

The 1st European Country To Regulate Crowdfunding

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After an extensive public consultation ended on April 30, 2013, the Italian financial markets regulator — *Commissione Nazionale per le Società e per la Borsa* (“Consob”) — issued on June 26, 2013, a regulation on the raising of venture capital by innovative startups through online portals, which implements Sections 50-quinquies (“management of portals for raising capital for innovative startups”) and 100-ter (“offers through portals for raising capital”) of Legislative Decree of Feb. 24, 1998, no. 58 (the “Consolidated Act on Finance”), as introduced by Law Decree of Oct. 18, 2012, no. 179, converted into Law of Dec. 17, 2012, no. 221.



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This makes Italy the first country in Europe to adopt an ad hoc regulation on equity crowdfunding. The regulation was published in the Official Gazette on July 12, 2013, and took effect on July 27, 2013.

Innovative Startups

Pursuant to the decree, a new type of legal entity called the “innovative startup” entered into our legal system, which is defined by the Consolidated Act on Finance as any joint-stock company or cooperative society incorporated under Italian law or any *Societas Europaea* residing in Italy:

- (a) which has been established and operating for no more than four years;
- (b) which has its headquarters in Italy;

(c) with a total annual output no greater than 5 million euros according to its most recent balance sheet, starting from the second year of life of such company;

(d) which does not distribute, nor has distributed so far, net incomes;

(e) exclusively aimed at developing, producing and marketing innovative products or services;

(f) which was not established as a result of a company's merger, split up, sale of business or transfer; and

(g) which meets at least one of the following requirements: (i) the R&D expenses are equal to or higher than 15 percent of the highest between the company's total annual costs and the correspondent outputs; (ii) one-third of the total number of its employees or consultants either holds a PhD or is attending a PhD program or holds a master's degree which includes a three-year research program certified at a public or private institute in Italy or abroad, or two-third of the total number of its employees or consultants holds a long-cycle degree; and (iii) it owns, or has been granted, a license in respect of a design/invention patent, or owns rights related to a primary computer program enrolled at the public register for computer programs.

Crowdfunding

The underlying rationale of equity crowdfunding is the possibility for companies (typically newly established) to raise venture capital through the Internet, thereby carrying out a solicitation of public savings addressed to a large number of recipients.

In practice, the aspiring entrepreneur publishes a request for funding on a website, describing the project he/she asks to be funded and adding a business plan thereon. The website typically facilitates the granting of funds from small investors, who can also contribute to the project in question with as a little as a few Euros.

There are different types of crowdfunding, which can be identified on the basis of what investors are promised in return for their contributions. In this respect, one can distinguish among the "donation," "reward," "pre-purchase," "lending" and "equity" models.

The most debated model is the equity-based one, which is represented by a sale of securities that can include the right to receive not only dividends, but also equity. Projects promoted through equity crowdfunding usually set a target amount and a fixed period for the fundraising.

The Main Novelties of the Decree

Section 100-ter of the Consolidated Act on Finance provides that public offers conducted exclusively via one or more portals dedicated to the collection of capital may have the sole purpose of underwriting financial instruments issued by innovative startups. The rules on solicitation of public savings laid down in Part IV, Title II, Chapter I, of the Consolidated Act on Finance do not apply to public offers of financial instruments issued by innovative startups, as long as the total price of the offer is less than 5 million euros.

Moreover, crowdfunding will be accessible only for financial instruments issued by innovative startups and will be available only to investment firms, banks or other entities enrolled in a special register held by Consob and incorporated as a joint stock company, a limited share partnership, a limited liability company, or a cooperative society, having its registered and its administrative head office in Italy.

The Regulation

As anticipated above, the regulation, which is substantially aimed at increasing access to public savings through online portals for innovative startups with a very high-risk profile and high-tech orientation, is the result of a long formation process, which has involved a preliminary investigation by Consob aimed at collecting data and information from the industry, an open hearing, and a consultation procedure.

The regulation consists of 25 articles and three parts (namely, general provisions, registration and regulation of portal's managers, and the rules applying to offers through portals), as well as of three attachments (namely, the instructions for submitting the registration application and two templates (one for reporting on corporate and organizational structure and the other for publishing the information on each offer)).

More in particular, with regards to part two of the regulation (“Register and regulation of portals’ managers”), it is worth pointing out the following:

(a) a single register is established in order to enter the portals’ managers, regardless of whether they are (i) “ipso iure” managers (i.e. banks and investment firms authorized to provide investment services and subject to MiFID rules (i.e.rules laid down by Directive 2004/39/EC and implementing measures)) or (ii) a legal entity authorized ad hoc by Consob, which are subject to MiFID rules only in so far as they are required to transmit investors’ orders to professional brokers (banks and investment firms) for the execution thereof;

(b) banks and financial intermediaries will be registered in a special section of the above register since they are already authorized to carry out investment services and therefore only need to notify Consob of their intention to start managing an online portal. However, prospective portal managers other than banks and financial intermediaries need to file an authorization application in order to be included in the register and, to this end, must provide Consob with a set of documents and information listed in Annexes 1 and 2 to the Regulation;

(c) Consob must decide on the registration applications within 60 days from the receipt thereof;

(d) in order to be registered, the applicants must comply with the integrity and professionalism requirements laid down by the Regulation in relation to persons holding a controlling interest and persons performing administrative, managerial or control functions in the company at issue. An interlocking ban is also envisaged whereby corporate officers of a portal manager cannot hold an equivalent position in another portal manager carrying out the same activity;

(e) as far as rules of conduct are concerned, MiFID rules apply only in relation to “ipso iure” managers, while the regulation sets forth ad hoc rules for other types of managers. More specifically, the regulation requires managers to provide material information to the investor and carry out suitability test on the latter. Moreover, prior to making any investment, investors must complete a questionnaire in order to verify that they are aware of the high risks involved therein;

(f) unlike the draft proposed in consultation, the regulation provides a different protection regime for retail investors, which depends on the amount they wish to invest in the project in question. An exemption from MiFID rules is indeed provided if a natural person intends to invest less than 500 euros in relation to each order or less than 1,000 euros considering the total amount of orders placed on a yearly basis. With regard to legal entities, the relevant thresholds for the above exemption are 5,000 and 10,000 euros, respectively. Such provision is aimed at reducing the intermediaries' obligations, while ensuring an adequate level of investor protection;

(g) the regulation entrusts Consob to adopt urgent precautionary measures in case of a material breach of the relevant law by portals' managers.

With reference to part three of the regulation ("Rules on offers through portals"), it should be noted that the portal manager must verify that:

(a) the innovative startup's bylaws provide for the retail investors' right to withdraw from the company or sell their participations should the controlling shareholders transfer the control of the company to third parties following the conclusion of the offer. This right can be exercised for at least three years after the conclusion of the offer; and

(b) at least 5 percent of the financial instruments offered have been subscribed by professional investors or banking foundations or incubators of innovative startups. This point has been object of several comments during the consultation: as a result, the five percent requirement mentioned above must be met not as a pre-condition for launching the offer, but as a requisite for the completion thereof.

In addition, the regulation provides for retail investors the right to revoke their adhesion to the offer when, between the adhesion and the conclusion of the offer, a new fact occurs or a material mistake concerning the information provided by the portal is noticed, which is likely to affect their investment decision. The revocation must be exercised within seven days from the date when the new fact occurred or the new information was communicated to the investor.

Conclusion

In order to succeed, the crowdfunding tool must tackle the issues of unclear regulation, low

levels of financing with high taxes, lack of awareness of potential investors, as well as technical difficulties related to payment systems. It has been left to Consob to identify suitable rules aimed at creating a stable and balanced environment in which investors can make informed decisions on the investments in innovative startups without burdening the startups and financial intermediaries with levies and obligations that are too heavy and prevent the creation of a competitive market.

In light of the foregoing, the regulation appears to be a reasonable compromise between the need for protection by investors and the goal to boost the growth of innovative startups through equity crowdfunding.

In this respect, some doubts have already been expressed by the industry after the publication of the regulation, particularly in relation to the five percent threshold requirement described above (concerning the subscription by professional investors of innovative startups' participations), which may frustrate, from the very outset, the access to the public savings for innovative startups. Moreover, some operators have pointed out that equity crowdfunding permitted only for innovative startups, may in turn create an unjustified discrimination in raising venture capital between companies of the same size and carrying out comparable activities.

It remains to be seen how the regulation's provisions will be applied in practice. Only then will it be possible to ascertain whether the new rules will serve as a catalyst for innovative startups, making growth a reality and not just an ambition.

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