

# DON'T CROWD OUT SAFETY

vzbv response to the legislative proposal for an EU framework on crowd and peer to peer finance

## INTRODUCTION

The Federation of German Consumer Organisations (vzbv) supports the goal of an improved allocation of capital through Capital Markets Union (CMU). Anyway, a CMU can only succeed if the results are favorable to consumers. Therefore consumer protection issues should be seen as essential interests in moving forward. Crowdfunding (CI) and Crowdlending (CL) are topics that directly affect consumers. Because they are different issues from regulatory viewpoint, vzbv suggests separate approaches that concentrate on the respective characteristics.

## REGULATION OF CI PLATFORMS

The main policy options offered four different scenarios for future regulation of the CI market. Out of these only a comprehensive EU approach is viable from a consumer standpoint. The cross-border solution would fail to protect consumers from malpractice on the national level and undermine the credibility of the market. The suggested European market for CI and CL is a natural monopoly market. The self-reinforcing pattern of “bigger platforms are better and better platforms get bigger” means that the service will function in a similar way that social media markets do. Thus CI platforms should be regulated as financial intermediaries and as platforms.

## REGULATION AS FINANCIAL INTERMEDIARIES

### 1. Qualification & Liability

CI platforms frequently claim to offer a vetting service for the projects they advertise. Investors using these services rely on the platform to weed out spurious or implausible projects. It has frequently been observed in Germany, that such promises of quality control where not actually met (see evidence attached). Therefore two pieces of regulation are required in this regard.

1. Qualification: the platform must actually possess the economics and business know-how to judge projects.
2. Due diligence and liability: If a platform neglects to perform an adequate screening of projects before offering them, the platform must be liable for the resulting damages. Neglect could for example be failing to inquire about previous debt accrued by the business attempting to get financed.

### 2. Business model

Currently, there is an inbuilt conflict of interest between investors and the platforms they use and rely on for safety. The business model employed by platforms is to take five to ten per cent of the financing volume as a commission for bringing investors and projects together. One of the issues with this practice is that the provider will be interested in raising as much money as possible regardless of the

quality of available projects. This is in conflict with the investor's interest to have the platform check the quality of projects carefully. Systematic conflicts of interest like this cannot be solved through transparency alone. Therefore CI platforms should be banned from accepting any form of commission. Raising uniform placement fees for projects and subscription fees for investors for example is a business model that does not create an incentive for the platform to damage consumer interests for personal gain.

### 3. Competent regulatory oversight

In Germany CI platforms are acting under a financial broker license and are thus overseen by local trade offices. Enterprises acting in the whole of the EU, or on the national level for that matter, cannot be adequately overseen by local institutions unfamiliar with performing the job of a financial markets authority. It is important to place CI under the supervision of the dedicated financial market authority on the national level. This would also allow for effective cooperation of supervision on the European level via ESMA. European integration would not be possible otherwise because the trade offices are themselves not integrated into a European framework.

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