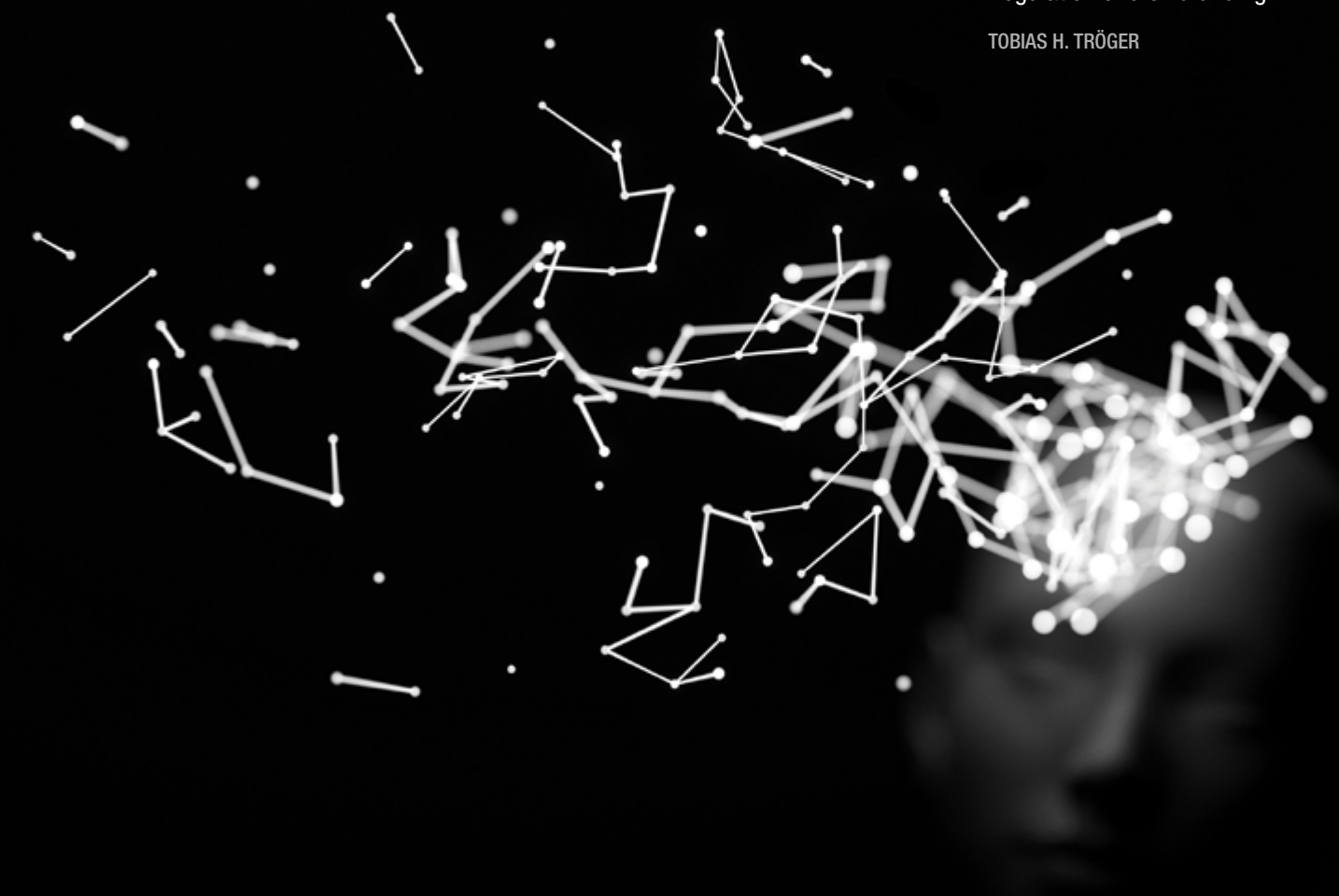
THE CAPCO INSTITUTE
JOURNAL
OF FINANCIAL TRANSFORMATION

SUPERVISION

Regulation of crowdfunding

TOBIAS H. TRÖGER



DESIGN THINKING

#48 NOVEMBER 2018

THE CAPCO INSTITUTE

JOURNAL OF FINANCIAL TRANSFORMATION

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DEAR READER,

Design thinking, a collaborative, human-focused approach to problem-solving, is no longer just for the creative industries. It has become an important management trend across many industries and has been embraced by many organizations. Its results are hard to ignore. Indeed, design-driven companies regularly outperform the S&P 500 by over 200 percent.[1]

To date, the financial services industry has not led in adopting this approach. However, leaders are recognizing that important challenges, such as engaging with millennial customers, can be best addressed by using design thinking, through the methodology's exploratory approach, human focus, and bias towards action. This edition of the Journal examines the value of design thinking in financial services.

Design thinking introduces a fundamental cultural shift that places people at the heart of problem-solving, which is critical in a technology-driven environment. If the customer's real problems are not fully understood, technological solutions may fail to deliver the desired impact. In this context, design thinking offers a faster and more effective approach to innovation and strategic transformation.

The case studies and success stores in this edition showcase the true value of design thinking in the real world, and how this approach is an essential competitive tool for firms looking to outperform their peers in an increasingly innovation-driven and customer-centric future. At Mastercard, design thinking has become a part of almost all organizational initiatives, from product development, research and employee engagement to solving challenges with customers and partners. Meanwhile, at DBS Bank in Singapore, a data-informed design model has been firmly embedded into the bank's culture, enabling them to successfully move from being ranked last among peers for customer service in 2009, to being named the Best Bank in the World by Global Finance in 2018.

I hope that you enjoy the quality of the expertise and points of view on offer in this edition, and I wish you every success for the remainder of the year.

Lance Levy, **Capco CEO**

[1] http://fortune.com/2017/08/31/the-design-value-index-shows-what-design-thinking-is-worth/

REGULATION OF CROWDFUNDING

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ABSTRACT

This paper is a shorter version of the national report for Germany prepared for the 20th General Congress of the International Academy of Comparative Law 2018. It gives an overview of the regulation of crowdfunding in Germany and the typical design of crowdfunding campaigns under this legal framework. After a brief survey of market data, it delineates the classification of crowdfunding transactions in German contract and corporate law and their treatment under the applicable conflict of laws regime. It then turns to the relevant rules in prudential banking regulation and capital market law. It highlights disclosure requirements that flow from both contractual obligations of the initiators of campaigns vis-à-vis contributors and securities regulation (prospectus regime).

1. INTRODUCTION

1.1 Policy objectives

Crowdfunding is a buzzword that signifies a subset of the new forms of finance facilitated by advances in information technology, usually categorized as fintech.[1] In contrast to financial innovation that pertains to (new or redesigned) financial products and is somewhat ambiguous in terms of its social value,[2] crowdfunding capitalizes on previously unavailable digital techniques to match supply and demand on money and capital markets. These developments can potentially disrupt traditional forms of intermediation by shifting the boundaries of the (financial) firm.[3] Put differently, crowdfunding does not typically lead to unprecedented forms of financing relations. Instead, it allows for traditional contractual or corporate law relationships between previously unacquainted providers and consumers of capital to be initiated and concluded on novel, IT-driven platforms. From this perspective, the potential of crowdfunding to garner economically significant volumes of financing relationships seems considerable,[4] thereby creating massive potential for momentous disruption as a consequence of disintermediation.

Once these projected developments gain traction, policy objectives traditionally pursued in financial regulation also become relevant for agents involved in crowdfunding.[5] Concerns about financial stability, investor and consumer protection, or the prevention of money laundering and funding of terrorism hinge incrementally on including these new techniques to initiate financing relationships adequately in the regulatory framework. More specifically, the legislation through which policymakers seek to implement the relevant objectives, ceteris paribus, have to be attentive to the specifics of crowdfunding.

Considering the aforesaid, the pertinent legislation must pay particular attention to the role of the platforms and their operators because they are at the heart of the

* A longer version of this paper was published in "German National Reports on the 20th International Congress of Comparative Law" 397-428 (Martin Schmidt-Kessel, ed., Tübingen: Mohr Siebeck, 2018).

technological innovation, which may both attenuate traditional justifications for government intervention and create new jeopardies for established policy goals. On the other hand, the laws that govern the relevant financing relationships once they are concluded face far fewer challenges insofar as they are not materially affected by the way relationships are initiated and concluded. Put differently, the contract or corporate law framework that underpins financing relationships is old-fashioned, but the way it is invoked is novel.

1.2 Economic relevance of crowdfunding in Germany

The available data largely pertains to the forms of crowdfunding that initiate classical financing relationships (loan contracts, purchase of debt instruments, or equity interests). Granular data on funding relationships with significant altruistic elements is largely lacking.[6]

1.2.1 CROWDLENDING/PEER TO PEER (P2P) LENDING

In a study commissioned by the Federal Ministry of Finance, financial economists produced data inter alia on the scope and structure of the crowdlending market over the period from 2007 to 2015.[7] The findings showed an enormous growth of what is the largest segment of the crowdfunding market (totaling €400 million of credit extended by the end of 2015, with average annual growth rates of 95%)[8] with a significant slowdown during the economic downturn and even a decline of 22% in 2011. While P2P lending to consumers occurred relatively early on, crowdlending to businesses is a comparatively new phenomenon, albeit with staggering growth rates.[9] Until the end of the observation period, the market was dominated by one player (Auxmoney), mainly used to roll-over existing loans or overdrafts and exhibiting relatively high default rates.[10] This arguably induced platforms to impose stricter access conditions for users seeking credit (presentation of credit ratings). They thus assumed a more important role as gatekeepers.[11]

1.2.2 CROWDINVESTING

Germany's preeminent scholars in the field produced descriptive statistics on the domestic crowdinvesting market.[12] They showed not only that the initial upward trend in the funds raised (a total of almost €53 million since the first crowdinvestment initiative in August 2011) has abated recently,[13] but that fundraising is largely concentrated on two platforms (Seedmatch and Companisto). These key players are also highly successful in placing the issues of start-ups (the success rate was 100% and 95% respectively), whereas other platforms have a significant fraction of failed offers that do not reach the funding threshold. With all due reservations concerning methodologically unhedged inferences, the data seems to indicate that platforms perform gate-keeping functions[14] and are in a position to build reputational capital as information intermediaries as well.

2. DEFINITION – LEGAL QUALIFICATIONS OF CROWDFUNDING

2.1 How is crowdfunding defined in your legal order?

German law does not have any statutory or otherwise authoritative definition of crowdfunding. Scholars define crowdfunding as "collecting financial contributions from a multitude of persons to achieve a common goal through the use of a specialized internet platform."[15] Even more broadly, the German Federal Financial Supervisory Authority (Bundesanstalt für Finanzdienstleistungsaufsicht, BaFin), understands crowdfunding as "a type of financing which is usually raised over internet platforms."[16] Although definitions vary in detail,[17] the common recurring theme is that crowdfunding campaigns are conducted and supply and demand are matched over the Internet or through social media.

2.2 Situations usually covered by the notion 'crowdfunding'

Variations in the terminology of the German scholarly debate aside, it is useful to distinguish between several sub-categories of crowdfunding. They are characterized by the diverging objectives that parties pursue with their transactions, which in turn shape the considerations stipulated in the contract.[18] In crowdsponsoring, contributors receive no financial compensation, but support a specific project with donations.[19] Alternatively, contributions are rewarded with (nominal) non-monetary benefits ("goodies") if the campaign is successful, like an acknowledgement on the cover of music media or in the credits at the end of a movie.[20] Alternatively, the consideration can have material value, for instance if supporters of crowdfunding campaigns receive a product from the first batch of production or acquire the preferential right to purchase the product immediately at a reduced

price (reward-based or pre-selling crowdfunding).[21] The funding relationship exhibits an even clearer character as an exchange agreement if a financial consideration is stipulated,[22] either as fixed compensation (interest) for the temporary provision of liquidity[23] (crowdlending) or as variable, performance-related payment that flows from investments in a business venture in the form of equity or mezzanine-capital instruments (crowdinvesting or commercial crowdfunding).[24] Finally, a similar arrangement occurs where supporters participate in the exploitation of copyrights, patents, and similar intellectual property rights that were facilitated through their crowdfunding contributions, for instance by receiving a share of the royalties paid to an artist.[25]

2.3 Legal qualifications for the different types of funding

The general stance of German contract law towards crowdfunding is determined by the fundamental principle of freedom of contract.[26] This holds true even for crowdinvesting instruments that grant sponsors participation rights in a business venture's future cash flows, because, as a matter of law, the hybrid capital instruments typically offered constitute debt contracts that are unaffected by corporate law's rigidity.[27] This latitude enables initiators of crowdfunding campaigns to structure the respective financing relationships to fit their preferences. Yet, it should not be ignored that the latter are frequently shaped by an appetite to avoid the constraints of banking and securities regulation. However, as initially noted, the legal qualification of financing relationships concluded on platforms poses no idiosyncratic challenge for German private law, because, in principle, all funding relationships existed prior to digitization in the analogue world and technological innovation has only facilitated their conclusion among previously unacquainted parties.

2.4 Crowdsponsoring

If contributions to the campaign are made as donations or no-interest "loans" without repayment-obligation the qualification as an immediately executed gift contract (Handschenkung) within the meaning of § 516 BGB is straightforward.[28] The classification requires that the contribution is made without consideration, meaning the grant does not legally depend on any return, however small.[29] Quite importantly, promises of non-monetary rewards also qualify as a consideration that precludes the qualification of a contract as a gift contract.[30] However, crowdfunding campaigns where initiators promise no more than to publicly announce the name of the contributor do not necessarily provide for such non-monetary compensation. If the mentioned name is only one among many others of those who made (small) contributions, the typical credits can be qualified as legally irrelevant references to the gift.[31] Only if the contribution that is supposed to be mentioned is more prominent, and thus allows for increased (media) attention can the relationship between the initiator and the contributor qualify as a sponsoring contract.[32] In these contracts, the publicity of the contribution materially serves the communicative purposes of the benefactor and its promise thus constitutes a relevant compensation for the granted funds.[33]

Moreover, German private law requires that both parties agree that the contribution occurs without consideration. Simply put, there must be contractual consensus on its gratuitousness.[34] Such a consensus exists when the contribution is neither in a synallagma with a consideration, nor the condition, nor the cause of law for such a quid pro quo.[35] Hence, if contributors enter into a legally binding arrangement promising them a material advantage in the form of an incentive or a goody (for instance a free download of funded music productions or meeting with the artist), the contract cannot be comprehensively qualified as a donation.[36] However, if the parties are aware of a significant mismatch between the higher value of the contribution and the lower one of the consideration, German doctrine splits the transaction into two independent contracts,[37] and thus treats the overshooting fraction of the contribution as a donation[38] and treats its compensated part as a reward-based crowdfunding contract.[39]

2.5 Reward-based crowdfunding

If investors in successful crowdfunding campaigns receive access to the product as a consideration for their contribution, for instance a physical delivery from the first manufacturing batch, a data medium with the produced movie or music album or a download code for it, the underlying contract can easily be qualified as a sale.[40] If contributors acquire only a right to buy the product (at a reduced price), the contractual relationship is a purchase of rights, which is explicitly qualified as a sale in BGB § 453 para. 1.[41] If media can only be streamed and no download-to-own is possible, the contractual relationship between investors and benefactors of crowdfunding campaigns represents a rental agreement.[42] Generally, if the product value (market price) or the price of the

acquired right is – in accordance with the parties' agreement – lower than the contribution, the transaction may be treated as consisting of two separate contracts.[43]

2.6 Crowdlending/P2P lending

P2P lending leads to regular, typically unsecured loan agreements.[44] Loans to finance the acquisition of real estate, in principle subject to the same provisions in the German civil code, are practically non-existent, because such transactions are typically executed through special purpose vehicles in crowdinvesting (infra 4).

However, direct contracting between lenders and borrowers, mediated through the platform as an agent, would trigger undesirable regulatory consequences[45] and is, therefore, rare in Germany, as operators have adjusted their business models accordingly. Although platforms match lenders and borrowers, they interpose a credit institution in the transaction that contracts with both the credit-seeking party and the funding party.[46] On the one hand, the borrower takes out a loan from the credit institution, procured by the platform that earns a service fee (borrowing fee). On the other hand, the funding party purchases the bank's redemption claim, which is subsequently assigned once the bank disburses the loan.[47] As an economic result of the transaction, the investor holds a claim against the borrower just like they would had they contracted directly.[48] This observation begs the question whether a differential treatment in regulation (see infra D.I.1) can be justified as a matter of public policy.

2.7 Crowdinvesting

Contributors to crowdinvesting campaigns receive a variable compensation that hinges on the financed venture's future cash flows. The specific design of the arrangements varies[49] and the observable differences are relevant for the legal qualification of the contractual relationships the parties typically conclude. In the vast majority of cases, the project-executing organization or person enters into direct contractual relationships with investors through the platform, whereas arrangements in which a special purpose entity bundles investments and then contracts with the initiator are rare.[50]

Recent empirical research highlights the legal structure of typical crowdinvestment products offered through the platforms to finance business ventures.[51] These insights are of critical importance, because they determine how and to what extent crowdinvesting affects the policy objectives of financial regulation. The legal structure of investment products sold on crowdinvesting platforms defines both the cash-flow and governance rights vested with investors, which in turn are crucial for investor protection, but also have an impact on financial stability.

Issuers typically structure the financing relationship as unsecuritized term-debt[52] with fixed interest rates[53] and various extents of profit participation.[54] In most cases, investors also participate in an increase of the going-concern value of the issuer.[55] Loss participation is limited to the funds invested in gone-concern scenarios.[56] Contractual arrangements in the indenture subordinate

the redemption claim to all other claims against the issuer.[57] The contractual relations that underlie typical German crowdinvestments seek to mimic equity-like risk-and-return structures. This becomes even more apparent when considering the protection against claim dilution in the case of follow-up funding,[58] which prevents new investors from externalizing risk to old investors and benefiting disproportionately from future cashflows.

However, the governance rights granted to investors on crowdinvesting platforms are limited compared to those vested with shareholders. In essence, investors do not have any influence on the decision-making process of the issuer concerning questions of management and business strategy.[59] Yet, contracts provide for periodic disclosure of key financial and other relevant data that in some cases have to be explained by initiators at web-based annual investor meetings.[60] Control rights beyond the entitlement to candid disclosure are almost non-existent.[61]

In essence, German law provides three types of contractual arrangements that conform to the rights and obligations the parties seek to establish in crowdinvesting transactions.[62] The relationship between contributors and initiators of crowdinvesting campaigns can be framed as either silent partnerships,[63] profit participation rights (Genussrechte),[64] or subordinated profit-participating loans (partiarische Nachrangdarlehen).[65] The precise classification of individual agreements is difficult and courts explicitly follow a case-by-case approach.[66] However, key indicators are (i) the lack of monitoring and control rights, which militates against a qualification as (silent) partnership;[67] (ii) the existence of a fixed repayment claim combined with a participation in the venture's profits or turnover, which speaks in favor of a profit participating loan contract;[68] and (iii) the absence of such a repayment claim and a loss participation not only in gone-concern scenarios that hints at the classification of the financing relationship as a profit participation right or a silent partnership.[69] To distinguish between profit participation rights and silent partnership interests, a pivotal factor is whether the crowdfunding relationship obliges contributors to further the project (common purpose) beyond their financial contribution.[70]

At times, commentators have sought to establish a separate category for single-project financing relationships like movie productions or music albums.[71] However, this further distinction is unnecessary, as these contracts can be understood as loans with (subordinated) fixed repayment obligations,[72] and the value of the latter hinges on the performance of a single asset and thereby leads to an automatic loss-participation of investors up to the contributed amount. Alternatively, the respective financing relationships can also be construed as profit participation rights granted by the producing entity, where no repayment claims exist and a loss-participation is possible.[73]

3. NORMATIVE FRAMEWORK

3.1 General

There has been no legislative intervention with regards to the private law qualification of contracts concluded on crowdfunding platforms, probably because the existing German private law framework allows parties to structure their financing relationships according to their economic goals. They can draw on well-established and thus broadly approved doctrinal concepts, which are applied to crowdfunding activities.[74] Deviations from the majority view in the literature are confined to narrow aspects, remain exceptions, and are ultimately not convincing.[75]

There is no specific law that regulates crowdfunding. Only very limited legislative interventions exist that relax primary market disclosure obligations in securities laws for crowdfunding activities.[76]

3.2 Conflict of laws

Typical financing relationships concluded on platforms (see supra B.III) fall within the remit of the Rome I Regulation.[77] This is also true for the most common crowdinvesting contracts, the subordinated profit participating loans (which are not negotiable instruments within the meaning of art. 1 para. 1 lit. d) Rome I Regulation[78]), unsecuritized profit participation rights, and – according to the majority view in the literature – silent partnership interests.[79] Although company law relationships are generally exempt from the regulation's scope of application,[80] silent partnerships, by their very nature, do not entail an actual organization but establish only contractual ties between the partners.

For all prevalent forms of crowdfunding, a choice of law is thus possible in principle.[81] There is no publicly available empirical evidence on whether the option is broadly used in practice.[82] In any case, the European conflict of laws rules limit the possibility to choose the applicable law in consumer contracts insofar as the

consumers would be deprived of the protection afforded to them by provisions that cannot be derogated from agreement by virtue of the law of the country of the consumer's habitual residence.[83] This rule applies in crowdfunding relationships concluded through German platforms, because even in crowdinvestment the relevant contracts do not establish rights and obligations that constitute a financial instrument within the meaning of the exception from the binding consumer protection afforded under the Rome I Regulation.[84] However, where platforms seek to derogate from German law, the most important consumer protection rules to be considered in the required comparison with the chosen legal system are the subscription limits stipulated in securities laws.[85]

> "The pertinent legislation must pay particular attention to the role of the platforms and their operators because they are at the heart of the technological innovation, which may both attenuate traditional justifications for government intervention and create new jeopardies for established policy goals."

Where choice of law clauses is not introduced in the respective contracts and consumer protection rules do not apply,[86] the relationship is governed by the law of the country where the party required to effect the characteristic performance has their habitual residence.[87] In crowdfunding relationships, this means the law of the country where the contributor lives.[88]

4. SUPERVISION OF CROWDFUNDING ACTIVITY

4.1 Licensing requirements

Germany has no specific prudential regulation for crowdfunding. Authorization requirements can, therefore, only flow from the general bodies of law that regulate the financial sector, in particular the regulations governing credit institutions and investment services firms. The intermediation of donation- and reward-based crowdfunding does not constitute an activity that can fall under the regimes of prudential banking and capital market regulation, as long as platforms avoid collecting the funds from contributors beforehand.[89] However, the cases of crowdlending (infra D.I.1) and crowdinvesting (infra D.I.2) are less straightforward and largely depend on platforms' business models. Where the business model leads to licensing requirements, the applicable regime for obtaining and withdrawing licenses is that which is prescribed for credit institutions and investment firms respectively (infra D.I.3).

4.2 Crowdlending/P2P lending

Whether crowdlending platforms require an authorization under the Banking Act hinges on whether their activity is classified as either banking business or financial service.[90]

From the outset, there is a broad consensus that the primary economic function of platforms, to broker credit, does not constitute banking business within the meaning of the law,[91] particularly because simple loans do not represent financial instruments and hence the activity of platforms does not amount to investment brokerage (Anlagevermittlung).[92] Yet, within this function, specific intermediate steps may amount to banking business and thus trigger the authorization requirement.

If platforms collected the monetary contributions from the crowdlenders before forwarding them to borrowers, they might fulfil the statutory elements of "deposit business" (Einlagengeschäft).[93] Although even registered users of the platform would provide "public funds" as required by the law,[94] platforms can avoid falling under prudential banking regulation by not offering lenders accounts, and collecting the funds in successful campaigns only after the threshold level has been reached and forwarding them as quickly as technically possible to borrowers. This already avoids the funds being regarded as being "taken" by the platform.[95] Platforms are even safer if they have contributions collected and forwarded by a cooperating bank, thereby avoiding the acceptance of lenders' funds in the first place.

The challenges faced by platforms when they wish to avoid their activities amounting to "credit business" (Kreditgeschäft)[96] are far more daunting. As long as platforms do not issue credits themselves, they do not violate a pre-authorization requirement with their own conduct.[97] However, they may be held liable for aiding and abetting others in such an infringement of the banking monopoly and supervisors may, therefore, enjoin their

operations.[98] Contributors themselves may fall under the very extensive interpretation of "credit business" and, therefore, conduct unauthorized banking operations.[99] Any person that extends money loans engages in "credit business" if the activity is commercial.[100] According to the majority view endorsed by supervisory practice, an activity is commercial if it is intended for a certain time period and motivated by an intent to achieve profits.[101] A single transaction may suffice, if the intention is to extend more loans in the future.[102]

Platforms react to the extensive authorization requirement by favoring the indirect contracting model (supra B.III.3).[103] Despite economically identical outcomes, the supervisory practice and the majority view in the literature accept that combining the transactions does not amount to "credit business" for any other party involved than the loan-originating bank, and this can, therefore, be conducted without (additional) banking licenses.[104] In particular, the various activities of platforms in the indirect contracting models also do not constitute banking business.[105]

4.3 Crowdinvesting

Licensing requirements for crowdinvesting platforms[106] under the Banking Act hinge on whether their activity qualifies as either banking business or an investment service.[107]

Regardless of the statutory stipulations of specific activities in the statutory definitions, any financial and investment service has to pertain to "financial instruments" as defined in banking and securities regulation.[108] Prior to June 1, 2012, silent partnership interests and unsecuritized participation rights were not included in this definition, essentially liberating crowdinvesting platforms from any authorization requirement and the prudential supervision attached to it. Since then, the definition of financial instruments also encompasses "financial assets" within the meaning of the Capital Investment Act,[109] and since July 10, 2015, these in turn also comprise subordinated profit participating loans.[110] Hence, the regulatory framework now in principle also captures the typical OTC investment products offered through platforms, like silent partnership interests, participation rights, or subordinated profit participating loans.

Consequently, the main query has become whether the activity of crowdinvesting platforms with regard to financial instruments constitutes one of the enumerated business activities that qualify as banking or investment services. The consensus among scholars is that platforms do not engage in underwriting business (Emissionsgeschäft),[111] because they do not assume the risk of a successful placement of the financial instruments issued.[112] Similarly, typical platform activities do not constitute placement business (Platzierungsgeschäft),[113] because this would require that the platform acts as an agent of the issuer and – according to the interpretation of BaFin – discloses this agency relationship.[114] Instead, platforms typically only deliver offers to buy or sell as messengers.[115] However, despite some quibbles about the precise meaning of the law,[116] platforms may indeed engage in investment brokerage (Anlagevermittlung),[117] because they intermediate the acquisition and sale of financial instruments.[118] According to the majority view, it does not matter whether the transactions occur on the primary or secondary market.[119] Hence, the execution of initial offerings through crowdinvesting platforms may fall under the definition of investment brokerage and thus constitute banking or investment services that, in principle, require authorization. Nevertheless, brokerage activities that pertain to financial assets are exempt from authorization requirements if brokers acquire property rights neither in the assets nor in the invested funds of the customers.[120] This tallies perfectly with the typical business model of crowdinvesting platforms. As a consequence, only a special form of trade supervision (qualifizierte Gewerbeaufsicht) applies.[121]

Finally, authorization requirements could be attached if a platform's activities constitute the operation of a multilateral trading facility (MTF).[122] Some commentators unconvincingly rule out this possibility by pointing to the regulatory rationale of the underlying European legislative initiatives that sought to capture MTFs as contemporary competitors of exchanges, arguing that this would require that platforms also host secondary market trading.[123] The relevant policy goal of the pertinent regulation is to counter efficiency losses that are associated with a fragmentation of trading. In this regard, price discovery on primary markets is just as important as it is on secondary markets.[124] The German supervisor has also repeatedly published the interpretation that crowdinvesting platforms can fall under the definition of MTFs.[125] However, it is unclear under which preconditions BaFin will actually find that the specific requirement of a "large number" of market participants trading at an MTF has been met in crowdinvestment initiatives.[126]

4.4 Licensing regime

If German crowdfunding platforms chose business models that require an authorization as a credit institution or an investment firm, they would have to fulfil all the requirements put forward in prudential banking or securities regulation, in particular the own funds requirements applicable to banks[127] and the extensive standards for the conduct and the organization of financial services firms.[128] Failure to comply would lead to licenses being revoked by the European Central Bank (banking license)[129] or BaFin (financial services firms).

5. SPECIFIC OBLIGATIONS OF PARTIES

5.1 Disclosure requirements

Obligations beyond regular contract law only apply to crowdlending and crowdinvesting.

5.1.1 CROWDLENDING

As a consequence of the indirect contracting model, the bank that cooperates with the platform has to fulfil the extensive disclosure obligations stipulated for consumer loans,[130] as prescribed in European law.[131] The platform itself incurs a duty to disclose information on the specifics of its involvement and the remuneration received for it.[132]

5.1.2 CROWDINVESTING

Funding an unseasoned business without a robust track-record is fraught with informational asymmetries between investors and founders (insiders) that typically lead to adverse selection problems.[133] These are all the more serious in our context, because the likelihood of failure of a funded venture and thus a default on investors' claims is usually high in crowdinvesting.[134] As a consequence, information obligations vis-à-vis investors are pivotal. These can follow either from contractual obligations to inform (infra A.I.1.a) or the prospectus requirement put forward in securities regulation (infra A.I.1.b).

5.1.2.1 Contractual obligation of platforms

Although platforms typically do not perform the role of an investment advisor with the respective set of extensive duties[135] simply because they do not recommend specific investments,[136] some commentators argue that they incur contractual obligations to provide specific information to investors as an investment broker.[137] The main argument is that, by pre-screening investments and structuring information presented to the crowd, platforms solicit trust in their superior expertise and access to information that investors rely upon.[138] However, others hold that platforms advertise investments without an intent to incur legally binding information obligations.[139] The latter position is not convincing given German courts' general tendency to generously presume tacit agreements where information asymmetries are striking.[140] Moreover, the practice of platforms not to gather, assess, and provide information is irrelevant with regard to establishing potential obligations and potentially amounts to neglectful behavior.

According to general standards, platforms, therefore, have an obligation to fully and correctly provide all information they possess that is material for the investment decision to be made.[141] Furthermore, they have to verify the plausibility of the information supplied by the initiator of the campaign.[142] This means, as a minimum, they have to assess whether the initiator provided all material information investors need to gauge the risks inherent in the investment (for instance on the project idea, business plan, specific risks, management, legal form of business venture, and investment) and to disclose information gaps, if the initiator's submission proves insufficient and additional data is unavailable.[143] Some commentators argue that platforms additionally have to roughly evaluate the viability of the venture, in order to weed-out "evidently extreme examples" of unrealistic business models.[144]

5.1.2.2 Prospectus requirement and investor information sheet

An important potential channel through which information asymmetries between issuers and investors can be countered in crowdinvesting are prospectus requirements. As intermediaries, platforms cannot have an original duty to draw-up a registration document themselves, but can serve as powerful gatekeepers, if the general prohibition to distribute financial instruments without a prospectus[145] also applies for investments initiated and concluded through crowdinvesting platforms.

Until July 10, 2015, a full-blown prospectus requirement under VermAnlG, § 6 for offerings with a nominal value of more than €100,000 existed, yet certain financing relationships, in particular subordinated profit participating loans, were generally not captured by the regime.[146] The reform package of the Small Investor Protection Act[147] closed the loopholes, but established

an exemption for financial assets offered through crowdinvesting platforms (Schwarmfinanzierung).[148] The main preconditions[149] are that the aggregate value of the offering does not exceed €2,500,000, that subscription limits that depend on net worth and income of investors range from €1,000-€10,000,[150] and that compliance with these preconditions is monitored by the platform. The primary source of information becomes the mandatory investment information sheet (Vermögensanlagen-Informationsblatt), which must be prepared by issuers and provided to potential investors who have to confirm that they (read and) understand a specific warning that points to the risk of a total loss of the invested funds.[151] It has to contain an explicit notice that no prospectus was prepared for the offering.[152] The advertisement restrictions, to be enforced by BaFin,[153] ensure that the express warnings prescribed by law do not go missing in any other relevant communication regarding the investment.[154]

Issuers on crowdinvesting platforms thus have limited choice regarding the regime for primary market disclosure.[155] They can either opt for a fully-fledged prospectus and offer their product publicly without restrictions or accept limitations and make use of the statutory exemption provided for crowdinvesting.

5.2 No obligation to guarantee accomplishment of, or follow-up on, the project?

German law does not provide for an obligation to guarantee the accomplishment of the project or the participation in follow-up projects. However, typical contractual arrangements contain all-or-nothing clauses that ensure that initiators will only draw on individual contributions if the campaign reaches the target volume of financing.[156] Hence, contributors have at least some certainty that the preconditions for successfully initiating the project are met. Moreover, some protections against abusive practices ex-post exist, most importantly the obligation to pay damages if the initiator misappropriates the funds received.[157]

5.3 Redress mechanisms in case of non-accomplishment of the project

If a crowdfunding project fails due to the breach of a specific contractual obligation and there is a finding of fault on the side of the party in breach, damages may be available.[158]

Platforms can only be liable for a breach of an obligation to inform. Such duties are most prominent in crowdinvesting where platforms may assume a role as investment brokers subject to specific information obligations (supra A.I.1.a), with a rich body of case law substantiating the respective duties.[159]

Fraudulent behavior aside, project directors may be liable if they deploy funds in a way that contradicts the project description in the campaign. This can occur through a breach of the primary obligation to produce a certain good (reward-based crowdfunding) or violate the secondary obligation to avoid any action that imperils the other party's contractual objectives (crowdsponsoring, crowdinvesting).[160] Whether a deviation from the original plans was a good faith attempt to achieve the original goals of the campaign or a misappropriation of funds is often difficult to discern.

In principle, unsound managerial decisions that are not in line with acceptable business practice can give rise to liability.[161] However, although no specific case law is available, courts will probably be reluctant to find fault in business decisions, as long as they were made on a sound informational basis and in the absence of conflicts of interest.[162]

ENDNOTES

[1] On fintech in particular, Zetzsche, D. A., R. P. Buckley, D. W. Arner, and J. N. Barberis, Forthcoming, "From FinTech to TechFin: the regulatory challenges of data-driven finance," New York University Journal of Law and Business.

[2] For proposals that seek to hedge financial stability against regulatory arbitrage without sacrificing the efficiency enhancing potential of financial innovation see Posner, E., and E. G. Weyl, 2013, "An FDA for financial innovation: applying the insurable interest doctrine to 21st century financial markets," 107 Northwester Universty Law Review, 1307 (arguing for pre-screening of financial innovations through a Federal Drug Authority like agency); Tobias H. Tröger, T. H., 2016, "How special are they? Targeting systemic risk by regulating shadow banks," in Lomfeld, B., A. Somma, and P. Zumbansen (eds.), Reshaping markets: Economic governance and liberal utopia, Cambridge University Press, 185-207 (showing how a normative approach to law enforcement allowed existing prudential regulation to capture regulatory arbitrage). For an overview of the regulatory challenges non-bank banks pose with regard to systemic risk, Wymeersch, E., 2017, "Shadow banking and systemic risk," EBI working paper no. 1.

[3] The extent to which allocation of resources occurs in a hierarchy (firm) depends on the transaction costs incurred in equivalent market transactions, for the fundamental insight, Coase, R. H., 1937, "The nature of the firm," 4 Economica 386; for a review of the literature carrying forward the theory of the firm see Furubotn, E. G., and R. Richter, 2005, Institutions and economic theory, University of Michigan Press, 2nd edition, 366-386. With regard to financial intermediation, this means that market-based solutions should become more prominent once the comparative advantages of intermediation within a big entity shrink, which is particularly the case if search costs are lowered as a function of technological improvements.

[4] The early literature points to crowdinvesting's potential to allow firms to receive financing from an additional source that complements bank and venture capital funding, Pope, N. D., 2011, "Crowdfunding microstartups: it's time for the Securities and Exchange Commission to approve a small offering exemption," 13 University of Pennsylvania Journal of Business Law, 101, 113; Hemingway, M., and S. R. Hoffman, 2011, "Proceed at your peril: crowdfunding and the Securities Act of 1933," 78 Tennessee. Law Review, 879, 931; Bradford, C. S., 2012, "Crowdfunding and the Federal Securities Laws," Columbia Business Law Review, 1, 103-104; for an account in the business press that envisions a far-reaching substitution of banks as providers of credit see Editorial, "Banking without banks," The Economist, 1 Mar 2014, at 70; for a delineation of crowdinvesting's potential in Europe see Zetzsche, D. A., and C. Preiner, 2017, "Cross-border crowdfunding – towards a single crowdfunding market for Europe, EBI working paper no. 8; for Germany, for instance, Meschkowski A., and F. K. Wilhelmi, 2013, "Investorenschutz im Crowdinvesting," 68 Betriebs-Berater (BB) 1411; specifically on the idea of a relative decrease in the costs of capital as a result of lower search and agency costs in crowdinvesting relationships, Klöhn, L., and L. Hornuf, 2012, "Crowdinvesting in Deutschland," 24 Zeitschrift für Bankrecht und Bankwirtschaft (ZBB) 237, 256-8 (arguing that the 'wisdom of crowds' is imperfect and partly irrelevant with regard to relevant agency relationships.

[5] For an overview of the policy issues, see Armour, J., and L. Enriques, 2017, "The promise and perils of crowdfunding: between corporate finance and consumer contracts, European Corporate Governance Institute working paper no. 366/2017; Zetzsche and Preiner (2017), supra note 4 at 9-16. The European Securities and Markets Authority (ESMA) has also identified what it considers to be key components for an adequate regulatory reaction to the new phenomenon and outlined several specific responses that draw-on and develop the existing E.U. regulatory framework, ESMA, Opinion: investment based crowdfunding 10-12 and 12-27.

[6] But see Dorfleitner, G., and L. Hornuf, 2016, "FinTech Markt in Deutschland," 22-25, https://bit.ly/2fwSa1C (presenting aggregate data for the donation- and reward-based crowdfunding markets that includes campaigns initiated by Germans on international platforms and showing that the overall funding capacity - €85 million between 2007 and 2015 – is small relative to other crowdfunding markets and dominated by three players, although sourcing occurs through a large number of intermediaries).

[7] Dorfleitner and Hornuf (2016) supra note 6 at 32-5. For older data, see Renner, M., 2014, "Banking without banks?" Rechtliche Rahmenbedingungen des Peer-to-Peer Lending, 26 ZBB 261, 262.

[8] This observation tallies with the global trend see Renner (2014) supra note 7 at 263.

[9] See also Zhang, B., R. Wardrop, T. Ziegler, A. Lui, J. Burton, A. James, and K. Garvey, 2016, "Sustaining momentum: The 2nd European Alternative Finance Industry Report," University of Cambridge study, https://bit.ly/2cMlUD9 (showing P2P-lending to consumers growing slower than P2P-lending to businesses, although on a higher level between 2013 and 2015). Projections indicate that the trend will continue in the future, see Statista, 2018, "Alternative lending segment report," https://bit.ly/2OqBlAE (reporting annual growth rates of 45.7% in the P2P business lending market until 2022, ultimately reaching €2,658 million).

[10] See also Dorfleitner, G., C. Priberny, S. Schuster, J. Stoiber, M. Weber, I. de Castro, and J. Kammler, 2016, "Description-text related soft information in peer-to-peer lending – evidence from two leading European platforms," 64 Journal of Banking and Finance 169 (reporting default rates of 12-14% for Germany's leading lending platforms).

[11] On the procedures of German crowdlending platforms see also Renner (2014) supra note 7 at 263.

[12] Klöhn, L., L. Hornuf and T. Schilling, 2016, "Crowdinvesting-Verträge," 28 ZBB 142, 143-5; for similar observations see Dorfleitner and Hornuf (2016) supra note 6 at 26-31; more recent data for 2016 corroborates the general trend, see Statista, 2018, "Gesamtvolumen des durch Crowdinvesting eingesammelten Kapitals in Deutschland von 2011 bis Q4 2016," https://bit.ly/2RaHJ2V. For additional empirical evidence see also Herr, S., and U. Bantleon, 2015, "Crowdinvesting als alternative Unternehmensfinanzierung – Grundlagen und Marktdaten in Deutschland," 53 Deutsches Steuerrecht (DStR) 532, 535 (2015); for granular data on the early phase, Klöhn and Hornuf (2012), supra note 4 at 239-46.

[13] See also Christopher D., 2016, "Crowdinvesting – Ist das Kleinanlegerschutzgesetz das junge Ende einer innovativen Finanzierungsform," 28 ZBB 20, 22 (observing above average growth of crowdinvesting only in real estate, ecological projects, and movie financing).

[14] For anecdotal evidence on very high rejection rates of up to 99%, see also Hornuf, L., and A. Schwienbacher, 2015, "The emergence of crowdinvesting in Europe: with an in-depth analysis of the German market," 25 note 12, LMU discussion paper 2014-43, https://bit.ly/1rqGpLq.

[15] Klöhn, L., L. Hornuf, and T. Schilling, 2016, "Regulation of crowdfunding in the German Small Investor Protection Act: content, consequences, critique, suggestions," 13 European Company Law 56 note 3; see also Klöhn and Hornuf (2012) supra note 4 at 239. This tallies with definitions present in the international literature, see, for instance, Hazen, T. L., 2012, "Crowdfunding or fraudfunding – social networks and the Securities Laws – why the specially tailored exemption must be conditioned on meaningful disclosure," 90 North Carolina Law Review 1735, 1736 (defining crowdfunding as sub-category of crowdsourcing "which refers to mass collaboration efforts through large numbers of people, generally using social media or the Internet"); similarly Hemingway and Hoffman (2011) supra note 4 at 881.

[16] https://bit.ly/2OZUAU1

[17] See, for instance, Meschkowski and Wilhelmi (2013) supra note 4 at 1411 (referring to the Wikipedia definition, which also highlights the collective effort in raising resources over the internet to support projects); see also Jansen, J. D., and T. Pfeifle, 2012, "Rechtliche Probleme des Crowdfunding," 33 Zeitschrift für Wirtschaftsrecht (ZIP) 1842, 1843 (pointing to the origins of crowdfunding in sponsoring charitable or altruistic projects through web-campaigns).

[18] For a distinction between altruistic and financially motivated crowdfunding see for instance, Sixt, E., 2017, Schwarmökonomie und Crowdfunding, Springer, 57. For a prudential supervisor's distinction of loan-based crowdfunding on the one hand and investment-based crowdfunding on the other, see Financial Conduct Authority, 2014, "The FCA's regulatory approach to crowdfunding over the internet, and the promotion of non-readily realisable securities by other media 5-6," Policy statement 14/4, https://bit.ly/2xSXL9A.

[19] A very effective example was Barack Obama's fundraising campaign for his initial Presidential Campaign, see Bradley, T., 2008, "Final fundraising figure: Obama's $750M," ABC News, December 5, https://abcn.ws/2RhAoOR.

[20] Jansen and Pfeifle (2012) supra note 17 at 1843; Bareiß, A., 2012, "Filmfinanzierung 2.0," Zeitschrift für Urheber- und Medienrecht (ZUM) 456, 460. For a delineation of possible designs, see also Schramm, D. M., and J. Carstens, 2014, "Startup-Crowdfunding und Crowdinvesting: Ein Guide für Gründer, Springer, 7.

[21] Sixt (2017) supra note 18 at 113.

[22] For a delineation of the respective categories see Bodensiek, K., and C. Leinemann, 2015, "Rechtliche Einordnung des Crowdfundings in Deutschland," 3-4 (Revue générale du droit, Études et réflexions No. 5, 2015), https://bit.ly/2lu7Rl9; Forster, M., 2013, Crowdfinancing 19 (2013); Sixt (2017) supra note 18 at 57-8; Schramm and Carstens (2014) supra note 20 at 7.

[23] On this fundamental feature of loan contracts, see Tröger, T., 2012, Loan, in Basedow, J., K. J. Hopt, and R. Zimmermann (eds.), The Max Planck Encyclopedia of European Private Law 1106, 1108-9.

[24] Specifically, on the definition of crowdinvesting as a form of financing of companies by granting an interest in the firm's future cash-flows, Tröger, T. H., 2017, "Remarks on the German regulation of crowdfunding," 12 Revue Trimestrielle de Droit Financier (RTDF) 79; similarly Klöhn et al. (2016) supra note 15 at 56 note 4 (2016); Klöhn and Hornuf (2012) supra note 4 at 239.

[25] Jansen and Pfeifle (2012) supra note 17 at 1843; Bareiß (2012) supra note 20 at 461-2.

[26] Bürgerliches Gesetzbuch [BGB] [Civil Code], Aug. 18, 1896, RGBl. at 195, § 311 para. 1 (translation at https://bit.ly/2QI7rQQ), empowers any person to create an obligation by contract.

[27] The German stock corporation law does not allow any material alteration of the statutory rights and duties of shareholders, Aktiengesetz [AktG] [Stock Corporation Act], Sept. 6, 1965, BGBl. I at 1089, § 23 para. 5. Even for other legal forms of business organizations, German law adheres to the principle of numerus clauses limiting the latitude to customize membership interests, see for instance Schmidt, K., 2002, Gesellschaftsrecht, Heymanns, 96-8 (4th ed.).

[28] Jansen and Pfeifle (2012) supra note 17 at 1843; Bareiß (2012) supra note 20 at 460.

[29] Reichsgericht [RG] [Imperial Court of Justice] Jan. 30, 1940, 125 Entscheidungen des Reichsgerichts in Zivilsachen [RGZ] 380 (383); Bundesgerichtshof [BGH] [Federal Court of Justice] Sept. 23, 1981, 82 Entscheidungen des Bundesgerichtshofs in Zivilsachen [BGHZ] 274 (280-2); Koch, J., 2016, § 516 BGB para. 24, in Säcker et al. (eds.), Münchener Kommentar zum BGB, Vol. III (7th ed.) Chiusi, T. J., 2013, § 516 BGB para. 49, in J. von Staudingers Kommentar zum BGB mit Einführungsgesetz und Nebengesetzen.

[30] BGH Oct. 2, 1991, 45 Neue Juristische Wochenschrift (NJW) 238, 239 (1992); Koch (2016) supra note 29 at § 516 para. 25; Chiusi (2013) supra note 29 at § 516 para. 40.

[31] For a similar assessment, see Bareiß (2012) supra note 20 at 461.

[32] Under German private law, sponsoring contracts are construed as a combination of service and work and labor contracts, see Schaub, R., 2008, Sponsoring und andere Verträge zur Förderung überindividueller Zwecke, Mohr Siebeck, 208-11.

[33] Bareiß (2012) supra note 20 at 461.

[34] Koch (2016) supra note 29 at § 516 para. 14, 24; Chiusi (2013) supra note 29 at § 516 para. 49.

[35] For this majority view see, for instance, BGH Nov. 27, 1991, 116 BGHZ 167 (170); Koch (2016) supra note 29 at § 516 para. 27. For an overview of the development of the doctrine, see Fischer, M., 2002, Die Unentgeltlichkeit im Zivilrecht, Heymann, 42-44; for a critique see Harke, J. D., 2018, § 516 BGB para. 67-70, in Gsell, B., W. Krüger, S. Lorenz, and C. Reymann (eds.), Beck'scher Online Grosskommentar zum BGB, Verlag C. H. Beck München.

[36] Bareiß (2012) supra note 20 at 461; Jansen and Pfeifle (2012) supra note 17 at 1843.

[37] If transactions are qualified as "mixed donations," see for instance Jansen and Pfeifle (2012) supra note 17 at 1843 note 6, these classifications are misguided. Only if the discrepancy in value was indeed reverse, i.e., the consideration was worth more than the worth more than the contribution, the transaction would be treated as a mixed donation, that is a single contract that combines elements of a donation and a sale (negotium mixtum con donatione), BGH Sep. 23, 1981, 82 BGHZ 274 (281-2); Koch (2016) supra note 29 at § 516 para. 34; Chiusi (2013) supra note 29 at § 516 para. 63. However, as a matter of pure economic rationality, it is almost inconceivable that the value of the consideration is higher than the crowdfunding contribution, because then the campaign would lose money and miss its primary purpose.

[38] Koch (2016) supra note 29 at § 516 para. 34; Harke (2018) supra note 35 at § 516 para. 104-5; Hähnchen, S., 2017, § 516 para. 28, in Westermann, H. P., B. Grunewald, G. Maier-Reimer; B. Erman, and W. Erman (eds.), Erman Bürgerliches Gesetzbuch, 15th ed., ottoschmidt; Dellios, G., 1981, Zur Präzisierung der Rechtsfindungsmethode bei "gemischten" Verträgen, Mohr Siebeck, 103-4 ; for a critique see Ernst, W., 2010, "Entgeltlichkeit - Eine Untersuchung am Beispiel des Tauschs, der gemischten Schenkung und anderer Verträge," in Richardi R., J. Wilhelm, and T. Lobinger (eds.), Festschrift für Eduard Picker, Mohr Siebeck, 139, 170-171.

[39] On the precise legal qualification of the latter, see infra 7.

[40] Bareiß (2012) supra note 20 at 461. If the campaign pertains to the production of a tangible good, the contract is one for work and materials ("Werklieferungsvertrag"), to which sales law also applies, cf. BGB, § 650 s. 1.

[41] For the general qualification of the acquisition of purchase rights for a consideration as a sale of rights, see Harm Westermann, P., 2016, § 453 BGB para. 4, in Säcker et al. (eds.), Münchener Kommentar zum BGB, Vol. III, 7th ed.

[42] id.

[43] See supra B.III.1.

[44] Renner (2014) supra note 7 at 263; see also Berger, S. C., and B. Skiera, "Elektronische Kreditmarktplätze: Funktionsweise, Gestaltung und Erkenntnisstand bei dieser Form des "Peer-to-Peer Lending"," 45 Kredit und Kapital 289, 291 (2012) (showing that a leading platform foresees that acquired cars are used as collateral in auto loans).

[45] See infra 0.

[46] Renner (2014) supra note 7 at 264.

[47] Sometimes, in order to minimize the need for costly information sharing, the credit-extending bank sells and assigns the redemption claim to a servicing firm, which is linked to the platform and subsequently passes the claim on to the ultimate investor, Renner (2014) supra note 7 at 264.

[48] In the U.S., the same result is reached with synthetic notes that replicate the cash flows from the loans platforms themselves and that are acquired by investors who may also trade on a secondary market, see Marte, J., 2010, "Credit crunch gives 'microlending' a boost," Wall Street Journal, September 26, at 1.

[49] For anecdotal evidence in addition to the empirical findings reported infra, see Jansen and Pfeifle (2012) supra note 17 at 1844; Bareiß (2012) supra note 20 at 461.

[50] Klöhn et al. (2016), supra note 12 at 145.

[51] The following section reiterates the main findings in Klöhn et al. (2016) supra note 12 at 148-178.

[52] Id. at 149 and 152-4 (showing that contracts usually are loan agreements that can be terminated after 5-7 years after a minimum notice period has elapsed and automatic termination after a fixed contract term representing an exception).

[53] Id. at 155-6 [finding annual interest rates varying from 1% to 8% and due either upon redemption, or periodically (annually, quarter-annually)].

[54] Id. at 158-60 (identifying an unlimited pro-rata profit participation in four-fifths of the cases and a capped participation in others).

[55] Id. at 161-5 (describing that investors either receive a payment based on an appraisal of the issuer at the time the investment is terminated or a fraction of the proceeds that accrue to equity holders if they sell their shares)

[56] Id. at 160 (also showing that liability was sometimes not limited in the past).

[57] Id. at 177-8. The reason for the subordination comes from prudential banking regulation, which would submit borrowers to an authorization requirement if the loans were not subject to a specific subordination clause, see Pölzig, D., 2014, "Nachrangdarlehen als Kapitalanlage," 68 Wertpapier-Mitteilungen (WM) 917, 919.

[58] Id. at 166-8 (indicating that contracts provide for a proportional adjustment of the participation ratio under which losses can only occur if the issuer is undervalued in the new round of financing).

[59] Id. at 168.

[60] Id. at 168-73 (describing that disclosure obligations provide inter alia for quarterly reporting, disclosure of annual accounts, and overview of profit and revenue participation).

[61] Id. at 173-76; Jansen and Pfeifle (2012) supra note 17 at 1844.

[62] For instance, Jansen and Pfeifle (2012) supra note 17 at 1846; Bareiß (2012) supra note 20 at 461; Klöhn et al. (2016) supra note 12 at 145; on the development of the market, which clearly shifted towards subordinated profit participating loans in reaction to prudential regulation see Klöhn et al. (2016) supra note 15 at 58-9.

[63] See generally, Handelsgesetzbuch [HGB] [Commercial Code], May 10, 1897, RGBl. 219, §§ 230-6 HGB, translation at https://bit.ly/2QmUS7K.

[64] The latter have not received a special treatment neither in the German Civil nor the Commercial Code, but are anticipated in different legislative acts, like for instance Capital Investment Act [Vermögensanlagengesetz, VermAnlG], Dec. 6, 2011, BGBl. I at 2481, § 1 para. 2 nr. 4, https://bit.ly/2QphGUl or AktG, § 221 paras. 3 and 4. The lack of statutory prescriptions together with the fundamental principle of freedom of contract allow for a highly flexible individual design of parties' obligations in these profit participation rights.

[65] The contract combines a regular loan with an additional stipulation of sharing in the profits or sales that flow from the investment of the borrowed funds as compensation for the lender, see for instance Schmidt, K., 2012, § 230 HGB para. 54, in Schmidt, K., (ed.), Münchener Kommentar zum HGB, Verlag: Beck, vol. 3, 3rd ed.; Schäfer, C., 2017, Vor § 705 BGB para. 107, in Säcker et al. (eds.), Münchener Kommentar zum BGB, Verlag: Beck, vol. 6, 7th ed.; Huffer, H., 1970, Das partiarische Geschäft als Rechtstypus.

[66] RG May 11, 1920, 99 RGZ 161 (163), BGH Jun. 6, 1965, 19 WM 1965, 1052 (1053); Freitag, R., 2015, § 488 BGB para. 70, in J. von Staudingers Kommentar zum BGB mit Einführungsgesetz und Nebengesetzen; Blaurock, U., 2010, Handbuch der Stillen Gesellschaft , 7th ed., para 8.30.

[67] See HGB § 233 para. 1, which describes typical control rights of a silent partner.

[68] See generally, Habersack, M., 2016, § 221 AktG para. 93, in Goette, W., and M. Habersack (eds.), Münchener Kommentar zum AktG, C. H. Beck, vol. 4, 4th ed.; Merkt, H., 2016, § 221 AktG para. 46, in Schmidt, K., and M. Lutter (eds.), AktG, vol. 2, 3d ed..

[69] Jansen and Pfeifle (2012) supra note 17 at 1846; Bareiß (2012) supra note 20 at 461.

[70] See generally, Schmidt, K., 2012, § 230 HGB para. 54, in Schmidt, K., (ed.), Münchener Kommentar zum HGB, vol. 3, 3rd ed.; Schäfer, C., 2017, Vor § 705 BGB para. 107, in Säcker et al. (eds.), Münchener Kommentar zum BGB, vol. 6, 7th ed.; in the context of crowdinvesting Jansen and Pfeifle (2012) supra note 17 at 1846; Bareiß (2012) supra note 20 at 461.

[71] See Jansen and Pfeifle (2012) supra note 17 at 1846 (submitting that these transactions should be seen as profit participation contracts sui generis).

[72] Cf. BGB § 488 para. 1 sentence 2 declaring a repayment obligation essential part of a loan contract under German law, see also Freitag (2015) supra note 66 at § 488 para. 70. Where investors receive a fraction of each individual sale (for instance a share of each cinema ticket sold), this contract design can be qualified as a special annuity arrangement (until the contribution is repaid) and a profit participation (after repayment).

[73] Bareiß (2012) supra note 20 at 462. Given the legal character of the participation rights as debt contracts, such a classification is not excluded simply because investors do not receive an ownership stake in the funded entity (for this view see Jansen and Pfeifle (2012) supra note 17 at 1844-5).

[74] On the lack of legal innovation in pertinent respect, see already supra A.I.

[75] See supra B.III.4.

[76] See infra A.I.1.b).

[77] Regulation (EC) No 593/2008 of the European Parliament and of the Council of 17 June 2008 on the law applicable to contractual obligations (Rome I), 2008 O.J. (L 177) 6 [hereinafter Rome I Regulation].

[78] According to the German majority view this requires securitization of the claim to facilitate its transfer by an assignment of the instrument, see for instance Martiny, D., 2012, Art. 1 Rom I VO para. 58-9, in Säcker et al. (eds.), Münchener Kommentar zum BGB, vol. 12, 7th ed.; Kieninger, E. M., 2018, VO (EG) 593/2008 Art. 1 para 15, in Ferrari et al. (eds.), Internationales Vertragsrecht, 3rd ed.

[79] Martiny (2012) supra note 78 at Art. 1 Rom I VO paras. 65, 72; Kieninger (2018) supra note 78 at VO (EG) 593/2008 Art. 1 para 15; Wedemann, F., § 230 para. 119, in: Oetker, H., (ed.) HGB, 5th ed.; Roth, W-H., 2014, Internationalprivatrechtliche Aspekte der Personengesellschaften, 43 Zeitschrift für Unternehmens- und Gesellschaftsrecht (ZGR) 168, 179; Spindler, G., 2017, "Crowdfunding und Crowdinvesting – Sach- und kollisionsrechtliche Einordnung sowie Überlagerung durch die E-Commerce-Richtlinie," 29 ZBB 129, 139.

[80] Rome I Regulation, art. 1 para. 2 lit. f).

[81] Rome I Regulation, art. 3 para. 1. On the preconditions for valid clauses in standard terms, see Verein für Konsumenteninformation v. Amazon, Case C-191/15, [2016] ECLI:EU:C:2016:612 (delivered July 28, 2016).

[82] The anecdotal evidence reported in Spindler (2017) supra note 79 at 139 note 144 is inconclusive as the terms and conditions the author cites are those for the relationship between investors and platforms only.

[83] Rome I Regulation, art. 6 para. 2 s. 2.

[84] According to recital 30 of the Rome I Regulation, its art. 6 para. 4 lit. d) pertains only to financial instruments within the meaning of Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU, art. 4 para. 17 and Annex I C, [2014] O.J. (L 173) at 349, which does neither capture silent partnership interests, nor profit participation rights, nor subordinated profit participating loans, for a discussion see Spindler (2017) supra note 79 at 139.

[85] Infra A.I.1.b). See also Spindler (2017) supra note 79 at 141 (showing that the relevant rules cannot be qualified as overriding mandatory provisions within the meaning of Rome I Regulation, art. 9 para. 1).

[86] Rome I Regulation, art. 6 para. 1 points to the law of the country of the consumer's habitual residence.

[87] Rome I Regulation, art. 3 para. 1.

[88] For a specific discussion, albeit focused on crowdinvesting relationships, see Spindler (2017) supra note 79 at 140.

[89] Otherwise this intermediate step in the discharge of the platform's role can be seen as "deposit business," which requires a banking license, cf. infra D.I.1.

[90] See Banking Act [Kreditwesengesetz, KWG], Sep. 9, 1998, BGBl. I at 2446, § 32, with the relevant definitions codified in KWG, § 1 para. 1a sentence 2 and Securities Trading Act [Wertpapierhandelsgesetz, WpHG], Sep. 9, 1998, BGBl. I at 2708, § 2 para. 3, https://bit.ly/2luhReh.

[91] BaFin, 2007, Merkblatt zur Erlaubnispflicht der Betreiber und Nutzer einer internetbasierten Kreditvermittlungsplattform nach dem KWG (2007), https://bit.ly/2NgoB0j; Renner (2014) supra note 7 at 264.

[92] As defined in KWG § 1 para. 1a sentence 2 no. 1; for an extensive discussion of the latter aspect see Veith, J., 2016, "Crowdlending – Anforderungen an die rechtskonforme Umsetzung der darlehensweisen Schwarmfinanzierung," 16 Zeitschrift für Bank- und Kapitalmarktrecht (BKR) 184, 186-7.

[93] Defined in KWG, § 1 para. 2 No. 1.

[94] Schäfer, F. A., 2016, § 1 KWG para. 46, in Boos, K-H., R. Fischer, and H. Schulte-Mattler (eds.), KWG, CRR-VO, 5th ed.

[95] Renner (2014) supra note 7 at 265. For a general discussion of the respective element in KWG, § 1 para. 2 No. 1 see Demgensky, S., and A. Erm, 2001, "Der Begriff der Einlage nach der 6. KWG-Novelle," 55 WM 1445, 1448.

[96] As defined in KWG, § 1 para. 2 No. 2.

[97] For the U.S. model which sees platforms extend loans see supra note 48.

[98] KWG, § 37 para. 1 s. 4 empowers BaFin to stop the operations of and wind-down firms that were involved in the initiation, conclusion, or execution of prohibited (unauthorized) activities.

[99] Veith (2016) supra note 92 at 186; Renner (2014) supra note 7 at 266 (with a critique that favors a more restrictive interpretation); see also Schwennicke, A., 2010, "Vergabe privater Darlehen und Erlaubnispflicht nach dem KWG," WM 542, 548 (2010) arguing in favor of firm de minimis limits.

[100] Cf. KWG, § 32 para. 1 s. 1. As a matter of practice, the second alternative of the provision, that the activity requires a commercial business organization (in kaufmännischer Weise eingerichteter Geschäftsbetrieb) is mute, because the elements of a commercial activity are usually met, even though no specific organizational arrangements are necessary.

[101] BGH Jul. 11, 2006, 60 Der Betrieb (DB) 2061, 2062 (2006); BaFin, Merkblatt Kreditgeschäft (2016), https://bit.ly/2Rc0Ppn; Schäfer (2016) supra note 94 at § 1 KWG para. 22.

[102] BaFin supra note 101.

[103] For an alternative proposal that would retain a direct contracting model but use subordinated loans see Veith (2016) supra note 92 at 187.

[104] BaFin supra note 103; Schäfer supra note 94 at § 1 KWG para. 43; Heer, P. E., 2012, "Die Übertragung von Darlehensforderungen – eine systematische Übersicht – zugleich Anmerkung zum Urteil des BGH vom 19. 4. 2011 – XI ZR 256/10," 12 BKR 45, 47 (2012).

[105] For an extensive discussion see Veith (2016) supra note 92 at 188-9.

[106] For an overview on the question if issuers need an authorization because they engage in "deposit business" (Einlagengeschäft) within the meaning of KWG, § 1 para. 2 No. 1, see for instance Nietsch, M., and N. Eberle, 2014, "Bankaufsichts- und prospektrechtliche Fragen typischer Crowdfunding-Modelle," 67 Der Betrieb (DB) 1788, 1790.

[107] Supra D.I.1.

[108] WpHG § 2 para. 2b; KWG § 1 para. 11

[109] Capital Investment Act [Vermögensanlagengesetz, VermAnlG], Dec. 6, 2011, BGBl. I at 2481, § 1 para. 2, https://bit.ly/2QphGUI.

[110] Prior to the 2015 reforms a debate existed about whether the definition of financial assets also included profit participating loans. See, for instance, Weitnauer, W., and J. Parzinger, 2013, "Das Crowdinvesting als neue Form der Unternehmensfinanzierung," 4 Gesellschafts- und Wirtschaftsrecht (GWR) 153, 155 (advocating an inclusive definition on normative grounds); Nietsch and Eberle (2014) supra note 106 at 1790 and 1793 (opposing such a wide definition).

[111] As defined in KWG, § 1 para. 1 sentence 2 no. 10; WpHG, § 2 para. 3 sentence 1 no. 5.

[112]On the general precondition of a firm underwriting to fall under the statutory regime see Schäfer (2016) supra note 94 at § 1 KWG para. 112; Kumpan, C., 2010, § 2 WpHG para. 72, in Schwark, E., and D. Zimmer (eds.), Kapitalmarktrechtskommentar, 4th ed..

[113]As defined in KWG § 1 para. 1a sentence 2 no. 1c; WpHG, § 2 para. 3 sentence 1 no. 6.

[114]BaFin, 2009, "Merkblatt – Hinweise zum Tatbestand des Platzierungsgeschäfts," https://bit.ly/2NgoB0j, (requiring a disclosed open agency relationship).

[115]Klöhn and Hornuf (2015) supra note 4 at 249-50.

[116]For a detailed description of the relevant provisions' content see, Jansen and Pfeifle (2012) supra note 17 at 1850-1; Klöhn and Hornuf (2015) supra note 4 at 250-1.

[117]As defined in KWG § 1 para. 1a sentence 2 no. 1; WpHG, § 2 para. 3 sentence 1 no. 4.

[118]See, for instance, Nietsch, M., and N. Eberle, 2014, "Crowdinvesting – Welche Auswirkungen hat das geplante Kleinanlegerschutzgesetz?" 67 DB 2575, 2576.

[119]BaFin, 2011, "Merkblatt – Hinweise zum Tatbestand der Anlagevermittlung,"; Assmann, H-D., 2012, § 2 WpHG para. 81, in Assmann, H-D., and U. H. Schneider (eds.), WpHG, 6th ed.

[120]As defined in KWG, § 1 para. 6 no. 8 Buchst. e); WpHG, § 2a para. 1 no. 7 Buchst. e).

[121]Trade Regulation [Gewerbeordnung, GewO], Feb. 22, 1999, BGBl. I at 202, § 34 para. 1 sentence 1, https://bit.ly/2y4Opa7.

[122]As defined in KWG, § 1 para. 1a no. 1b; WpHG, § 2 para. 3 no. 8. See also Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC, 4 para. 1 no. 15, 2004 O.J. (L 145) 1 [hereinafter MiFiD].

[123]Klöhn & Hornuf, supra note 4 at 251.

[124]See MiFiD, recital 5.

[125]BaFin (2011) supra note 119; BaFin, Crowdinvesting, https://bit.ly/2QpcZtl

[126]For a general overview see Assmann (2012) supra note 119 at para. 110.

[127]Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012, [2013] O.J. (L 176) 1.

[128]WpHG, §§ 63-98.

[129]Council Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions, art. 4 para. 1 lit. a), [2013] O.J. (L 287) 63.

[130]BGB, § 491a. For detailed description of the information duties Schürnbrandt, J., 2016, Vor § 491 para. 4, in Säcker et al. (eds.), Münchener Kommentar zum BGB, vol. 3, 7th ed.; for a discussion in the context of crowdlending see Veith (2016) supra note 92 at 193; Renner (2014) supra note 7 at 268-9.

[131]Directive 2008/48/EC of the European Parliament and of the Council of 23 April 2008 on credit agreements for consumers and repealing Council Directive 87/102/EEC, art. 5-7, [2008] O.J. (L 133) 66, implemented in BGB, §§ 491a, 493.

[132]Einführungsgesetz zum Bürgerlichen Gesetzbuche (EGBGB) [Introductory Act to Civil Code], Aug. 18, 1896, RBl. 604, Art. 247 § 13.

[133]Gilson, R. J., 2003, "Engineering a venture capital market: lessons from the American experience," 55 Stanford Law Review 1067, 1077 (2003) (describing the key problems in venture capital investing); Cumming, D. J., and S. A. Johan, 2009, Venture capital and private equity contracting: an international perspective, Elsevier, 48-52 (showing that the features of equity claims make for lemon markets in both equity and debt financing of start-up firms because unprofitable ventures are more likely to issue equity while riskier ones have a proclivity to seek debt financing).

[134]Bradford, C. S., 2012, "Crowdfunding and the Federal Securities Laws," 2012 Columbia Business Law Review, 1, 105; more specifically for Germany Meschkowski and Wilhelmi (2013) supra note 4 at 1410-11.

[135]An investment advisor has to provide recommendations inter alia with a view to the specific financial situation of individual investors and the characteristics of the investment, see for instance BGH, July 6, 1993, BGHZ 123, 126 (128-9); Emmerich, V., 2016, § 311 BGB para. 101, in Säcker et al. (eds.), Münchener Kommentar zum BGB, vol. 2, 7th ed.

[136]However, if platforms use client data to provide recommendations derived from algorithms, for instance based on past investment behavior, they might be seen as investment advisors and incur far reaching fiduciary obligations, see Jansen and Pfeifle (2012) supra note 17 at 1849.

[137]Jansen and Pfeifle (2012) supra note 17 at 1849; generally on the highly relevant distinction of investment advice on the one hand and investment brokerage on the other in German law, see Assmann, H-D., 2002, "Negativberichterstattung als Gegenstand der Nachforschungs- und Hinweispflichten von Anlageberatern und Anlagevermittlern," 23 ZIP 637, 648; Möllers, T. M. J., and T. Ganten, 1998, "Die Wohlverhaltensrichtlinie des BAW im Lichte der neuen Fassung des WpHG – Eine kritische Bestandsaufnahme," 27 ZGR 773, 785-6.

[138]For these well-established, general preconditions for a tacit agreement to provide information, see for instance BGH, Mar. 22, 1979, 74 BGHZ 103 (106); BGH, Mar. 4, 1987, 100 BGHZ 117 (118-9); BGH, May 13, 1993, 14 ZIP 997 (1993) BGH, Oct. 19, 2006, 27 ZIP 2221 (2006); Heermann, P. W., 2017, § 675 BGB para. 122, in Säcker et al. (eds.), Münchener Kommentar zum BGB, vol. 5/2, 7th ed.; Siol, J., 2017, § 45, "Anlagevermittlung und Prospekthaftung der Banken," in Schimansky et al. (eds.), Bankrechts-Handbuch para. 6, 5th ed.

[139]Meschkowski and Wilhelmi (2013) supra note 4 at 1413.

[140]For an analysis and critique of cases, see Benedict, J., 2005, Die Haftung des Anlagevermittlers, 26 ZIP 2129, 2131-3.

[141]See generally 74 BGHZ 103 (110); BGH, Feb. 16, 1981, 80 BGHZ 80 (81-2); Emmerich (2016) supra note 135 at para 127; Siol (2017) supra note 138 at para 9.

[142]Emmerich (2016) supra note 135 at para 127.

[143]Emmerich (2016) supra note 135 at para 127; Siol (2017) supra note 138 at para 9.

[144]Jansen and Pfeifle (2012) supra note 17 at 1850.

[145]VermAnlG, § 18 para. 1 no. 2 and no. 3 empower the supervisor (BaFin) to prohibit public offerings of investments from going forward if they violate the prospectus requirements.

[146]See Meschkowski and Wilhelmi (2013) supra note 4 at 1415; Klöhn and Hornuf (2012) supra note 4 at 259; Nietsch and Eberle (2014), supra note 106 at 2579.

[147]Small Investor Protection Act [Kleinanlegerschutzgesetz, KASG], July 3, 2015, BGBl. I at 1114, art. 2 no. 4.

[148]VermAnlG, § 2a.

[149]For a more granular description of the relevant statutory requirements, Klöhn et al. (2016) supra note 15 at 59-60; for in-depths analyses see Casper, M., 2015, "Das Kleinanlegerschutzgesetz – zwischen berechtigtem und übertriebenem Paternalismus," 27 ZBB 265, 275-80; Nietsch and Eberle (2014), supra note 106 at 1789.

[150]For a policy discussion of investment limits, see Klöhn & Hornuf (2012) supra note 4 at 262-4. For a critique of the current limits see Klöhn, L., and L. Hornuf, 2015, "Die Regelung des Crowdfunding im RegE des Kleinanlegerschutzgesetzes – Inhalt, Auswirkungen, Kritik, Änderungsvorschläge," 68 DB 47, 52-53.

[151]VermAnlG, §§ 13, 15. For details see Klöhn et al. (2016) supra note 15 at 60.

[152]VermAnlG, § 13 para. 3a.

[153]VermAnlG, § 16 para. 1; see Klöhn et al. (2016) supra note 15 at 60.

[154]VermAnlG, § 12 para. 2 and 3 prescribe that the expressed warnings that a total loss of funds invested is possible and that a promised return is not guaranteed are sufficiently visible also in advertisement campaigns. For a granular delineation of the restrictions see Waschbusch, G., 2016, "Die Masse macht's – Crowdfunding als Finanzierungsmöglichkeit für Existenzgründer," 67 Der Steuerberater (StB) 206, 208.

[155]On the concept, see Romano, R., 1998, "Empowering investors: a market approach to securities regulation," 107 Yale Law Journal 2359, 2362, 2418 (1998) (proposing that issuers be permitted to opt into both U.S. States' and foreign nations disclosure regimes); Palmiter, A. R., 1999, "Toward disclosure choice in securities offerings," Columbia Business Law Review 1, 86-91 (restricting issuer choice to the selection of a primary market disclosure regime); for a critique see Fox, M. B., 1999, "Retaining mandatory securities disclosure: why issuer choice is not investor empowerment," 85 Virginia Law Review 1335, 1345-56 (holding that the divergence between managers' private benefits and social benefits derived from disclosure rules will induce suboptimal outcomes under a regime of issuer choice).

[156]Jansen and Pfeifle (2012) supra note 17 at 1844; Bareiß (2012) supra note 20 at 459 (reporting that payment accounts of contributors are only debited if target levels for overall financing are reached or contributions are returned if these levels are undercut).

[157] At least the general duty to avoid any acts that threaten the purpose parties pursue with the contract (on the respective construction of the accompanying duties mentioned in BGB, § 241 para. 2 see Bachmann, G., 2016, § 241 para. 85, in Säcker et al. (eds.), Münchener Kommentar zum BGB, vol. 2, 7th ed.) applies, regardless of the legal qualification of the crowdfunding relationship. See Jansen and Pfeifle (2012) supra note 17 at 1845 note 21, 1846 without doctrinal specification. See also infra E.III.

[158] BGB, §§ 280 para. 1, 276 para. 1.

[159] The cases do not specifically pertain to crowdinvesting, but to investment brokers in general and are, therefore, relevant for the determination of platforms' duties to inform. For an overview see Siol (2017) supra note 138 at para. 18-21.

[160] See already supra note 157.

[161] To find negligence, BGB, § 276 para. 2, requires a showing that the debtor violated the duty of care as observed by the respective public circles. Hence, the objective standard needs to be specified with a view to the respective contractual obligation, see for instance BGH, Mar. 17, 1981, BGHZ 80, 186 (193); Grundmann, S., 2016, § 276 BGB para. 55-6, in Säcker et al. (eds.), Münchener Kommentar zum BGB, vol. 2, 7th ed.).

[162] An explicit safe harbor protecting business judgement against judicial second guessing prone to hindsight bias is codified in AktG, § 93 para. 1 s. 2 for managers of stock corporations. Beyond the narrow scope of this specific provision, the underlying principle is also relevant in general private law.

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