Verband deutscher Kreditplattformen

Managing Director

04/16/2021

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Chairwoman of the Finance Committee
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Statement on the government draft bill of an accompanying legislation to the ECSP regulation

The Association of German Debt Capital Platforms represents the interests of the digital debt capital ecosystem. Our members include online market places in the areas of consumer, corporate and municipal finance as well as private and predominantly institutional investors. Together, they come to a cumulative financing and investment brokerage volume of EUR 11.7 billion in 2020.

Liability provisions in Sections 32c,d Securities Trading Act (WpHG)

The European Crowdfunding Service Provider regulation (EU/2020/1503 – ECSP regulation) grants the option to the member states according to Art. 23(9) and 24(4), respectively, to impose responsibility on both the project owner and debt capital platform, respectively, and its respective administrative, management or supervisory bodies. We appeal to Members of Parliament to reconsider the full use of this framework. There is no legal or actual necessity for this. The draft bill also leads to a systemic and legally unjustifiable discrimination against the bodies of SME (often start-up founders), which have opted for this new form of EU regulated debt capital financing within the limited scope of its application of up to EUR 5 million, compared to the less strict liability for capital market financing under the traditional liability regimes pursuant to the Securities Prospectus Act (Wertpapierprospektgesetz (**WpPG**)) or the Capital Investment Act (Vermögensanlagengesetz (**VermAnlG**)), which often have significantly higher volumes.

The liability regime provided for in Sections 32c, d WpHG is disproportionately broad compared to German prospectus liability law and compared to the liability regimes for prospectus-free issues under the VermAnlG and the WpPG. In particular, neither the WpPG nor the VermAnlG nor the Capital Investment Code (Kapitalanlagesetzbuch (**KAGB**)) recognize this completely unbalanced coexistence of the liability of the offeror and the offeror's body. The statement in the explanatory memorandum to the government bill - Bundestag official record 19/27410, page 51: "*The liability provisions are based on the proven liability standards in prospectus law*" - is incorrect. The draft bill is not compatible with the existing German capital market liability system.

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Nor is it comprehensible why liability should already be assumed for simple negligence in the case of crowdfunding services according to the ECSP regulation. In contrast, liability is assumed for intent and gross negligence in accordance with Section 13(1) WpPG, Section 22(3) VermAnlG and Section 306(3) KAGB.

Correctly, the Bundesrat points out in its statement of 03/16/2021 that different liability regimes create legal uncertainty and disadvantages "*without any objective reason being discernible for this*."

Objectives of the ECSP Regulation

We recall that, according to the reasons and objectives in the Commission's proposal (COM (2018) 113), the aim of the ECSP regulation was to expand access to finance for innovative companies, start-ups and other unlisted companies.

Thus, according to their impression, access to financing for these companies - especially if they wanted to move from the start-up to the expansion phase - would still prove difficult. The over-reliance on short-term unsecured bank loans, COM said, often comes at a high cost. In addition, bank loan volumes for both start-ups and SMEs had suffered greatly from the financial crisis of 2008 and had not yet returned to pre-crisis levels, so lack of funds would play a significant role in the failure of start-ups.

As is well known, the Corona pandemic has once again drastically exacerbated this situation, especially for young companies. In addition, more and more banks are withdrawing from the financing of unsecured loans - partly prompted by regulation due to further tightened lending requirements, but also driven by the recent development lending policy, which creates an incentive to focus on house bank business with profitable margins at low risks. The restricted balance sheets have thus created a financing gap, particularly in the area of unsecured loans of up to EUR 5 million, which could be successfully closed by means of CSPs.

Sections 32c,d WpHG make CSP lending unattractive

In the meantime, we have grave doubts about the interest of the responsible bodies of, for example, a start-up in a crowdfunding service, should they become aware of this very far-reaching personal liability risk. As a rule, young founders act as business managers and have usually already used all their private capital to build up their company. Their appetite for this additional, difficult-to-control personal financial liability risk under Sections 32c,d WpHG is regularly likely to be weak.

This must be practically illustrated by the requirements for the capital market information provided for in the ECSP regulation, the so-called "Key Investment Information Sheet" (KIIS).

Very detailed information requirements must be met in a space of no more than six pages in DIN A-4 format (this is the specific requirement in Art. 24 (3) ECSP regulation). The "*Consultation Paper on draft technical standards under the ECSP Regulation*" recently published by ESMA on March, 26th, contains a draft KIIS form that fills ten and a half printed pages with numerous technocratic specifications for describing key points of the asset investment.[1] It will be a challenge for any SME

[1] https://www.esma.europa.eu/press-news/esma-news/esma-consults-regulating-crowdfunding.

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to boil down this form to six printed pages while accommodating enough text space for truly material information about the company and the specific risks of the investment. Who can be absolutely sure that "*important information*..." is not missing in the sense of § 32c No. 2 WpHG, "...*which is necessary to support investors in their decision whether to invest in a crowdfunding project*"? But you better be absolutely sure, because slight negligence is enough!

To make matters worse, the procedural scenario is extraordinarily unfavourable for the management to defend against such investor lawsuits. By the time Section 32c No. 2 WpHG is applied - in investor litigation before the courts - insolvency has usually already occurred. The investors (rather, the specialized investor law firms that would represent the "crowd" in such cases in a class action) then only have to study the insolvency administrator's insolvency report and will come across many details about the market and company situation in the months and possibly years before the insolvency, which can certainly easily be classified as important information "*required to support the investor's decision*" within the meaning of Section 32c No. 2 WpHG, but which the managing director did not include on the six DIN A-4 pages in the KIIS. This can be, for example, a reference to the long known strong competitor X, the weak market Y, the possibly missed trend Z, which can be found in the insolvency report, but not on the six DIN-A-4 pages of the KIIS. Then private insolvency is almost inevitable for the management, because in retrospect it is easy to argue that this could have been accommodated in the KIIS.

All this is a horror scenario for start-up founders. Most start-up founders will therefore keep their hands off this financing option.

This liability risk applies even more acutely to supervisory bodies, which - by the very nature of the control function - are further removed from day-to-day operations and do not even have the opportunity to ensure that a KIIS is not, for example, negligently inaccurate or incomplete.

Contrary to what COM so full of hope described, this threatens digital debt financing by means of German CSPs as an attractive alternative for German SMEs. The situation is exacerbated by the fact that crowdlending services that fall within the scope of the regulation may no longer be provided under national regulations, even if they are not to be offered throughout the EU.

Furthermore, the comparison with the liability regulations established in Germany in capital market information law shows that the liability regulations pursuant to Sections 32c and 32d WpHG are legally misguided. This is because there is a risk of blatant unequal treatment here. Anyone who wishes to structure a crowdfunding as an ESCP financing in the volume of up to EUR 5 million, which is only permissible here, is subject as a managing director / executive board member to the extremely strict liability described above. However, anyone seeking larger financing by means of crowdfunding without a prospectus can structure the financial product as a security (which is becoming increasingly cost-effective in view of the constantly expanding dematerialized, electronic possibilities) and approach the capital market with a simply designed securities information sheet (Wertpapierinformationsblatt (**WIB**)) similar to the KIIS in accordance with Section 3 No. 2 and Section 4 WpPG in a volume of up to EUR 8 million. This is already successfully practiced in many cases in Germany in the context of crowdlending. In this case, however, only the offering company

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is primarily liable, and there is a possibility of exoneration if the defect in the WIB is not due to grossly negligent ignorance (Sections 11, 13 WpPG).

Equally privileged compared to ESCP issuers are the large issuers beyond the prospectus requirement thresholds. On the one hand, these large issuers can usually afford large teams of lawyers who, after lengthy due diligence reviews, prepare comprehensive prospectuses that, while exceeding the reading horizon of the ordinary investor, point out every conceivable risk and thus minimize the liability risk. On the other hand, issuers of securities with prospectuses are also subject to the significantly weaker liability regime of the WpPG (Section 9 WpPG) compared to Sections 32c and 32d WpHG. Here, too, only the issuer is primarily liable, with the possibility of exoneration in the case of causal, not grossly negligent, ignorance.

It is clear that a member of a corporate body can also be personally liable under Sections 9, 11 WpPG, but not as under Section 32c WpHG in the sense of a kind of automatic, accessory liability, but in accordance with the principles of liability of the "prospectus initiators". This is expressed in Section 9(1) sentence 1 No. 2, Section 11 WpHG (likewise in Section 306 KAGB) as liability of "*those from whom the issuance of the securities information sheet/prospectus emanates*". For example, a member of the board of directors/member of the management is liable as "*issuer of the prospectus*" if he or she "*has his or her own business interest in the issue*". A recognized example is, for example, a particularly high incentive in the case of an IPO. Only then does personal board liability come into play.

This unequal treatment of ESCP issuers and WpPG issuers under Section 32c WpHG can only be summed up as "let the small ones hang - let the big ones go."

A further misalignment of Section 32c WpHG arises when considering that crowdinvesting in the form of qualified subordinated/junior secured loans (qualifizierte Nachrangdarlehen) according to the definition of "loan" in Art. 2(1)(b) ESCP regulation does not fall within the scope of this regulation. To this extent, the previous liability regime for prospectus-free asset investments with an “asset investment information sheet" (Vermögensinformationsblatt (**VIB**)) pursuant to Sections 2a, 13, 22 VermAnlG, i.e. with liability only of the provider, continues to apply to crowdinvesting. Thus, while the investment product of non-subordinated/senior secured loans distributed in accordance with the ESCP regulation, which is significantly less risky for investors, results in strict liability for the issuer and its executive bodies, the liability for subordinated/junior secured loans, which are significantly riskier for investors, is significantly milder. Hence, Section 32c WpHG could counteract the incentive - which is to be welcomed from the investor's point of view - towards non-subordinated/senior secured loans in crowdlending.

Impact on Germany as a financial centre

Digital debt capital platforms are important drivers of innovation. Today, banks want to make their processes just as highly automated and efficient for the benefit of their customers. With their technological edge, online market places therefore make an important contribution to strengthening Germany as a financial centre. They can make important contributions to overcoming the consequences of the Corona pandemic. In addition, they are reviving the hitherto restrained

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diversification in the financing of SME through alternative digital debt financing offers. However, the regulation in Sections 32c,d WpHG puts this innovative power at risk because it discourages project promoters and platforms alike from exploiting the potential of the regulation for a comprehensive, area-wide and efficient allocation of digital debt capital by licensed CSPs.

Moreover, it would not only run counter to the Commission's objectives, but also to the efforts of the German government, which has repeatedly stated that it wants to do everything in its power to create attractive framework conditions in Germany that are conducive to innovation.

The business in the German market is thus threatened by those platforms that have their registered office in a Member State that has opted for liability only of the project owner and CSP. Thus, Sections 32c,d WpHG set German digital debt capital platforms back in competition with their European rivals.

Against this background, we propose the following amendments and additions to the text of the government draft bill, i.e. a return to the current regulatory model for crowdlending in accordance with Section 22 VermAnlG:

Draft bill	**Alternative proposal**
Section 32c Liability for information in the key investment information document pursuant to Article 23 Regulation (EU) 2020/1503	Section 32c Liability for information in the key investment information document pursuant to Article 23 Regulation (EU) 2020/1503
The project owner responsible for the key investor information document pursuant to Article 23 of Regulation (EU) 2020/1503 ***and the responsible members of the administrative, management or supervisory bodies of a project owner*** within the meaning of Article 2(1)(h) of Regulation (EU) 2020/1503 shall be liable to compensate the investor within the meaning of Article 2(1)(i) of regulation (EU) 2020/1503 for any loss or damage which arises from the fact that in an investment fact sheet pursuant to Article 23 of Regulation (EU) 2020/1503 or any translations into official languages of a Member State of the European Union, intentionally or negligently 1. misleading or inaccurate information is provided, or	***(1)*** The project owner responsible for the key investor information document pursuant to Article 23 of Regulation (EU) 2020/1503 within the meaning of Article 2(1)(h) of Regulation (EU) 2020/1503 shall be liable to compensate the investor within the meaning of Article 2(1)(i) of regulation (EU) 2020/1503 for any loss or damage which arises from the fact that in an investment fact sheet pursuant to Article 23 of Regulation (EU) 2020/1503 or any translations into official languages of a Member State of the European Union, intentionally or negligently 1. misleading or inaccurate information is provided, or 2. important information is not provided which is necessary to assist investors in deciding whether to invest in a crowdfunding project.

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2. important information is not provided which is necessary to assist investors in deciding whether to invest in a crowdfunding project.	***(2) Pursuant to paragraph 1, no claim may be brought against a person who proves that he was unaware of the inaccuracy of the information contained in the basic investment information sheet, that he was misled by such information or that such information was incomplete and that such unawareness was not due to gross negligence.***
Section 32d Liability for information in the key investment information document pursuant to Article 24 of Regulation (EU) 2020/1503 The crowd funding service provider responsible for the key investment information document pursuant to Article 24 of Regulation (EU) 2020/1503 ***and the members of its administrative, management or supervisory bodies responsible for such key investment information document*** shall be liable to compensate the investor within the meaning of Article 2(1)(i) of Regulation (EU) 2020/1503 for any damage resulting from the fact that in a key investment information document pursuant to Article 24 of Regulation (EU) 2020/1503 or any translations into official languages of a Member State of the European Union intentionally or negligently 1. misleading or inaccurate information is provided, or 2. important information is not provided which is necessary to assist investors in deciding whether to make their investment by managing the loan portfolio individually.	Section 32d Liability for information in the key investment information document pursuant to Article 24 of Regulation (EU) 2020/1503 ***(1)*** The crowd funding service provider responsible for the key investment information document pursuant to Article 24 of Regulation (EU) 2020/1503 ***and the members of its administrative, management or supervisory bodies responsible for such key investment information document*** shall be liable to compensate the investor within the meaning of Article 2(1)(i) of Regulation (EU) 2020/1503 for any damage resulting from the fact that in a key investment information document pursuant to Article 24 of Regulation (EU) 2020/1503 or any translations into official languages of a Member State of the European Union intentionally or negligently 1. misleading or inaccurate information is provided, or 2. important information is not provided which is necessary to assist investors in deciding whether to make their investment by managing the loan portfolio individually. ***(2) Pursuant to paragraph 1, no claim may be brought against a person who proves that he was unaware of the inaccuracy of the information contained in the basic investment information sheet, that he was***

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	misled by such information or that such information was incomplete and that such unawareness was not due to gross negligence.

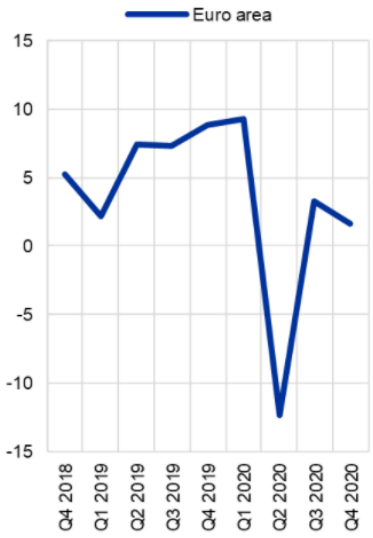
In addition, it should be considered that our proposal is implemented subject to further review of whether the level of liability under the existing Section 22 VermAnlG is factually appropriate in the area of crowdfunding. This could be combined with the observation of how other EU member states use the leeway under the ECSP regulation in designing this liability regime.

The Finance Committee of the German Bundestag could therefore (following the example of the "Small Investor Protection Act" (Kleinanlegerschutzgesetz) of 2015, see Resolution Recommendation and Report of the Finance Committee of April, 22nd, 2015, Bundestag official record 18/4708, page 60, where the Federal Government was also given an evaluation mandate) formulate the following in the upcoming report:

> *"The Finance Committee of the German Bundestag requests the Federal Government to prepare an evaluation by the end of 2022 with regard to the liability regulation newly adopted in § 32c and § 32d of the Securities Trading Act in filling the scope of Articles 23(9) and 24(4) of Regulation (EU) 2020/1503 and to submit it to the Finance Committee with a statement on any necessary amendments. This should include a discussion of the extent to which the current level of liability under Section 22 of the Capital Investment Act, Sections 32c and 32d of the Securities Trading Act in the area of crowdfunding is objectively appropriate, particularly against the background of investor protection. At the same time, the manner of implementation in other EU member states should also be taken into consideration."*

In addition, we have included four charts below to support our central theses:

1. The rejection rate for corporate loans with banks has recently risen significantly (source: ECB).



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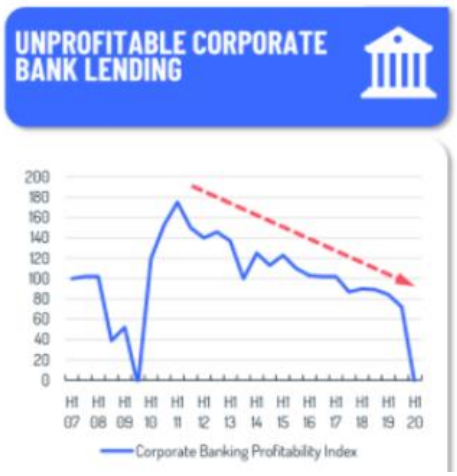
2. Banks are increasingly tightening their debt capital policies toward companies (source: KfW Research) - and they started doing so even before the outbreak of the Covid19 crisis. Banks have been particularly restrictive with regard to loan requests from SME.

3. Negative earnings development makes corporate financing increasingly unattractive for banks - return on equity increasingly fails to cover the cost of equity (source: Bain & Company) - Covid19 and competition have reinforced this trend.



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4. Market volume for unsecured SME loans is large (source: Deutsche Bundesbank, Federal Statistical Office, Creditreform).

Market for unsecured SME loans in Germany (top – down approach)		Market size
Volume of new loans 2019[1]	• Volume of new loans to enterprises by banks in Germany • Focus on non-financial corporations, (insurance, fin. service excluded)	EUR 952.0 bn
thereof unsecured loans [2]	• Volume of new unsecured to enterprises by banks in Germany • Unsecured lending derived from difference between a) total new lending business and b) new lending business collateralised	EUR 831.1 bn
thereof unsecured loans to SMEs[3]	• New unsecured loans to SME companies by German banks • SME definition as per EU Council (turnover ≤ EUR 50 m, employees ≤ 249) • Unsecured lending distribution across SMEs based on VAT statistics	EUR 83.1 bn

(1) Volume refers to new loans only, excluding revolving loans, extension of credit lines
(2) Volume of unsecured loans 2019 refers to new loans only
(3) SME defined as companies with turnover up to EUR 50 m

According to Deutsche Bundesbank statistics, annual new business for "unsecured loans to SMEs" is expected to exceed EUR 83 billion. This is a large market segment from which banks are withdrawing. Unlike consumer credit, however, corporate credit is still largely undigitized, and we are at the beginning of an already discernible rating migration that will make unsecured debt capital even more difficult and unprofitable for traditional banks. But SME and start-ups need in rem unsecured loans. If it doesn't come from banks, it must come from private investors via debt capital platforms. This is the guiding principle that ECSP has in mind.

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