposes and the subordinated character of equity investments, these investments are much riskier than financing established businesses through fixed-interest loans. For an informed decision, investors should analyse thoroughly the business in question, its financials and business plans in order to assess risks and benefits. Repayments usually depend on certain milestones; only in case of a successful project progression can investors exit their investments at returns which are hardly predictable.

Crowdlending (roughly a €20bn industry in 2017 in Europe) provides small and micro enterprises, which are not well served by banks, with access to finance. The lack of finance for this sector results from the small loan sizes involved which are not attractive to banks for various commercial reasons. Crowdlending usually works with fixed-interest loans which support an established business. Credit platforms can assess the probabilities of default with their own risk models, data provided by credit bureaus and their own risk analysts. Repayments are predictable since they are clearly determined by their amounts and due dates. Further, crowdlending is a much more standardised form of investing than
crowdinvesting. Apart from loan amounts, interest rates and terms, the financing conditions do not differ between individual credit projects.

In summary, the differences between crowdlending and crowdinvesting are the following:

<table>
<thead>
<tr>
<th>Crowdlending</th>
<th>Crowdinvesting</th>
</tr>
</thead>
<tbody>
<tr>
<td>Financing for SMEs for running business activities.</td>
<td>Financing for start-ups or substantial expansions.</td>
</tr>
<tr>
<td>Borrowers are typically established businesses.</td>
<td>Borrowers are typically at an early stage of company growth.</td>
</tr>
<tr>
<td>Risk analysis by platform based on risk models and credit analysts.</td>
<td>No risk analysis by platform.</td>
</tr>
<tr>
<td>Assessment of risk by established credit analysis methodology.</td>
<td>Risky investments, probabilities of default hardly assessable with established methodology.</td>
</tr>
<tr>
<td>Repayments: regular, clearly determined payments based on annuity loans or bullet loans.</td>
<td>Profit realisation by “exit” or after reaching uncertain milestones.</td>
</tr>
<tr>
<td>Debt capital (fixed-interest loans or loan receivables).</td>
<td>Equity (usually participation in entities or profits).</td>
</tr>
<tr>
<td>Opens SME financing as an asset class for retail investors.</td>
<td>Opens venture capital as an asset class for retail investors.</td>
</tr>
<tr>
<td>Investment strategy: diversification over many individual credit projects based on credit analysis of the credit platform.</td>
<td>Investment strategy: individual investments based on thorough analysis by the investor.</td>
</tr>
</tbody>
</table>

This difference is relevant for the ECSPR as it calls for different investor protection strategies, different transparency requirements and ultimately for different regulation in these two asset classes.

As an example, in crowdlending, a focus on the transparency of a platform’s loan performance would encourage investors to choose credit platforms based on their performance and to apply investment strategies based on diversification. As a precondition for this
reasonable approach, investors need to be able to review the performance of the loans generated by credit platforms. This includes default rates, recovery rates and other key indicators. For crowdlending investors, this is much more helpful than detailed information on individual projects. Highly detailed individual information (as for example provided in the KIIS, Art 14–16 ECSPR) is burdensome for borrowers to compile, prone to inaccuracies and may lure investors into a “second underwriting” based on much less data than the platform has at hand for its own risk assessment. Bitkom’s crowdfunding platforms disclose their loan performance on their websites. While this is much more than banks do and not required by law, we feel that it should become obligatory and good practice in the interest of investor protection.

We suggest

• that the KIIS requirement (Art 16) is not applied to credit platforms (or crowdlending providers);

• that instead credit platforms are obliged to disclose performance data of the loans they have generated and further information, possibly in the form of a “key information sheet for credit platforms”.

As another example, unlike equity-based crowdfunding, credit platforms need to enable investors to diversify their investments, if these investors want to participate in the loan performance rather than to take a higher risk exposure by investing in only a few loans.

3.3 The scope of the ECSPR

Besides the two fundamental aspects discussed above, we note the following issues with the scope of the ECSPR, which we feel need to be addressed if it was to provide a solid and attractive basis for international expansion into and out of Germany.

• By catching only “transferable securities” (cf Art 4 no 44 MiFID2) and loans, this regulation would not apply to the vast majority of the German industry it intends to regulate. The financial assets which German crowdfunding platforms handle do not fall into this definition. In equity-based crowdfunding, hardly any asset would meet the definition of transferable securities. Many German crowdlending platforms broker loan receivables and would therefore also operate outside of this regulation. Only to the extent that platforms are active in subordinated loans (which we feel are questionable from an investor protection perspective), would this regulation actually apply to the German industry. German credit platforms would admittedly mostly switch to a direct lending model under the ECSPR but in order to allow a “dual track solution” and orderly transitions, loan receivables should be included in Art 3 no 1 (a) ECSPR.
We suggest to extent the scope of the ECSPR to all financial assets incl. loan receivables and not just transferable securities.

- The €1m cap (Art 2 para 2 lit (d)) will exclude many platforms, such as real estate financing platforms and many equity-based crowdfunding platforms. On the other hand, we feel that this restriction in scope presents a very good opportunity to test direct lending for crowdlending in the limited field of small SME loans of up to €1m (which banks typically do not provide and are therefore most urgently needed).

- On a final note on the scope, we would like to stress that we disagree with the underlying assumption of the ECSPR that crowdlending is only an option for startup financing or expansion financing (which, in our view, drives adverse assumptions as to the risk profile of crowdlending). In reality, banks do not serve small and micro enterprises which seek relatively small loans. However, 99.8% of all European businesses are small or micro businesses and all of them can and do benefit from credit.

  We suggest to clarify this in the recitals of the ECSPR.

3.4 Overly restrictive rules for viable proposition to crowdlending retail investors

As outlined above, we believe that some of the rules of the ECSPR are only suited for equity-based crowdfunding (i.e. investments with a significantly higher risk profile and less predictability). Those rules should not apply to the much bigger SME crowdlending industry which is active in a less risky, much more predictable investment environment.

- Far reaching information on individual projects (Art 14-16). These rules are adequate in relation to equity-based crowdfunding (where project specific disclosure is much more important given the bespoke project terms applying to each equity offering) but we believe that they do not suit crowdlending (which, as noted above, is effectively a commoditised credit asset class from an investor portfolio perspective). While credit platforms should be under a duty to inform investors about individual projects, the information requirements suggested by Art 14-16 are too detailed and do not add any benefit. As pointed out above, we believe that the crucial information for investors is the performance of the loans generated by a credit platform. We believe that – in the interest of investor protection – this transparency, together with high underwriting and credit risk management standards, should be at the core of any credit platform regulation.
First of all, a credit platform is carrying out a credit assessment based on much more information than available to investors. The key investment information sheet ("KIIS") might therefore be misleading in many cases.

Secondly, it will also cause long delays in the funding process and inaccuracies since the business owners/borrowers would be responsible for its content.

Finally, this concept would be hard to reconcile with automated diversification tools which are already now market standard in European crowdlending and also offered in Germany. Diversification tools enable investors to efficiently diversify their investments on a platform. We strongly believe that this is the right approach for retail investors who want to limit their risk through diversification and participate in a platform’s performance instead of relying on a risky and less informed “second underwriting”.

We suggest:

- that the KIIS requirement (Art 16) is not applied to credit platforms (or crowdlending providers);
- that instead credit platforms are obliged to disclose performance data of the loans they have generated and further information, possibly in the form of a “key information sheet for credit platforms”;
- to include minimum requirements for credit platforms in order to ensure professional credit analysis and a professional management of credit risks and operational risks.

No functioning secondary market (Art 17). Experience shows that the option to sell is essential in any proposition to retail investors, in particular if more long-term investments are concerned. For this reason, we believe that a credit platform should be able to offer a secondary market in which retail investors can sell and purchase loan parts and that the ECSPR should provide a workable set of rules for such purposes. A mere bulletin board fails to protect investors adequately. Given that such a bulletin board would operate largely outside a credit platform’s control, there is a risk that sellers under urgency to sell can be exploited just as well as purchasers might be exploited if vital information is not disclosed to them (such as historical bad performance of a loan).

We suggest to amend Art 17 in order to allow a functioning secondary market within the scope of the ECSPR.
3.5 Further issues

- We note that ESMA does not have solid experience as a regulator and that this arrangement, together with the judicial recourse to the ECJ, might lead to various complications and negative effects on the supervision. In particular, given that the ECSPR may also apply to exclusively domestic investments (e.g. a German investor investing in German business loan), it seems odd that the ESMA shall be in charge of this arrangement.

  *We suggest to align competencies under the ECSPR with the MiFID rules.*

- The obligatory payment services license for handling clients’ assets (Art 9) could lead to complications and unintended consequences. We feel that this rule needs to be reconsidered. First of all, in our assessment, this requirement will lead to a “double regulation” for most platforms, i.e. a national regulator in view of payment services and ESMA in view of the ECSPR. More importantly, this requirement is not in line with most payment services license rules in the member states. Many activities in which a credit platform or an affiliated entity hold clients’ funds do not qualify as payment services under (PSD compliant) national rules. In these cases, a platform would struggle to obtain the payment services license required by the ECSPR as national regulators would not qualify such activities as payment services. Therefore, we do not see how Art 9 can be reconciled with the member states’ own discretion in their incorporation of the payment services directives. We suggest to leave this topic to national legislation which is in line with the PSD being a European Directive.

  *We suggest to amend Art 9 and leave the rules on payment services to each member state based on the Payment Services Directive.*

Art 7 prohibits balance sheet lending in order to avoid conflicts of interest. We agree that this approach is reasonable, in particular because the role of a credit platform is to connect counter parties. However, we think that, under certain circumstances, a limited exposure to the loan book can be necessary, for example to the extent a platform is required to buy back certain loans from investors under contractual breaches or goodwill measures. We also believe that, within the limits of a sound conflicts of interest management, employees should be allowed to invest in loans.

  *We suggest*

- to allow balance sheet investments for credit platforms if they are fully disclosed and non-discretionary;
• to allow investments by employees if they are subject to a strict conflicts of interest management and fully disclosed.

• In the interest of achieving adequate regulation for a sustainable development of the crowdlending industry, we would also like to point out the following points which we feel should be included in any platform regulation.

— Credit platforms are not only originating loans; they are also servicing their loan books. In our assessment, one of the biggest risks for crowdlending investors would be the failure of their credit platform. For this reason, we strongly believe that credit platforms need to take precautions against adverse events. To this end, one of Bitkom’s crowd-funding platforms has set up business continuity plans based on impact assessments and has appointed a back-up service provider which will step in should the German platform fail. We believe that this should be obligatory for any credit platform.

  We suggest obliging credit platforms to take precautions against business interruptions including business continuity plan and investor protection arrangements in insolvency scenarios.

— As pointed out above, we believe that credit platforms should be obliged to disclose the credit performance of the loans originated through them to investors.

— As mentioned, credit platforms should be required to put in place a sound credit risk management including professional credit assessment and collection and recoveries strategies and processes.

— Finally, we believe that credit platforms should be captured by AML/CTF obligations. While we would not rate the actual risks involved particularly high, this would prevent any risk of abuse and is a necessary step in developing crowdlending into a mainstream asset class and financing option.

  We suggest to include crowdfunding service providers as obliged parties in the national rules for anti-money laundering and counter-terrorism financing.