

CONSOB REGULATION ON EQUITY CROWDFUNDING

After an extensive public consultation ended on 30th April 2013, the Italian financial markets regulator (*Commissione Nazionale per le Società e per la Borsa*, "**Consob**") issued on 26th June 2013 resolution no. 18592, by means of which a regulation on the raising of venture capital by innovative start-ups through on-line portals (the "**Regulation**") was adopted, which implements Sections 50-*quinquies* ("*Management of portals for raising capital for innovative start-ups*") and 100-*ter* ("*Offers through portals for raising capital*") of Legislative Decree 24th February 1998, no. 58 (the "**Consolidated Act on Finance**"), as introduced by Law Decree 18th October 2012, no. 179 (the "**Decree**"), converted into Law 17th December 2012, no. 221.

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 of 12th July and will enter into force on 27th July 2013.

This alert is aimed at providing a brief summary of the main novelties introduced by the Regulation. However, in order to have a full picture of the phenomenon of equity crowdfunding, as regulated so far in Italy, it is necessary, first of all, to briefly comment upon the provisions laid down by the Decree with regard to the establishment and growth of innovative start-ups.

1. THE PROVISIONS OF THE DECREE ON INNOVATIVE START-UPS

1.1 Innovative Start-ups

Pursuant to the Decree, a new type of legal entity called "innovative start-up" entered into our legal system, which is defined by Section 1, sub-section 5-*decies*, of the Consolidated Act on Finance (introduced by Section 25 of the Decree) as any joint-stock company or co-operative society incorporated under Italian law or any *Societas Europaea* residing in Italy pursuant to Section 73, sub-section 1, of Presidential Decree 22nd December 1986, no. 917 (as amended):

- (a) which has been established and operating for not less than forty-eight months;

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- (b) which has its head office in Italy;
- (c) with a total annual output not higher than 5 million euro, as resulting from the latest approved balance-sheet, as from the second year of its activity;
- (d) which does not distribute, nor has distributed so far, net incomes;
- (e) exclusively aimed at developing, producing and marketing innovative products or services characterised by an hi-tech value;
- (f) which was not established as a result of a company's merger, split up, sale of business or transfer of going concern; and
- (g) which meets at least one of the following requirements: (i) the R&D expenses are equal to or higher than 15% 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 ("*laurea magistrale*"); 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.

In order to be deemed as an innovative start-up pursuant to the Decree, a company already incorporated upon entry into force of Law 17th December 2012, no. 221 (i.e. on 19th December 2012) should have filed with the competent Register of Companies, within sixty days therefrom (i.e. by 19th February 2013), a declaration signed by its legal representative stating that the company itself meets all the above mentioned requirements.

Innovative start-ups benefit from a less burdensome regime with regard to administrative encumbrances, stamp duties, as well as fiscal charges, for a four-year period following their incorporation. Moreover, Section 26 of the Decree sets forth some exemptions from the corporate law rules enshrined in the Italian Civil Code which, *inter alia*, allow start-ups constituted in the form of a limited liability company to issue quotas without voting rights or with voting rights unrelated to the number of quotas held or limited to certain corporate matters or subject to the occurrence of certain events.

Moreover, unlike what envisaged under Section 2474 of the Italian Civil Code (prohibiting transactions on own participations), start-ups constituted in the form of a limited liability company can purchase or accept in guarantee their own quotas, or grant loans or guarantees for the purchase or subscription thereof, if such transactions are carried out pursuant to an incentive plan that assigns quotas to employees, consultants, members of the administrative body or other persons carrying out professional services in favor of such company.

Furthermore, Section 28 of the Decree provides for specific rules governing the relationship between innovative start-ups and their employees.

1.2 Crowdfunding

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

In practice, the aspiring entrepreneur publishes a request for funding on a web-site, describing the project he/she asks to be funded and adding a business plan thereon. The web-site typically facilitates the granting of funds from small investors, who can also contribute to the project in question with 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 crowdfunding phenomenon has grown, in particular, in anglo-saxon countries (especially Canada and USA) through the "donation" (where investors receive nothing in return) and "reward" (where investors receive the product/service of the entrepreneur at issue or other "perks"¹, but no interest or part of the earnings of the venture) models.

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

1.3 The main novelties of the Decree

Section 100-*ter* of the Consolidated Act on Finance, as inserted by the Decree, 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 innovating start-ups. 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 start-ups, as long as the total price of the offer is lower than 5,000,000 euro².

Moreover, Section 50-*quinquies* of the Consolidated Act on Finance provides that "*the management of portals for the collection of capital for innovative start-ups is reserved to the investment companies and banks authorised to provide the relative investment services and to the subjects entered in a special register held by Consob, providing these latter transmit the orders regarding the underwriting and trading of financial instruments representing capital exclusively to banks and investment companies*". Therefore, crowdfunding will be accessible only for financial instruments issued by innovative start-ups and will be available only to investment firms, banks and any other entity enrolled in a special register held by Consob incorporated as (i) a joint stock company ("*società per azioni*"), (ii) a limited share partnership ("*società in accomandita*").

¹ "Perks" means any kind of privilege granted to investors in exchange of their contribution (*i.e.*, advanced sales of goods or services, discounts, coupons or gift certificates, acknowledgments, thanks or recognition). Perks are usually used as a non-monetary incentive to attract investors.

² See Section 34-*ter*, sub-section 1 c), of Consob resolution 14th May 1999, no. 11971 (the "Issuers Regulation"), as amended.

per azioni"), (iii) a limited liability company ("*società a responsabilità limitata*"), or (iv) a cooperative society ("*società cooperativa*"), having its registered and administrative head office in Italy³.

For a quick reference on how the equity crowdfunding has been addressed so far in the United States, it is worth mentioning the so-called Jumpstart Our Business Startups Act (better known as the "**Jobs Act**"), signed into law by President Obama on 6th April 2012, which introduced the possibility for entrepreneurs to raise money by selling online equity stakes in their companies.

The Jobs Act created, by amending the Securities Act, a new exemption for "crowdfunded" securities' offers of an amount up to \$1 million, provided that individual investments do not exceed certain thresholds⁴ and the issuer in question uses the services of an intermediary that is either a broker or a "funding portal" registered with the SEC.

2. THE MEASURES IMPLEMENTING THE DECREE

2.1 The Regulation

As anticipated above, the Regulation, which is substantially aimed at increasing access to public savings through on-line portals for innovative start-ups 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 (held at Consob on 1st February 2013), and a consultation procedure, opened on 29th March and ended on 30th April 2013.

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 organisational structure and the other for publishing the information on each offer), which include, *inter alia*, a warning, as well as information on risks, issuer, financial instruments and the offer at issue).

More in particular, as regards part II of the Regulation ("Register and regulation of portals' managers", Sections 4 to 23), 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 authorised to provide investment services and subject to MiFID rules) or (ii) other legal entities authorised *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;

³ For EU companies it will be sufficient to hold a permanent establishment in the Italian Republic (*see* Section 50-*quinques*, sub-section 3 b), of the Consolidated Act on Finance).

⁴ Section 302(a)(B) of the Jobs Act provides that "*the aggregate amount sold to any investor by an issuer, including any amount sold in reliance on the exemption provided under this paragraph during the 12-month period preceding the date of such transaction, does not exceed (i) the greater of \$ 2,000 or 5 percent of the annual income or net worth of such investor, as applicable, if either the annual income or the net worth of the investor is less than \$ 100,000, (ii) 10 percent of the annual income or net worth of such investor, as applicable, not to exceed a maximum aggregate amount sold of \$100,000, if either the annual income or net worth of the investor is equal to or more than \$100,000*".

- (b) banks and financial intermediaries will be registered in a special section of the above register since, being already authorised to carry out investment services, they only need to notify Consob of their intention to start managing an on-line portal. On the contrary, prospective portal managers other than banks and financial intermediaries need to file an authorisation 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 sixty days from the receipt thereof. Such term may be suspended should Consob request missing documentation to the applicant within seven days from the receipt of the application;
- (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 consultation document, 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, whilst ensuring an adequate level of investor protection. If the afore-said thresholds are exceeded, the intermediaries must apply all the rules governing the provision of investment services contained in the Consolidated Act of Finance and in the implementing Consob regulations;
- (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 III of the Regulation ("Rules on offers through portals", Sections 24 and 25), it should be noted that the portal manager must verify that:

- (a) the innovative start-ups' by-laws provides 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. The above right can be exercised for at least three years after the conclusion of the offer; and

- (b) at least 5% of the financial instruments object of the offer has been subscribed by professional investors or banking foundations or incubators of innovative start-ups. This point has been object of several comments during the consultation: as a result, the 5% 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 (see Section 25) provides for retail investors' 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 were communicated to the investor.

3. FINAL REMARKS

Taking into account that, in order to succeed, the crowdfunding tool must tackle the issues of unclear regulation, low level of financing with high taxes regime, lack of awareness of potential investors⁵, as well as technical difficulties related to payment systems, it has been left to Consob⁶ to identify suitable rules aimed at creating a stable and balanced environment in which, on one side, investors can take an informed decision on the investment in innovative start-ups, and, on the other side, the latter as well as financial intermediaries are not burdened with levies and obligations too heavy, which may prevent the creation of a competitive market.

In light of foregoing, the Regulation appears to be a reasonable compromise between the investors protection need and the goal to boost the growth of innovative start-ups 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 5% threshold requirement described above (concerning the subscription by professional investors of innovative start-ups' participations), which may frustrate, from the very outset, the access to the public savings for innovative start-ups . Moreover, some operators have pointed out that, being equity crowdfunding permitted only for innovative start-ups, this may, in turn, create an unjustified discrimination in raising venture capital between companies of the same size and carrying out comparable activities.

It remain to be seen how the Regulation's provisions will be applied in practice. Only then it will be possible to ascertain whether the new rules serve as a catalyst for innovative start-ups' growth, making the hoped developments a reality and not just an ambition.

⁵ Pursuant to Section 32 of the Decree, the Ministry of Education, University and Research together with the Ministry of Economic Development had sixty days from the entry into force of Law 17th December 2012, no. 221 (i.e. from 19th December 2012), to announce a national contest for an awareness campaign on the subject-matter. However, such announcement has not been made yet.

⁶ It is interesting to note that the SEC has missed the deadline of 31st December 2012 (i.e., 270 days from the entry into force of the Jobs Act), for issuing new rules on crowdfunding, likely because SEC's officials are in the process of gathering as much information as possible from the industry in order to regulate this phenomenon adequately.