



Public Consultation on Regulation of Crowdfunding

Response Submission from:

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1.0 Introduction

1.1 About Initiative Ireland

Initiative Financial Services Limited t/a Initiative Ireland was established in 2015 to provide specialist alternative financial services. As a syndicated property finance platform, our model falls within the scope of the Marketplace Finance or Crowdlending Industry. The company was founded by a team of experienced professionals with backgrounds in regulated, mainstream financial services here in Ireland and is a recognised HPSU with Enterprise Ireland.

At **Initiative Ireland**, we syndicate and thereafter actively manage Secured Property Loans on behalf of our Private Lending Members. Our model offers experienced property developers (businesses) access to Secured Property Finance at competitive rates and terms. Our primary focus is the financing of residential developments, supporting the construction of family homes in areas of high demand across Ireland. Our loans are professionally managed by our experienced Property Teams to provide confidence and ease to our borrowers and lenders alike.

All our loans are carefully vetted and pre-approved by our Internal Credit Committee prior to syndication amongst our lenders for financing. All loans offered will be secured with a 1st Lien on Irish Real Estate and managed closely from end-to-end by our Relationship Managers and partnering professional service providers. As such, our model is designed to offer our lending members access to a professionally managed, relatively low-volatility asset class, with the potential to earn optimised returns.

1.2 Existing Compliance Culture

The company operates in compliance with our own Internal Policy Framework. This framework is comprised of both internal and external policies which have been identified for compliance within the company. Albeit these policies are not all mandated by the Financial Regulator for our firm at this time, we aim to comply with the spirit of existing regulatory regimes in the interest of our clients. This



approach has been taken on an interim basis in anticipation of a future bespoke regulatory regime for the industry. In this way, the company aims to promote sustainable, prudential and fair practices within the emerging industry in Ireland. As such, the company welcomes the introduction of bespoke regulation for the crowdlending industry here in Ireland to establish consistent, proportionate and transparent standards. We would also welcome the opportunity to contribute further to any additional upcoming dialogue and/or consultation.

1.2 Response Approach

The following response has been provided to aid in the development of future regulatory policy and to promote a much-needed dialogue between the emerging industry, stakeholders and regulatory bodies. The response herein has been provided on a 'best endeavours' basis in the absence of any clear proposal.

It is our position that Crowdfunding (equity participation) and Crowdlending (debt participation) should both be regulated within the market under separate regulatory regimes.

Although the term 'Crowdfunding' has been used in the Public Consultation paper with the meaning of both industries, for the avoidance of doubt where Initiative Ireland has used the term Crowdlending, we do so in reference only to models which enable debt participation.

Where the terms "Consumer Crowdlending" is used, this refers to models which would offer Consumer Loans.

Where the terms "Business Crowdlending" is used, this refers to models which would offer Business Loans.

2.0 Consultation Questions

Question 1: Should Crowdfunding in Ireland be regulated?

Response 1:

Initiative Ireland welcomes the introduction of new regulation and/or the extension of existing regulation for the crowdlending industry, provided such regulation is



proportionate. It is important that any new regulatory regime does not unduly impact the emergence of an industry which can offer significant value to both borrowers and lenders alike. Furthermore, with the right regulatory approach, Crowdfunding can deconcentrate risks, increase financial inclusion and competition, support private wealth management and provide industries with sustainable, low-volatility funding. While individual Credit Institutions may at times increase or decrease the level of funding they make available to the market, crowdfunding enables different entities to provide finance without having to establish a local operational footprint. As such, the industry could serve to stabilise access to funds through different credit cycles while also bringing a consistency to the management and administration of alternative credit in the market.

Appreciating the diversity of models which may exist within this emerging industry, it is our position that initial mandatory regulation should focus on the areas presenting the most material **systemic, prudential** and **conduct** risks.

It is the position of Initiative Ireland that any new regulation should be introduced on a phased basis, giving consideration to firms such as Initiative Ireland who have a domestic presence and existing commitments in the market.

When the FCA introduced a regulatory pathway for crowdfunding in the UK, they did so establishing a different route for existing operators. This avoided any unnecessary disruption to such operators, effectively fast-tracking their applications, providing them with a window in which they could operate pending retroactive approval. Recognising the benefit of supporting emergent Irish Crowdfunding platforms, it is our recommendation that a similar approach be taken in the Irish Market.

Q 2 (a): What risks associated with crowdfunding should be considered and addressed in any potential regulatory regime? How could they be mitigated?

2a.1 Systemic & Structural Risks

There is a risk that in the absence of clear regulation to regulate the management and practices of the industry, Crowdfunding could achieve such scale as to present systemic risk. However, there is an equal opportunity to reduce overall systemic risk



and volatility within the Irish Financial Services industry by properly regulating the Crowdlending Industry in a timely manner, thereby promoting an industry which can increase financial inclusion and competition in the market, while deconcentrating credit risk.

There is a risk that excessive or unfit regulation of the industry could prove prohibitive to many innovative, sustainable models which have yet to emerge. It is the position of Initiative Ireland that regulation should be proportionate, focussing on universal, material risks initially. Thereafter, administration of the regulatory approval process for Crowdlending should rest with a body empowered to tailor subsequent approvals and apply bespoke conditions to applicants, such as the Central Bank of Ireland.

Guidance should be provided as to whether a firm, which might otherwise qualify as a mortgage intermediary, credit intermediary, moneylender or other established regulated firm and which now qualifies for regulation as a Crowdlending platform must seek dual authorisation under these pre-existing pathways in addition to Crowdlending approval.

2.a.2. Prudential & Conduct Risks:

Where a Crowdlending Institution provides membership to consumers as either lenders or borrowers, a significant duty of care should apply. Consideration should be given to how a company advises, promotes and conducts themselves in addition to the experience and prudential management of the firm.

It is the position of Initiative Ireland that a pathway should exist for Crowdlending firms to become ***regulated financial service providers***. This would have the effect of extending a number of basic requirements to the industry. While Initiative Ireland has introduced many non-mandatory controls internally on a voluntary basis, it is our position that these standards should be extended to the industry as a whole. As a minimum, consideration should be given to extending regulation specifically to address the following Material Risks:

A) Segregation of Client Money



There is a material risk that service providers may fail to segregate client funds from the trading funds of the service provider. Regulation should mandate that client funds be segregated from the company's own funds.

B) Business Continuity

In addition to segregating client funds, in the event that the platform ceases to trade, arrangements should be put in place to ensure a continuity of service to customers with regard to their existing loans.

Where a Crowdfunding Platform also participates in their loans as a lender, they should be subject to capital provisioning requirements proportionate to their participation. Where they act as an intermediary only, their capital adequacy minimum should relate solely to their anticipated operating capital requirements i.e. a minimum of 12 months of funding on deposit to cover the operational costs of the business.

C) Money Laundering & Terrorist Finance

Crowdfunding firms should have policies in place to authenticate the identity and source of funds which are loaned through their platform, along with the identity of their borrowers. It is the position of Initiative Ireland that the Criminal Justice (Money Laundering and Terrorist Financing) Act should be extended to explicitly include Crowdfunding Firms in Ireland as a priority.

D) Fitness & Probity

Where a Crowdfunding Institution provides membership to consumers as either lenders or borrowers, such firms should be subject to minimum professional standards such as the Central Bank's Minimum Competency Code and Fitness & Probity Regime. While Initiative Ireland has introduced these regimes internally on a voluntary basis, it is our position that this should be extended to the industry as a whole.

E) Conduct of Business - Lenders

Crowdfunding provides optimised returns on par with the level of risk and return offered from investment products. It is vital that risks and rewards are presented



to the lending consumers in a manner consistent with investment marketing and promotion. Consideration should be given to the way products are advertised, the warnings provided, the transparency of risks and the provision of any financial advice offered by a platform. It should be clear to a lender whether the services provided include financial advice or if services are provided without advice.

F) Conduct of Risk - Borrowers

Where a platform provides credit to a consumer, it is vital that rates, risks and standards are advised in a manner consistent with those offered by other regulated firms. To facilitate this, a pathway should be established (and/or clarified) under the Consumer Credit Act for Crowdlending Firms seeking regulatory approval to offer consumer loans. Equally consideration should be given as to whether firms have adequate controls in place to protect vulnerable customers.

G) Complaints Management

Once the industry has become regulated, a clear pathway should be established for consumers who wish to raise a complaint with Financial Service Ombudsman. Not only should this expedite resolution of queries for consumers but it should also provide visibility to the regulator with regard to failings within the industry which may require intervention.

Q 2 (b): If regulation is to be introduced, should there be minimum standards of due diligence, disclosure and a process in the event of default, insolvency or bankruptcy? Should there be a standard suggested procedure or best practice outlined? If so, what should this include and what would best practice entail?

2 (b). Explicit Disclosure

It is the position of Initiative Ireland, that in facilitating the listing of a funding request on the platform, lending members may presume a minimum level of due diligence has been performed by the platform. In the case of Initiative Ireland this is an accurate assumption, as all our listings are in fact subject to pre-approval by our experienced Internal Credit Committee prior to syndication. This is disclosed to



our lenders. Importantly however, we still advise our lenders that they should take due care in assessing which loans to fund themselves and that the Credit Risk rests solely with the lender.

It is our position, that rather than establishing a prescriptive format for due diligence (other than necessary money laundering standards), it should be mandated that firms explicitly disclose whether they have or have not performed any due diligence on their applications. It should be made clear to the consumer whether or not they have recourse to the platform in the event of a default and if so, to what degree. Such information should be provided to the lender pre-contract.

It should also be made clear what action, if any, the platform will take on their behalf if a loan defaults i.e. will the firm seek debt sale or recovery etc.?

In the event that a pathway is established for Consumer Crowdlending specifically, care should be given to ensure that all consumer loans are reported to the Central Credit Register. Some indication of the borrower's credit worthiness should be provided to lenders. If the platform has performed a credit assessment, this might take the form of an aggregate credit score, which factors in all their due diligence checks. If however the platform does not perform any credit assessment a standardised Bureau Score should be provided, as an indication of the Credit Risk presented by the borrower.

Q 2 (d): Crowdfunding platforms in Ireland are not currently covered by prudential rules (including capital and liquidity requirements), by client asset rules or conduct of business rules. Should there be such standards for crowdfunding platforms in Ireland? If so, what should these standards include?

2 (b). Explicit Disclosure

Yes, this is an area of significant concern, please see our response in 2.a.2.

Q 2 (e): Should the SME Regulations be applied to crowdfunding platforms?

2 (e) SME Lending



Where a Crowdlending firm provides finance to a company which otherwise qualifies as a borrower under the SME Regulations and where the Crowdlending firm now falls within the scope of the SME Regulations (as a regulated firm), these regulations should apply.

Some consideration and exemptions may be required on a clause by clause basis to preserve the non face-to-face operating model of crowdlending platforms. Consideration should also be given to the quantum of finance being provided to the borrower, to ensure regulation is proportionate.

Q 2 (f): Should there be a limit on the maximum level of investment in a 12 month period that an individual may invest in one or more crowdfunding projects / businesses that a crowdfunding platform can accept from an individual? Should there be other restrictions on retail investors before they can invest in both loan based and equity based crowdfunding?

2 (f) Lending Limitations

It is important to note that Crowdlending platforms may be funded by both individual and institutional lenders. A further distinction should be made between a high-net worth lender, who would qualify as a 'Qualified Investor' and an individual with limited disposable income who finds crowdlending more accessible than investment products on offer. Furthermore, the level of risk and reward offered by one platform may be materially higher or lower than another platform. As an example, the level of risk exposure for an individual providing an unsecured loan to a small limited company is not on par with the level of risk when financing a secured, asset-backed loan to an established firm.

Appreciating that crowdlending offers increased financial inclusion for a variety of lenders, any limits should be proportionate and considerate to these different lending profiles of the individual so as not to unduly limit participation at appropriate levels.

It is our position that any limits would be recommended limits only at this time, provided to lenders as a point of guidance. These limits should be means based and



proportionate to the client's wealth. This could be facilitated through a standard warning statement for lenders e.g.

We do not recommend you commit more than 15% of your Net Disposable Wealth via the platform at any given time. You may wish to secure independent financial advice before lending. When you lend your capital is at risk.

Q 2 (g): Are there any considerations that should be taken into account with respect to the cost of regulation or the cost of regulatory compliance?

2 (g) Proportionate Costs

Unlike traditional lenders, Crowdlending providers do not benefit from maturity transformation. In most cases, most of the Net Income generated from the lender's funds goes directly to the lenders. As such, after deduction of operating costs, Crowdlending Platforms often operate subject to tight budgets, pending scale. It is therefore recommended that the cost of application and ongoing regulation should be considerate of same, so as not to prove prohibitive.

Any regulatory costs should be proportionate to the size and maturity of the lender. A minimum fee should apply however the overall cost should be proportionate to the operator's crowdlending business. This is likely best determined by giving consideration to the total value of loans originated by the platform in a given year, along with the number of active customers, stepping up any costs on a scheduled basis.

Consideration should also be given to the internal costs of compliance for firms.

Finally, as this is an emerging industry, the short-term costs incurred by the regulator (which are likely to be disproportionately high) would ideally be recouped over the long-term from the industry. Otherwise there is a risk that the current, domestic operators within the market would be left to absorb the short-term costs entirely to the material benefit of later foreign market entrants.



Q 2 (h): Should Ireland consider developing non-regulatory supports to encourage the development of crowdfunding?

2 (H) Non-Regulatory Supports

Revenue Loss Deductions

When a lender establishes an account with different Crowdlending platforms, it is foreseeable that they will generate income from performing loans and losses from non-performing loans. It would be reasonable that an individual would be able to offset any losses experienced on their loans against any interest earned for the purposes of calculating their net taxable income. A Crowdlending platform would thereafter be able to provide an annual net income statement to the lender, to facilitate their self-declaration.

