Status Artis: Research in the Law and Practice of Crowdfunding

Stefano Cattelan* & Thomas Neumann**

* PhD, Master of Laws. Research assistant at the CLEAR project: crowdfunding, law, education, and research, at Aalborg University, Denmark. https://orcid.org/0000-0002-4730-3434.
** PhD, Master of Laws. Associate professor of commercial law and chair of the CLEAR project: Crowdfunding, Law, Education, and Research at Aalborg University, Denmark. The author discloses an economic interest below a total of €10,000 placed through the following crowdfunding service providers: Brickshare/The Many, Flexfunding, Kameo, Lendino and Mintos. https://orcid.org/0000-0002-0477-7429.
1. INTRODUCTION ................................................................................................................. 9
   1.1. GROWING BUSINESS AND GROWING LEGISLATIVE EFFORTS ........................................... 9
   1.2. DEFINITIONS AND ACTORS .............................................................................................. 13
2. NON-INVESTMENT CROWDFUNDING MODELS ................................................................. 16
   2.1. OVERVIEW ......................................................................................................................... 16
   2.2. DONATION CROWDFUNDING ............................................................................................ 17
   2.3. REWARD-BASED CROWDFUNDING .................................................................................. 21
3. INVESTMENT CROWDFUNDING MODELS ........................................................................ 25
   3.1. OVERVIEW ......................................................................................................................... 25
   3.2. DEBT-BASED CROWDFUNDING ....................................................................................... 27
   3.3. EQUITY CROWDFUNDING .................................................................................................. 31
4. CONCLUSION AND PERSPECTIVES .................................................................................. 36
5. BIBLIOGRAPHY ON LEGAL SCHOLARSHIP .................................................................... 39
   5.1. SCHOLARSHIP ON DONATION CROWDFUNDING ............................................................. 39
   5.2. SCHOLARSHIP ON REWARD CROWDFUNDING ............................................................... 41
   5.3. SCHOLARSHIP ON DEBT-BASED CROWDFUNDING ......................................................... 43
   5.4. SCHOLARSHIP ON EQUITY CROWDFUNDING ............................................................... 47
ABSTRACT

The present article aims to provide a comprehensive overview of the state of the art of legal science on crowdfunding and to lay the foundation for the understanding of some of its key concepts, facilitating the development of future legal research. This paper demonstrates that legal scholarship seems to not take full comparative advantage of the fact that many concerns are common across jurisdictions, such as encouraging SME development through access to risk capital or ensuring the protection of the unsophisticated investor. It also shows that scholarship and legislative efforts, predominantly in the US and the EU, are most often focused on investment crowdfunding and that these efforts usually attempt to define the obligations of the crowdfunding service provider, striking a balance between stimulating access to risk capital for start-ups and scaling up the crowdfunding business while, at the same time, protecting investors - in particular the unsophisticated ones. Even though it is challenging to legally define specific crowdfunding services, the commonly used typology of crowdfunding is found to be meaningful in a legal context, as it denotes the applicable legal framework. Considering that there is a correlation between the clarity of regulation in a country and the volume of crowdfunding, and given that crowdfunding is growing as both a method of finance and as a business, the time is ripe for legal scholars to direct their attention to the field. In doing so, they assist the actors in the market, the legislators, and the judiciary.

1. INTRODUCTION

Crowdfunding is no longer a complete novelty and several publications have been devoted to various aspects of this phenomenon. However, it appears that the focus has been on the economical, entrepreneurial, and financial aspects of crowdfunding. Research in the legal and regulatory aspects of crowdfunding has only recently shown signs of vitality. The present article aims to provide a comprehensive overview of the state of the art of legal science on crowdfunding and to lay the foundation for the understanding of some of its key concepts, facilitating the development of future legal research. Thus far, legal scholarship appears to have been patchy and disconnected. This paper demonstrates that legal scholarship often addresses common themes across jurisdictions and therefore could benefit from a more integrated, comparative, and internationally focused approach.

1.1. GROWING BUSINESS AND GROWING LEGISLATIVE EFFORTS

Although crowdfunding as a concept has existed for a long time, it only recently took off as a mass phenomenon in its online form. The enormous potentialities of the internet 2.0 made it possible to connect
fundraisers and funders across different countries and continents. In the aftermath of the 2008-2009 financial crisis, banks and financial institutions reduced credit outputs and increased constraints on access to capital - the so-called credit crunch. In reaction, struggling companies, ambitious individuals, start-ups, and social campaigners started to view crowdfunding as a viable alternative to bank lending and other traditional capital raising methods. Especially small and medium enterprises (SMEs), which play a major role in the economy and provide employment to a large portion of the world population, may benefit from access to risk capital via crowdfunding. SMEs have always experienced difficulties in accessing credit, a phenomenon that amplifies itself in times of economic crisis - especially innovative SMEs and start-ups.

From the 2000s onwards, several forms of crowdfunding have evolved to serve fundraisers’ and funders’ various needs. The scholarship usually relies on four primary types of crowdfunding.

---


crowdfunding, where the contributors receive no material or monetary return in exchange for their donation. Second, reward-based crowdfunding, where the contributors receive perks, discounts, or early access to the funded product or service in exchange for their contribution. Third, debt-based crowdfunding, where the investors receive interests from the lendee on the money contributed. Fourth, equity crowdfunding, where the investors receive a stake in the company in exchange for their contribution. The two former crowdfunding types are usually categorised as non-investment crowdfunding, while the latter two are referred to as investment types. This foundational taxonomy is established both in economics and law literature, although further subdivisions are seen especially regarding investment crowdfunding.

In the last few years, the number of crowdfunding platforms and the amount of money raised have continued to increase. If we exclude the unique context of China, global volumes concerning alternative finance have grown by 28% - from € 42 billion in 2016 to € 55.5 billion in 2017, growing by a further 48% - to € 79 billion in 2018 (see fig. 1 below). More specifically, the European alternative finance market (including the United Kingdom) grew from € 10.6 billion in 2017 to € 15.9 billion in 2018, which represents a 52% year-on-year increase. Note that all currencies in this paper have been converted to € by the average currency rate for the year in question.

SMEs, which constitute the backbone of the European economy, are hoped to become the primary beneficiaries of such growth of the crowdfunding market, fostering economic recovery and new entrepreneurial activities. Across all macroregions, debt-based crowdfunding remains the dominating crowdfunding type in terms of volume, while non-investment crowdfunding is relegated to a fraction of the total, albeit socially significant (see table below).

---


See below section 3.

Ibid. 26. See also Dibrova (n 4) 38-40.

Ibid. 39.

<table>
<thead>
<tr>
<th>Region</th>
<th>Debt</th>
<th>Equity</th>
<th>Non-investment</th>
</tr>
</thead>
<tbody>
<tr>
<td>APAC</td>
<td>€ 7.6 b</td>
<td>€ 394.9 m</td>
<td>€ 313.1 m</td>
</tr>
<tr>
<td>China</td>
<td>€ 74.0 b</td>
<td>€ 0.06 m</td>
<td>€ 8.8 m</td>
</tr>
<tr>
<td>Europe</td>
<td>€ 9.6 b</td>
<td>€ 849.2 m</td>
<td>€ 8.8 m</td>
</tr>
<tr>
<td>LAC</td>
<td>€ 4.1 b</td>
<td>€ 43.3 m</td>
<td>€ 92.6 m</td>
</tr>
<tr>
<td>MENA</td>
<td>€ 640.7 m</td>
<td>€ 11.3 m</td>
<td>€ 17.9 m</td>
</tr>
<tr>
<td>SSA</td>
<td>€ 0.9 b</td>
<td>€ 13.9 m</td>
<td>€ 50.3 m</td>
</tr>
<tr>
<td>UK</td>
<td>€ 7.3 b</td>
<td>€ 547.4 m</td>
<td>€ 1.9 b</td>
</tr>
<tr>
<td>US, Canada</td>
<td>€ 43.2 b</td>
<td>€ 1.7 b</td>
<td>€ 666.1 m</td>
</tr>
</tbody>
</table>

Fig. 1. Total volume by Region and Model Categories in 2020. (APAC = Asia-Pacific, excluding China; LAC = Latin America and the Caribbean; MENA = Middle East and North Africa; SSA = Sub-Saharan Africa). Original data from Ziegler, Shneor, Wenzlaff et al., The 2nd Global Alternative Finance Market Benchmarking Report, 44. Currencies converted to € using the 2020 average rate from USD to EURO of 0.877.

Furthermore, the internationalisation of crowdfunding campaigns is on the rise. Not only is there a notable increase in the number of firms that operate in multiple jurisdictions, but also an increasing number of cross-border activities across regions. All the above mentioned four models are concerned by this trend.13

Finally, the growth of crowdfunding as a business is challenged by fragmented national legislation.12 National legislators, as well as the EU, are increasingly aware of the need to regulate this dynamic fundraising method. On the one hand, crowdfunding carries enormous potential for the funding of SMEs, start-ups and social goals, but, on the other, its nature and characteristics present challenges as far as fraud and funders’ protection are concerned.13 Generally speaking, donation and reward-

11 Ziegler, Shneor, Wenzlaff et al (n 5) 25.
12 Karsten Wenzlaff, Ana Odorovic, Tania Ziegler and Rotem Shneor, ‘Crowdfunding in Europe: Between Fragmentation and Harmonization’ in Rotem Shneor, Liang Zhao and Bjorn-Tore Flåten (eds), Advances in Crowdfunding: Research and Practice (Springer International Publishing 2020), 373-375.
based crowdfunding have thus far been subject to a minimal regulatory effort by legislators. In contrast, debt-based and equity crowdfunding have been subject to more legislative scrutiny and attention. Indeed, their higher complexity and their inclusion in the broader category of alternative finance appear to require specific rules.\textsuperscript{14} Besides, as shown in the chart above, investment-based crowdfunding now involves much larger capitals, and individual contributions tend to be more significant compared to non-investment crowdfunding.

Before turning to the state of the art of each of the four crowdfunding types, it is necessary to establish who the involved actors are and how fundamental concepts are defined at present. After providing the state of the art and thereby extrapolating the current trends in crowdfunding research, a bibliography of legal scholarship is provided in the hope that it will encourage and further future internationally oriented legal scholarship. A bibliography is created for each of the four crowdfunding types and therefore duplicates may occur regarding materials that are concerned with more than one of the four crowdfunding types.

1.2. DEFINITIONS AND ACTORS

Crowdfunding has no firm definition in scholarship, though the following statement seems to encapsulate the essence of most definitions and the traits of the trade: Crowdfunding is “the efforts by entrepreneurial individuals and groups – cultural, social, and for profit – to fund their ventures by drawing on relatively small contributions from a relatively large number of individuals using the internet, without standard financial intermediaries”\textsuperscript{15}

Three parties are involved in crowdfunding transactions; the fundraiser, the funder, and the platform (“tripartite business”).\textsuperscript{16} First, the fundraiser (or borrower, investee) is defined as any individual or entity that proposes a public call for the financing of a project with a particular purpose.\textsuperscript{17} Second, the funder (or contributor, investor, lender, backer, supporter) can be defined as any individual or organisation that provides finance by answering a public call for the funding of a project with a particular purpose.\textsuperscript{18} The advantages of crowdfunding for the funders may

---

\textsuperscript{14} Fialkow (n 1) 398.
\textsuperscript{15} See Sunghan Ryu, \textit{Beauty of Crowdfunding: Blooming Creativity and Innovation in the Digital Era} (Routledge 2020), 16, where more definitions are listed. The cited definition is attributed to Ethan Mollick, ‘The Dynamics of Crowdfunding: An Exploratory Study’ (2014) 29 Journal of Business Venturing 1 in the above work.
\textsuperscript{16} De Quesada (n 5) 109.
\textsuperscript{17} Rotem, Shneor and Liang Zhao, ‘Introduction: From Fundamentals to Advances’ in Rotem Shneor, Liang Zhao, nad Bjørn-Tore Flåten (n 12) 3-4.
\textsuperscript{18} Ibid.
be financial as well as non-financial. Customer engagement may be enhanced by allowing influence on the design of future products and future consumption opportunities while at the same time the customers’ sense of belonging to a certain group or community is strengthened.\(^\text{19}\)

Third, the crowdfunding platform (or platform, crowdfunding service provider) can be defined as “an Internet application linking fundraisers and their potential backers while facilitating the exchanges between them in accordance with pre-specified conditions”.\(^\text{20}\) Such intermediaries make their income in the forms of campaign success fees and payments for supporting services and may, despite their intermediary role, be in their own contractual relationship with the fundraiser as well as the funder. A salient role of the crowdfunding platform is to create a trustworthy framework for bringing fundraisers and funders, who are unknown to each other, together. Hence, each successfully completed campaign enhances the platform’s own reputation, making them more attractive facilitators for future fundraising initiatives.\(^\text{21}\)

However, platforms usually specify in their terms of use and contracts that they do not guarantee to funders that the money raised by the campaign will actually be used for the goals stated by the fundraisers.\(^\text{22}\) Crowdfunding platforms operate under regulations set by each national jurisdiction where they are based. However, the crowdfunding business seems characterised by an international nature, with platforms increasingly diversifying their activities outside their headquarters country in order to reach fundraisers and funders abroad.\(^\text{23}\) The fact that the internationalisation of platforms and cross-border flows of capital are

---

\(^{19}\) More specific terms are used to refer to the different crowdfunding models: donors (in donation crowdfunding), investors (in equity crowdfunding), sponsors (reward crowdfunding), and lenders (debt crowdfunding). Ibid. 4; Norbert Steigenberger, ‘Why Supporters Contribute to Reward-Based Crowdfunding’ (2017) 23(2) International Journal of Entrepreneurial Behavior & Research 336.


\(^{22}\) In case of mismanagement concerning the money raised by a campaign, funders will have to recover their contribution directly from the fundraisers, a perilous endeavour. See De Quesada (n 5) 111; Steven C. Bradford, ‘Shooting the Messenger: The Liability of Crowdfunding Intermediaries for the Fraud of Others’ (2015) 83 University of Cincinnati Law Review 371.

\(^{23}\) For an overview, see Oliver Gajda (ed), Review of Crowdfunding Regulation: Interpretations of Existing Regulation Concerning Crowdfunding in Europe, North America and Israel (Brussels: European Crowdfunding Network 2017).
gaining momentum, notably across Europe, presents its own challenges concerning cross-border regulation and enforcement.24

Also, in light of the regulatory fragmentation hinted at above, public authorities are often seen as additional stakeholders in the crowdfunding process. Although they are “not directly involved in each transaction, [they] do carry great influence on the way the industry develops, and how each party to the crowdfunding transaction interacts with the other”.25 More specifically, legislative acts and regulations provide the rules by which the different types of crowdfunding may be practised. Indeed, they define compliance requirements primarily aimed at consumer/investor protection and market integrity. However, at the same time, public authorities have also vested interests in supporting new channels for the financing of social and entrepreneurial goals in their jurisdictions, facilitating greater public contributions to initiatives that align with government policies and agendas and that would otherwise remain underfunded.26

Throughout the 2010s, crowdfunding platforms seeking to offer their services across the European Union member states’ borders have faced the lack of common rules and diverging licensing requirements.27

24 On the internationalisation of platforms, see Ziegler et al Shifting Paradigms: The 4th European Alternative Finance Benchmarking Report (n 5) 48-52. The report highlights that in the European context, platforms operating from small open economies (e.g. the Baltic countries and Ireland) seem to be benefiting more from international operations, while platforms operating in relatively large home markets (i.e. France, Spain and Germany) tend to rely primarily on the growth of the domestic market.

25 Shneor et al. (n 12) 4.

26 Ibid. 4-5. On the role of institutions, see Nir Kshetri, ‘Success of Crowd-Based Online Technology in Fundraising: An Institutional Perspective’ (2015) 21(2) Journal of International Management 100.

27 This has resulted in high compliance and operational costs, which prevented crowdfunding platforms from efficiently scaling the provision of their services. As a result, small businesses had fewer financing opportunities available to them, while investors faced less choice and more uncertainty when investing cross-border. European Commission, Proposal for a Regulation of the European Parliament and of the Council on European Crowdfunding Service Providers (ECSP) for Business, 2018/0048, 2018; Proposed Regulation on European Crowdfunding Service Providers (ESCP) for Business Position Paper of the European Crowdfunding Network, 8 October 2018; Proposed Regulation on European Crowdfunding Service Providers (ESCP) for Business Position Paper of the European Crowdfunding Network, Trialogue Stage, 2 October 2019. See also Antonella Francesca Cicchiello, ‘Harmonizing the crowdfunding regulation in Europe: need, challenges, and risks’ (2020) 32(6) Journal of Small Business & Entrepreneurship 585; Dirk Zetzsche and Christina Preiner, ‘Cross-Border Crowdfunding: Towards a Single Crowdfunding Market for Europe’ (2017) 8 EBI Working Paper Series; Wenzlaff, Odorović, Ziegler and Shneor, ‘Crowdfunding in Europe: Between Fragmentation and Harmonization’, in Shneor, Zhao, and Flåten (n 12), 373-390.
Hence, the European crowdfunding market has been lagging behind other regions. More recently, the European Union has shown the willingness to create a coherent and harmonised crowdfunding market. After a number of proposals and tentative steps, the new Regulation on European Crowdfunding Service Providers (ECSP) for business was adopted in December 2020.\(^\text{28}\) The ECSP regulation will enter into force in November 2021.

The new EU regulation lays down common rules for the member states relating to equity crowdfunding and debt-based crowdfunding services. Thus, it does not concern non-investment crowdfunding types. The ECSP regulation allows platforms to apply for an EU passport based on a single set of rules, which will enable them to offer their services across the EU with a single authorisation. The new rules are expected to both boost crowdfunding campaigns and enhance the investor protection framework. They lay down harmonised rules regarding information disclosure for fundraisers, platform governance, risk management, and the improvement of national authorities’ supervisory powers.\(^\text{29}\)

The ECSP rules are further addressed below at 3.1. Further regional legislative developments are seen in both the US and China. These are described further below.

2. NON-INVESTMENT CROWDFUNDING MODELS

2.1. OVERVIEW

Thinking that crowdfunding is a “method to obtain money from large audiences, where each individual provides a small amount, instead of raising large sums from a small group of sophisticated investors”, it is obvious that this is no new phenomenon. Donation crowdfunding can be seen as a simple fundraising campaign, which could take place through any media. Donation and reward crowdfunding have always played a role in financing creative and cultural projects. A well-known example from 1885 is the pedestal of the Statue of Liberty, which was paid for by 160,000 people donating less than a dollar on average. Contributors donated to the project only for benevolent reasons and in return for having their name printed in Joseph


Pulitzer’s newspaper, The New York World. Before Pulitzer’s fundraising campaign, the statue was at risk of not being erected at all or even relocated to other cities that were able to pay the pedestal’s costs.31

Actual reward crowdfunding, where the contributor receives a benefit in return for a contribution, is also an old phenomenon. Rewards in return for donations are known to have been used by artists such as Mozart and Beethoven. Around the time that Mozart and Beethoven were children, Alexander Pope successfully crowdfunded his translation of the famous ancient Greek poem Iliad into English by promising 750 contributors that they would be mentioned in the acknowledgements and receive a copy of the first edition of the work.32 While fundraising from a crowd is nothing new, the novelty of crowdfunding lies in the use of the internet to reach many more potential contributors, who may be geographically spread over vast distances. Nowadays, it is possible to reach contributors virtually anywhere and the world has seen significant long-distance cross-border fundraising.33 Donation and reward crowdfunding were the first to appear in an online context and from here the debt-based and equity crowdfunding models have developed.

2.2. DONATION CROWDFUNDING

Charitable fundraising through the use of a crowdfunding platform is characterised by the fact that the contributors (funders or donors) receive “no material but immaterial, social rewarding in return for their contributions” and that they are, as with any fundraising, driven by their benevolent reasons and desire to participate in efforts to solve “real world problems”.34 Hence, the donation crowdfunding model is sometimes also referred to as

32 Ryu (n 15) 13.
33 The creation of the George Floyd Memorial constitutes a recent example of successful donation-based campaigns, which confirmed the effectiveness of this fundraising method in supporting social goals. Following Mr. Floyd’s killing by a Minneapolis police officer, his relatives launched a crowdfunding campaign on GoFundMe which raised almost $14 million amid ongoing protests for his death in several countries. See Julie Bort, ‘George Floyd’s GoFundMe Accounts Have Raised over $13.7 Million for His Family ... and Counting’ (Business Insider, 8 June 2020): <https://www.businessinsider.com/george-floyd-memorial-gofundme-has-raised-million-2020-6> accessed 25 May 2021; Chelsea Ritschel, ‘George Floyd’s GoFundMe Receives Most Donations of All Time’ (The Independent, 5 June 2020): <https://www.independent.co.uk/life-style/george-floyd-gofundme-donations-record-protests-memorial-a9551561.html> accessed 25 May 2021.
charity crowdfunding. However, it is difficult to unequivocally distinguish donation and rewards models in practice as they are often mixed.

Donation crowdfunding is most often used to finance “humanitarian, social, or artistic projects”\(^{35}\) but also medical and educational projects attract donations.\(^{36}\) In some regions, neglected children or the elderly are major receivers of donations through charity crowdfunding,\(^{37}\) which could be linked to the general culture of donation in a society.\(^{38}\) One significant crowdfunding service provider is GoFundMe Charity. The platform was formerly operating under the name Crowdrise, which was established as early as 2010 and later acquired by GoFundMe. While being registered in the United States, the platform demonstrates the inherent international character that the crowdfunding business has. Indeed, GoFundMe Charity offers fundraising services to fundraisers in almost twenty countries, including most of the European Union, UK, US, and Canada, but accepts donations worldwide.\(^{39}\)

The market for donation crowdfunding for 2016 was estimated by the University of Oxford and SAÍD Business School to be € 0.50 billion/year.\(^{40}\) A few years later, GoFundMe Charity reported that they

---


36 GoFundMe Charity operates with project categories medical, memorial, emergency, charity and education.


38 Krishnamurthy Suresh, Stine Øyna and Ziao Haque Munim, ‘Crowdfunding Prospects in New Emerging Markets: The Cases of India and Bangladesh’ in Shneor, Zhao, and Flåten (n 12) 297-318.

39 Countries blocked from donating: Afghanistan, Haiti, Libya, Saint Kitts and Nevis, Syria, Bangladesh, Saint Lucia, Timor-Leste, Kosovo, Iran, Myanmar (Burma), Saint Vincent and the Grenadines, African Republic, Iraq, Pakistan, Turkey, South Sudan, Uzbekistan, Palestine, Lebanon, Ghana, Cuba, Singapore, Kosovo, Sudan, Korea (North) according to GoFundMe Charity *Countries blocked from donating* <https://charitysupport.gofundme.com/hc/en-us/articles/360050070451-Countries-blocked-from-donating> accessed 18 March 2021.

40 Michele Scataglini and Marc Ventresca, ‘Funding the UN Sustainable Development Goals: Lessons from Donation-Based Crowdfunding Platforms’ (Social Science Research Network, Scholarly Paper ID 3328731 2019), 37.
raised more than €8 billion. Given that the total charity market, of which charity crowdfunding may take up an increasing part, is estimated to be approximately €355 billion/year, it is no neglectable business to service providers, fundraisers, criminals, and lawmakers.

The fact that some jurisdictions leave donation crowdfunding largely unregulated enables platforms to become global marketplaces, but at the same time, the lack of crowdfunding specific regulation also opens the door to fraud and malpractice. With most contributions in donation crowdfunding campaigns being less than €50, it is unlikely that each individual contributor will pursue any legal action. However, there may be a lot of money involved for the fraudulent fundraiser. Popular media has recently reported convictions due to various fundraising crimes through donation crowdfunding, including for example fake cancer treatments (approx. €50,000) or withholding money collected for a homeless veteran (approx. €355,000).

While donation crowdfunding is subject to the general regulation of public fundraising in each jurisdiction, the predominant legislative development focuses on debt-based crowdfunding and equity crowdfunding, most likely because donation crowdfunding and reward

---


42 Scataglini and Ventresca (n 40).


44 Scataglini and Ventresca (n 40).


48 I.e. Denmark in LOV nr 511 af 26/05/2014 and BEK nr 160 af 26/02/2020.

49 See Gajda (n 23).
crowdfunding are not considered an investment product \textit{per se}.\textsuperscript{50} It is unknown from legal scholarship whether donation crowdfunding is in need of more, less, or different regulation, as legal scholarship on donation crowdfunding is very scarce.\textsuperscript{51} However, it is obvious that crowdfunding is a target of fraud as any other activity, and the scale of fraud may reach further and wider when relying on the internet.

It has been pointed out that the most effective way to combat fraud is to combine regulation, internal auditing with the platform, and a critical attitude by investors - a funder beware/caveat emptor principle.\textsuperscript{52} In retrospect, it is therefore no surprise that China became the breeding ground in 2014-2015 for what turned out to be a major crowdfunding-based Ponzi scheme, as there was almost no regulation in place at the time. The investment platform Ezubao was founded in 2014 and within two years the people behind the platform had managed to defraud 900,000 investors through their fake crowdfunding platform containing mostly fake investment projects. Even though the Chinese courts eventually convicted the people behind the € 8 billion scam,\textsuperscript{53} it serves to show the need for at least some degree of preventive regulation.\textsuperscript{54} In addition, the subsequent regulatory reaction by the Chinese authorities was perhaps an overreaction, as it cut the crowdfunding market by more than 40% and confirms the difficulty in balancing the need for regulation while avoiding over regulating.\textsuperscript{55}

Even though donation crowdfunding is regulated by the general rules of public fundraising in a jurisdiction, the fact that crowdfunding takes place online raises questions about the applicable law and its

\textsuperscript{50} Osborne Clarke, ‘Regulation of CrowdFunding in Germany, the UK, Spain and Italy and the Impact of the European Single Market’ (European CrowdFunding Network - ECN 2013).

\textsuperscript{51} See bibliography on scholarship relating to donation crowdfunding below under 5.1.


\textsuperscript{54} China subsequently regulated the market, a development that is described further below under 3.2. For more on the regulatory conundrum, see Tsai C-H, ‘To Regulate or Not to Regulate? A Comparison of Government Responses to Peer-to-Peer Lending among the United States, China, and Taiwan’ (2019) 87 University of Cincinnati Law Review 1077.

\textsuperscript{55} According to Ziegler and Shneor (n 5) 132, the market saw a 40% drop due to stricter regulation. See also Lin Lin, ‘Managing the Risks of Equity Crowdfunding: Lessons from China’ (2017) 17(2) Journal of Corporate Law Studies 327; Kang Yuan and Xu Duoqui, ‘Legal Governance on Fintech Risks: Effects and Lessons from China’ (2020) 7(2) Asian Journal of Law and Society 275; Ding, Kavuri, and Milne (n 14).
enforcement, since the fundraiser, the crowdfunding platform and the contributor may very well be located in different jurisdictions. The question of applicable law and enforcement aside, the crowdfunding industry and fundraisers can benefit from having some regulation in place that both enables crowdfunding and increases trust in the system and the platforms.

Scholarship points out that crowdfunding is a way to harness the wider community’s will to contribute to, for example, a policy development, such as achieving the 17 sustainable development goals set by the UN.56 One may wonder if international or regional legislative efforts can eliminate some of the legal fragmentation that exists and, in turn, increase trust in crowdfunding as a method of finance, helping to realise the inherent potential of crowdfunding to develop sustainable business practice and technologies.57 In relation to crowdfunding in China, it has been stated that crowdfunding may trigger “an upsurge of public support and [thus] elevating issues prioritised by the government, [hence] micro-charities may serve as an input institution in the spirit of ‘responsive authoritarianism’”58 and thereby perhaps expand the space for civil society.

In sum, donation crowdfunding has strong international characteristics, with economic, developmental, and democratic potential. Legislative efforts and scholarship are scarce and leave room for further legal research. The purpose of such research could be to tease out palpable criteria for classifying donation crowdfunding as well as exploring whether the current legal framework facilitates trust, limits fraud, recognises the international character of the business, and strikes a fair and equitable balance between the interests involved. However, authors are right in stating that the level of risk of fraud undermines the positives of crowdfunding, including donation crowdfunding, and therefore regulation is required if crowdfunding is to have a future as a driver of initiative, creativity, and solidarity.59

2.3. REWARD-BASED CROWDFUNDING

The reward-based model is characterised by the contributor receiving a benefit in return for a contribution. The benefit, or perk, may be unrelated to the product being backed, such as a poster or a cap, or it may be directly related to the product by way of early access or right to purchase the backed product at a discounted rate once it is released.

56 Scataglini and Ventresca (n 40).
Reward-based crowdfunding is often tiered so that the bigger the contribution, the more benefits are received. Several platforms combine the reward-based model with the donations model, allowing contributors to pledge either a small amount as a donation or a larger amount in return for a reward. Combined models may be effective, since they appeal to both philanthropic focused contributors, who often donate early in the fundraising process, and reward focused contributors, who often donate late in the fundraising process.

Cultural production most often relies on reward crowdfunding and, in particular, music production - hence the term culture crowdfunding. Some platforms do not vet the fundraising projects, thus creating ample opportunity for anyone to seek funding from the crowd. However, even though crowdfunding creates an opportunity for the individual artist, one has to be aware that the growth of cultural crowdfunding is partly due to cuts in public funding. The most successful campaigns relying on the reward-based model have mass appeal and it is therefore natural that they often are creative products or consumer products. For those categories, rewards crowdfunding is a way to gain working capital and an initial demand test while ensuring advance cover of the production costs. The rewards model is now also used to fund litigation in return for a reward such as access to products or services ‘saved’ if the supported party wins the lawsuit.

A rewards campaign can be the first step towards developing and testing out new products and a way to generate user involvement. However, although the involvement of the customers is key to funding the campaign, it may also turn customers away. When Oculus VR in 2012 raised €1.9 million in a reward campaign to develop their product, it generated a lot of bad will for both the platform and Oculus VR when the latter decided to sell the company to Facebook for €1.55 billion just two

63 Rykkja et al. (n 61) 423-435.
65 De Buysere et al (n 5) 18.
66 Chapman (n 65) 51-52.
years later - a sale that the many contributors received no monetary stake in, but felt they had been instrumental in.\textsuperscript{68}

One third of crowdfunding platforms in Europe are rewards-based ones.\textsuperscript{69} The European market raised € 98 million in 2015\textsuperscript{70} and € 158.80 million in 2017\textsuperscript{71}. One significant platform in the market is Kickstarter.com, which at the time of writing had more than € 4.25 billion in pledges where the category ‘games’ and ‘design’ attracted € 1.25 billion and € 1.05 billion in pledges respectively.\textsuperscript{72} Two variations of the reward model exist, a keep-it-all and an all-or-nothing model. While the all-or-nothing model attracts more contributions because it demonstrates the fundraisers commitment and places the risk of not reaching the set target on the fundraiser,\textsuperscript{73} the keep-it-all model may make sense if the fundraiser intends to supplement the crowdfunding capital with funding from a venture capitalist to reach the target.\textsuperscript{74}

Reward-based crowdfunding is not subject to any specialised legislation. However, in most jurisdictions, it is governed by the general laws of contracts, sales, marketing and consumer protection, and notably not by the financial and securities regulation.\textsuperscript{75} Offering products in exchange for early capital is often seen by scholars as a pre-sale and not

\textsuperscript{70} Ibid. 10.
\textsuperscript{71} Ziegler et al., \textit{Shifting Paradigms: The 4th European Alternative Finance Benchmarking Report (n 5) 31.}
an investment. Therefore, the rewards model is not governed by securities laws.\(^7^6\) Even though some state-specific securities laws in the US may apply, federal securities law in the US does not apply when the purchaser is motivated by a desire to consume the product.\(^7^7\) Hence, fundraisers may choose to raise funds through reward-based crowdfunding as it avoids most regulation, especially the detailed and demanding securities regulation.\(^7^8\)

It has been stated that reward crowdfunding in the UK legal context will likely be treated as pre-paid goods or services without guarantee that the contributor will actually receive the product.\(^7^9\) In terms of legal implications, one should probably distinguish between reward-based crowdfunding - where a perk is received - and pre-purchase - where the funded product itself is to be received\(^8^0\) -, as this may affect whether the general contract law applies or not in some jurisdictions. However, the legal obligations between the fundraiser and the contributor(s) are largely undetermined in scholarship\(^8^1\) and deserve attention to create predictability for the stakeholders.

Despite the importance, no legislative efforts have been identified that will deter fundraisers from being trapped in a development promise they cannot fulfil and ensure that contributors understand that when it comes to delivery time, final design and function, rewards crowdfunding is different from purchasing off-the-shelf products\(^8^2\) and so should the legal implications be too. The lack of a crowdfunding-specific legal framework and the lack of legal scholarship in the field amplifies the importance of the contractual framework drafted by the platform. In this regard, Kickstarter’s terms of use have been criticised for creating room for fraud and leaving the contributor without any real remedies\(^8^3\), and this is most likely not unique to the terms of Kickstarter. Legal analysis could

---


\(^7^8\) Bowman (n 76) 325-326.


\(^8^3\) Moores (n 81) 390-391.
assist in both classifying reward-based crowdfunding in relation to existing contract law regimes and establishing a legal framework that balances the need to combat fraud and promote innovation. It has been suggested that platforms could, or should, make use of online dispute resolution mechanisms to handle the, often low value, claims involved.\textsuperscript{84}

3. \textsc{Investement Crowdfunding Models}

3.1. \textsc{Overview}

The above mentioned non-monetary models usually receive the most media coverage, especially concerning socially significant campaigns on platforms such as GoFundMe or Kickstarter. However, platforms that offer monetary returns to crowdfunders have grown at a faster pace in recent years, and are now moving much larger amounts of money.\textsuperscript{85} Indeed, investment-based crowdfunding is a more modern creature, which originated in the US and the UK at the end of the 2000s, then spreading across the globe.\textsuperscript{86} The central characteristic of all investment-based crowdfunding is that it involves financial return for the funders (or contributors, investors, lenders). However, funders often choose to support a campaign for non-financial motives, because they believe in the campaign’s potentialities and objectives, as well as “the investee’s chances of success”.\textsuperscript{87} Unlike traditional finance, investment crowdfunding puts the contributors, belonging to a crowd, in closer contact with the project owner.\textsuperscript{88}

Investment-based crowdfunding is usually subdivided in two main categories: debt-based crowdfunding (or loan-based crowdfunding, peer-to-peer lending, crowdlending) and equity crowdfunding (or crowdinvesting). Further subdivisions have been identified by commentators.\textsuperscript{89} Investment-based crowdfunding constitutes nowadays a


\textsuperscript{86} Chapman (n 64) 52; Eleanor Kirby and Shane Worner, ‘Crowd-Funding: An Infant Industry Growing Fast’ (IOSCO 2014) Staff Working Paper of the IOSCO Research Department, 12.


\textsuperscript{88} Ibid. 70.

\textsuperscript{89} The taxonomy proposed by the CCAF and the University of Agder once again appears the more widely accepted one: Ziegler et al., \textit{Shifting Paradigms: The 4th European Alternative Finance Benchmarking Report} (n 5) 31.
dynamic branch of alternative finance and FinTech. It holds great potential for the democratisation of access to financial capital and investment, making it possible for investors and fundraisers to bypass the traditional gatekeepers - the banks.\(^9\) However, various regulatory and legal aspects remain problematic, which could hinder the full development of investment crowdfunding in the long term. Indeed, the financial sector has historically been characterised by a continuous and reciprocal chase between financial innovation and regulation, the so-called “regulatory dialectic”. This interplay appears accentuated in investment crowdfunding because of the accelerated pace of technological progress characterising the early twenty-first century.\(^9\)

Furthermore, since investors typically contribute only small sums in projects, investment crowdfunding appeals to what has been dubbed “retail” or “consumer” investors as distinguished from sophisticated or professional investors. The main issue is that retail investors usually have limited capacity to assess a business’s prospects and related risks. As a result, they are prone to making investment decisions subject to biases and herding behaviour, following the crowd. Apart from potential losses to investors, this can cause capital to be misallocated to low-quality entrepreneurial projects instead of more solid ones. These risks raise

---


The regulation provides harmonised rules on the organisation and operation as a crowdfunding service provider, authorisation and supervision of platforms, and investor protection. It is worth noting that the ECSP regulation is very detailed and relies on further technical standards drafted by European Securities and Market Authority (ESMA). The technical standards are expected by the time the ECSP regulation enters into force on 10 November 2021.

3.2. DEBT-BASED CROWDFUNDING

Debt-based crowdfunding (or loan-based crowdfunding, crowdlending, peer-to-peer lending) has been subject to some attention by legal scholars in recent years.\footnote{See bibliography below at 5.3 for an overview on the existing legal scholarship concerning debt-based crowdfunding. Sharath Chandupatla and Manal Shah, ‘Peer-to-Peer Lending and Equity-Based Crowd Funding - Status Quo and the Leap Forward’ (2019) 9(1) Nirma University Law Journal 103-104; Catherine Houssa, ‘Le Peer-to-peer Lending: Un Disrupteur Innovant à L’avenir Encore Incertain’ 2016 2 StradaLex: Forum Financier / Droit Bancaire et Financier 75-84.}

In debt-based crowdfunding, an investee will raise finance by way of a loan from multiple lenders. In return, the investee agrees to pay the principal plus interest according to an agreed schedule. Debt-based crowdfunding platforms emerged in the mid-2000s with Zopa being established in the UK in 2005, Prosper and LendingClub in the United States soon after.\footnote{Ziegler and Shneor, Lending Crowdfunding: Principles and Market Development, in Shneor, Zhao, and Flåten (n 12) 63; Alexander Bachmann, Alexander Becker, Daniel Buercrner et al., ‘Online Peer-to-Peer Lending – A Literature Review’ (2011) 16(2) Journal of Internet Banking and Commerce 1; Garry Bruton, Susanna Khavul, Donald Siegel et al., ‘New Financial Alternatives in Seeding Entrepreneurship: Microfinance, Crowdfunding, and Peer-to-Peer Innovations’ (2015) 39(1) Entrepreneurship Theory and Practice 9.}

These platforms were created to connect potential lenders (or investors) to potential borrowers (or lendees, fundraisers). Especially in the last few years, the number of active
platforms has increased.\textsuperscript{96} In contrast to equity crowdfunding, in debt-based crowdfunding the borrower does not surrender any portion of the company’s ownership. For the lender, the prospect of a capital and interest repayment schedule may be attractive as a yield generating opportunity, as opposed to the possibility of a dividend and/or capital gain later in the future.\textsuperscript{97}

Although debt-based, or peer-to-peer lending (P2P), is not easily defined in a strict manner, the model can usefully be described as the “matching of investors (lenders) and project owners (borrowers) through the use of an electronic information system (the platform) managed by a service provider, which as a legal person facilitates the granting of loans.”\textsuperscript{98} Here, the term ‘peers’ refers to both individuals and businesses.

Indeed, debt-based crowdfunding is usually divided into two main categories depending on the nature of the borrower. First, P2P business lending, whereas “individuals or institutional funders provide a loan to a business borrower”\textsuperscript{99}. Second, P2P consumer lending, “understood as individuals or institutional funders who provide a loan to a consumer borrower”.\textsuperscript{100} In both types, the platform acts as the intermediary between borrowers and lenders, vetting prospective borrowers.\textsuperscript{101} Given their need to build trust and a respectable platform, it is in the interest of the crowdfunding service providers to vet prospective borrowers. Hence, a degree of self-regulation in the business is to be expected.

In terms of numbers, debt-based crowdfunding models exhibit high year-on-year growth rates and account for the majority of funds raised across all macroregions, such as Europe, North America and the Asia-Pacific.\textsuperscript{102} For instance, in 2017, P2P business lending accounted for €466.60 million across European markets, or 14% of the total. P2P consumer lending accounted for €1,392.38 million, or 41% of the total, the largest single category by far.\textsuperscript{103} In 2018, if we exclude the UK, debt-based crowdfunding models accounted for approximately €7,745.00 million overall.\textsuperscript{104} The global Covid19 crisis is likely to impact P2P


\textsuperscript{97} Chapman (n 64) 53.

\textsuperscript{98} Jørgensen (n 96) 234.

\textsuperscript{99} Ibid. 234.

\textsuperscript{100} Ibid. 235.

\textsuperscript{101} For the typical procedure for the obtention of a P2P financement, see Rainer Lenz, ‘Peer-to-Peer Lending: Opportunities and Risks’ (2016) 7(4) European Journal of Risk Regulation 688.

\textsuperscript{102} Rau (n 11) 4; Ziegler et al., Shifting Paradigms: The 4th European Alternative Finance Benchmarking Report (n 5) 31; De Quesada (n 5) 114.


\textsuperscript{104} Ziegler and Shneor (n 5), 41. The UK continues to be the largest p2p market in Europe, although its share is decreasing year after year.
numbers’, although the industry’s prospects remain positive. Commentators have highlighted that institutional investors are increasingly becoming involved in debt-based crowdfunding. Debt-based crowdfunding can provide a cheaper and promising funding opportunity for both consumer and business borrowers, while usually offering higher interest rates to lenders compared to traditional and more structured forms of investment. However, debt-based crowdfunding comes with its own set of risks and legal challenges. Thus, the need for balanced regulations and investor protection is particularly felt among commentators.

Looking at China, which by far is the biggest market for debt-based crowdfunding provides an illustrative example as it has been the object of recent scholarship. Indeed, Chinese P2P lending expanded by a factor of sixty between 2013 and 2017, dwarfing all other markets. In 2017, P2P lending volumes in China peaked at €292.18 billion, while in the US, the second largest market volumes reached only €15.46 billion. P2P lending met both the demand for alternative financing sources for Chinese SMEs and savers’ demand for a better investment alternative. In a few years, it attracted millions of retail investors.

---


107 Regarding the benefits of P2P lending, see Kirby and Worner (n 86) 21-22. The authors list: 1) Helping economic growth through new and increasing flows of credit to SMEs and other users in the real economy; 2) filling a gap left by banks; 3) Lower cost of capital/high returns - Leveraging off a lower cost basis; 4) creating a new product for portfolio diversification; 5) cost efficiency and convenience; increased competition in a sector traditionally dominated by a few providers.

108 More in general, among the risks of P2P lending, Kirby and Worner (n 86) 23-28, list: 1) risk of default; 2) platform risk; 3) risk of fraud; 4) information asymmetry; 5) risk of investor inexperience (retail investors); 6) liquidity risk; 7) risk of cyber-attack. See also Lenz, "Peer-to-Peer Lending: Opportunities and Risks", 688-700. With regard to the US, see Andrew Verstein, ‘The Misregulation of Person-to-Person Lending’ (2011) 45 UC Davis Law Review, 445.

109 Ding, Kavuri and Milne, (n 14) 134. See also Lin (n 55) 327; Yuan and Xu (n 55) 275.

110 Ding, Kavuri and Milne (n 13) 134.

111 Traditionally in China “the interest rate is kept artificially low by the state so that cheap loans become
However, the country recently saw the closure of hundreds of P2P lending platforms due to issuers’ defaults. This was caused, as foreseen by some scholars, by the poor level of oversight and regulation imposed by Chinese authorities on P2P platforms. In the 2010s, the authorities allowed the industry’s numbers to rise exponentially in what effectively was, until 2015, a regulatory vacuum, as opposed to the traditionally tightly regulated Chinese financial sector. Furthermore, many platforms applied the ‘guarantee’ model, under which a P2P platform not only matches lenders and borrowers, acting as an intermediary, but also provides guarantees for the lender’s principal and interests. Due to the lack of specific regulation, platforms allowed underserved borrowers to receive financing, which in turn made the investments riskier for consumer lenders. The ensuing series of financial scandals, platform failures, frauds and massive Ponzi schemes received ample media coverage.

In reaction, the Chinese government imposed a more stringent and comprehensive regulatory framework, the 2016 Interim Measures on Online Lending, which is described as the “cornerstone” of the Chinese regime. These interventions inevitably increased the operational costs for platforms, making it difficult for them to sustain themselves and causing a steep contraction of the P2P lending market and the number of active P2P platforms in the country. The Chinese case of study highlights the inherent difficulty of striking a balance between investor protection and business promotion. European institutions in recent years have shown to be aware of the necessity to strike such a delicate balance. One may available to borrowers”, and this made P2P lending even more attractive to investors compared to traditional financial instruments (so-called “policy of financial repression”). In Ding, Kavuri and Milne (n 13) 135.


113 Ding, Kavuri and Milne (n 13) 136.

114 See Fialkow (n 1) 391-405; Yuan and Xu (n 56) 275-304.

115 Ding, Kavuri and Milne (n 13) 137.

116 Ibid. 134. In 2018, the Chinese market volume fell to € 174.70 billion, compared to € 23.10 billion in the US.

117 See Fialkow (n 1) 391-405; Yuan and Xu (n 56) 275-304.

wonder what the impacts of the recently passed ECSP regulation in the EU may be in this regard. While legal scholarly opinion is extremely scarce and leaves the field wide open, it is seen in the preparatory works that crowdfunding in Europe is “[...] characterized by its highly heterogeneous nature, shaped by the different starting points of nascent national crowdfunding sectors across the EU, and largely determined by the incumbent regulatory frameworks”. The European Commission concluded already in 2016 that crowdfunding is rapidly developing, is transforming the financial system, and has the potential to become a key source of SME finance.119 Prior to any legislative action, the predictability of law, transaction costs, authorisation of crowdfunding service providers, the conduct of crowdfunding businesses, and investor protection had the attention of the European Commission.120

3.3. EQUITY CROWDFUNDING

Debt-based crowdfunding does not allow investors to acquire stakes in the business or venture they wish to finance. To fill this gap, equity crowdfunding (or crowd investing) has evolved as a further alternative fundraising channel. It complements, more than substitutes, the traditional source of equity funding represented by venture capitalists.121 Equity crowdfunding enables companies, start-ups, and entrepreneurs to obtain capital from a large range of investors, each of them acquiring a small piece of equity. Specialised online platforms act as intermediaries, and investors receive shares in the company in return for their investment, enjoying the opportunity to be part of the business instead of mere creditors.122 This aspect makes equity crowdfunding more complex than


120 Ibid. 30-31; European Commission and European Crowdfunding Network (n 118).
121 Venture capitalists and angel investors have traditionally focused their resources on established businesses or on highly innovative firms with the potential for fast growth, usually located in clusters of innovation, such as Silicon Valley. See Alan Tomczak and Alexander Brem, ‘A Conceptualized Investment Model of Crowdfunding’ (2013) 15(4) Venture Capital: An International Journal of Entrepreneurial Finance 335, 351-355; David Groshoff, ‘Equity Crowdfunding as Economic Development?’ (2016) 38 Campbell Law Review 48. See bibliography below at 5.4 for an overview on the existing legal scholarship concerning equity crowdfunding.
debt-based crowdfunding from a contractual perspective, since “the transaction between the investor and the promoter is not a single exchange contract, or a loan, but it has instead a more associative nature that approximates it to the field of corporate law.”

The investor base in equity crowdfunding is usually composed of a motley “group of individuals with varying levels of professional and educational backgrounds and investor professionalism.” In addition, angel and venture capital investors themselves are starting to make use of the opportunities offered by equity crowdfunding platforms. While investors’ motivations for investing are heterogeneous, a wish for financial returns generally appears to be the common driving force.

The equity crowdfunding market grew significantly in the early 2010s across the world. However, from 2016 onwards, volumes in some regions have experienced declines driven by regulatory uncertainty and restraints. Across European countries (excluding the UK) equity-based crowdfunding accounted for €210.93 million, or 6% of the crowdfunding market in 2017. In 2018, the amount rose to €740.00 million, or 11.5% of the total volume.

On the one hand, equity crowdfunding certainly holds promise for entrepreneurs as an innovative source of financing and a remedy to SMEs' traditional shortfall of capital. On the other hand, recent studies suggest that, based on the so-called pecking-order-theory, entrepreneurs usually prioritise internal funds whenever possible, then external capital obtained through debt, including both traditional types and debt-based crowdfunding, turning to equity crowdfunding only as a last resort.

---

123 De Quesada (n 5) 116.  
126 Lukkarinen (n 125) 93-94.  
128 Ziegler and Shneor (n 5) 41.  
addition, equity crowdfunding may only generate a financial return in the long run and, of course, only if the investee proves successful. Like venture capitalists, equity crowdfunders invest in nascent businesses with all the related uncertainties and risks. However, unlike venture capitalists “retail crowdfund investors usually lack specialist expertise about the prospects of the business projects they back, which leaves them more exposed to poor selection”. Therefore, they do not take control rights because the costs of doing so outweigh the benefits, given crowdfunding investors’ lack of expertise and high coordination costs. This lack of control leaves them more exposed than a venture capitalist to opportunistic and potentially fraudulent conduct by the fundraiser after the investment is made.

The literature review carried out for the purpose of this paper shows that US legal literature on equity crowdfunding is three times the amount compared to European writings. The finding is not surprising, as the US was one of the first countries to implement legislative initiatives on the subject starting from 2012. However, commentators generally view the current US regulatory regime as unsatisfactory. Indeed, until 2012 equity crowdfunding in the US remained regulated by the securities laws first issued in 1933, after the Great Depression. Securities laws are designed to regulate financial products deemed to be securities, imposing costly registration procedures to the issuers. The US Congress designed the Securities Act with a focus on disclosure of information about investments, more than on the quality of investments in itself. US legislators believed that full and truthful disclosure would allow individuals to make informed investing decisions, while the U.S. Securities and Exchange Commission (SEC) acted as the watchdog.

The cession of equity crowdfunding shares, which are securities, was initially subjected to the requirements of the securities laws. This seemed too burdensome since the object of crowdfunding investments were

Empirical evidence suggests that firms listed on equity crowdfunding platforms are usually less profitable, often presenting excessive debt levels, and have more intangible assets than matched firms not listed on these platforms.

131 Armour and Enriques (n 92) 12.
132 Ibid.
133 Regarding the regulation of equity crowdfunding in the US, see Fialkow (n 1) 391-405; Abbey Stemler, ‘Equity-Based Crowdfunding: Allowing the Masses to Take a Slice of the Pie’, in Méric, Maque, and Brabet (n 35) 219-232.
relatively small sums. Therefore, the American Congress intervened in 2012 with Title III of the Jumpstart Our Business Startups Act (JOBS act). It outlined an exemption for crowdfunding from many securities law requirements, in order to boost this new alternative finance method.\(^{137}\) Thus, Title III of the JOBS Act (also known as CROWDFUND Act, or “Capital Raising Online While Deterring Fraud and Unethical Non-Disclosure Act”) opened the door for wider participation in crowdfunding by allowing non accredited investors to make limited investments in privately held companies.\(^{138}\) The JOBS Act maintained the distinction between consumer and accredited investors, the latter being defined only by their higher net-worth.\(^{139}\)

Under Title III, entrepreneurs and small business owners may utilise the crowdfunding exemption to raise up to US $ 1 million within a one-year period without registering the sales with the SEC. However, the legislator still envisaged requirements concerning disclosure, registration of the crowdfunding service provider, and capital limitations. Any investor, whether accredited or unaccredited, could invest in companies relying on the crowdfunding exemption, albeit with a max cap determined by their income or net worth.\(^{140}\)

In order to make Title III effective at the federal level, especially in terms of consumer equity crowdfunding, the SEC needed to adopt implementing regulations. The latter were released only in October 2015, entering into force in May 2016.\(^{141}\) Since its inception, a number of

---

137 Heminway (n 134) 191.
139 Commentators highlight how wealth in itself is not a real indicator of whether an investor is sophisticated or not. Cf. Porrata-Doria (n 135) 224.
140 More specifically: JOBS Act, § 302 (a) amending Section 4 of the Securities Act of 1933: “... (B) 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; and (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...”.\(^{141}\)
scholars have lamented the complexity and costs for intermediaries and issuers of this equity crowdfunding regulatory regime.\textsuperscript{142} Besides, it has been noted that it did not really prevent crowdfunding from becoming a "market of lemons".\textsuperscript{143} Other commentators remain sceptical regarding the so-called wisdom of the crowds, considering that non-sophisticated investors are still likely to make poor investment decisions and incomplete risk assessments, especially considering the limited information available to them.\textsuperscript{144} Others continue to underline that the danger of fraudulent offerings is amplified because the small volume of individual investments makes it uneconomical and difficult to get redress via the traditional legal remedies, while enforcing a judgement vis-à-vis impecunious fraudsters remains unlikely.\textsuperscript{145}

Existing legal literature in the US has so far focused on the regulatory regime devised by the legislator from the JOBS Act onwards, its shortcomings and suggested improvements.\textsuperscript{146} The securities watchdog, the SEC, remains concerned with investor protection, while legislators confront the need to boost SMEs’ access to capital through equity crowdfunding. That being said, the SEC is currently reflecting on modifying its regulations to address some of the weaknesses highlighted by practitioners and scholars alike.\textsuperscript{147} In other words, the analysis of the interplay between financial innovation / inclusion and investor protection / fraud avoidance so far has taken the lion’s share of US legal literature on crowdfunding.

In comparison to the US, European legal literature on equity crowdfunding appears still in its infancy, focusing on each jurisdiction’s regulatory approach to equity crowdfunding.\textsuperscript{148} Indeed, throughout the

---

\textsuperscript{142} Porrata-Doria (2015) 256-260; Dylan J. Hans, ‘Rules Are Meant to Be Amended: How Regulation Crowdfunding’s Final Rules Impact the Lives of Startups and Small Businesses’ (2018) 83(3) Brooklyn Law Review 1089; Lee (n 77) 21: “The author contends that for the high-growth issuers targeted by the legislation, crowdfunding is likely to be too expensive, too complex and have too great of liability risk to undertake, when the issuer has other financing alternatives.”

\textsuperscript{143} Hurt (n 136) 254-255.


\textsuperscript{145} Steven C. Bradford, ‘Online Arbitration as a Remedy for Crowdfunding Fraud’ (2018) 45 Florida State University Law Review 1169.

\textsuperscript{146} For instance, see Stemler (n 133) 231. Most legal articles on the subject were published between 2014 and 2017.

\textsuperscript{147} Porrata-Doria (n 135) 256.

\textsuperscript{148} For instance, see Nehme (n 122); Macchiavello E, “La travagliata evoluzione normativa dell’equity crowdfunding in Italia, il nuovo regolamento Consob e la
2010s the regulatory framework remained fragmented across the continent. While some states, such as France (Ordonnance 2014-559), Spain (Ley 5/2015), Italy (Decreto Legge 179/2012), and the UK (FCA 2014), introduced specific laws regulating equity crowdfunding, other states opted for the application of the general rules while yet others simply have maintained a ban on equity crowdfunding. The UK has consistently remained the major market for equity crowdfunding, although its neighbours are increasing their share of the total volumes of equity crowdfunding raised across the continent. In November 2021, the entering into force of the ECSP Regulation across the EU member states will likely provide new momentum to European scholarship on equity crowdfunding.

4. CONCLUSION AND PERSPECTIVES

Upon examination, almost 300 unique publications on crowdfunding law have been identified globally. By comparison, it is evident that crowdfunding, as an area of legal scholarship, is still in its infancy. Knowing that the amount of money raised through crowdfunding is growing, domestic and regional legislators increase their efforts to regulate, and that there is a documented “correlation between regulatory clarity – the introduction of an explicit legal crowdfunding regulation in a country – and the volume of crowdfunding in the subsequent year.” The time is ripe for legal scholars to contribute to the development of the market.

No matter the specific type, and possible crowdfunding-specific legislation, like the ECSP regulation in the EU aside, crowdfunding activities are governed by general legal frameworks, such as marketing law
and intellectual property law. Despite focusing on various crowdfunding models and different jurisdictions, legal scholarship is often concerned with questions of how to regulate a highly internationalised market, how to encourage development to the benefit of innovation and, at the same time, protect the often-unsophisticated investors. Legal researchers should beware that the regulation dialectic may taint crowdfunding, that investors may be unable to assess prospects and risks properly, and that presumptions of crowd wisdom may in fact be mindless herd behaviour.

Virtually all legal scholarship in the field relies on a distinction between investment and non-investment crowdfunding types and categorises crowdfunding models into four basic types: the donation model, the rewards model, the debt-based model, and the equity model. While there are several other crowdfunding sub-models, there is a consistent reference to the four primary types in the literature, which correlates with the fact that the general legal framework is often dependent on the four types.

Legislators appear to recognise, welcome, and react to the disruptive nature that crowdfunding has on the financial market and that it is part of a larger trend concerning democratisation and digitalisation of the financial sector. Much of the legal writings seem to focus on the US JOBS Act and less on European initiatives. However, there is an overlap in themes across scholarship as it often addresses predictability of law, conduct of the crowdfunding businesses, protection of investors / disclosure, and access to risk capital. Legal scholars who desire to carry out comparative studies will have at least some footing to do so in the pool of literature. Further legal studies may help abate some of the uncertainties of interpreting the legal framework of crowdfunding. Moreover, they could provide a critical and comparative opinion to the benefit of crowdfunding service providers forum shopping, harmonisation, and development of national and regional legislation. All stakeholders in crowdfunding, the investors, the crowdfunding service providers, the fundraisers, and public authorities too, have a mutual interest in a common and predictable legal framework to increase trust in crowdfunding as a source of finance.

Even though crowdfunding is still not the typical source of risk capital for start-ups, the sector is growing fast in both the volumes of money raised, types of crowdfunding services, and the number of service providers. As a result, one may wonder if crowdfunding provides a useful method for civil society to help kick-start the economy in a post-pandemic world.

---

153 Møller Toftegård and Krull (n 75) 42-46.
Both legislators and legal scholars have largely overlooked donation and reward-based crowdfunding. One problem attached to these crowdfunding types is that it is difficult to distinguish between donation and reward-based crowdfunding, as they are often mixed in practice. The distinction is critical for deciding whether the general legal framework regarding public fundraising or the laws of contract and sales apply to the activity. Another problem is that it is unknown whether these frameworks are predictable enough to create trust in crowdfunding and to effectively decide the default legal obligations of fundraisers and crowdfunding service providers. It is unknown whether the many consumer protection measures in place, especially in Europe, apply, and whether they are possible to modify in crowdfunding pre-sales situations as there may be good reasons to do so. It is problematic that donation and rewards-based crowdfunding provide the opportunity of testing initial demand and involving consumers in product development on one hand when, on the other hand, the legal relationship between funder and fundraiser remains unexplored. One may fear that, over time, this will lead to disappointed stakeholders and therefore less trust and use of crowdfunding.

Investment crowdfunding has attracted more legal scholars than the non-investment types. In addition to the concerns already raised, the focus on investor protection is stronger in the literature addressing debt-based and equity crowdfunding. The disruption of the financial markets becomes particularly apparent here, as crowdfunding relies on more lax regulation to work the best. At the same time, stakeholders have an interest in combating fraud that undermines the trust that is instrumental to crowdfunding. Legislators attempt to strike the right balance between protecting the retail or unsophisticated investors while still encouraging SMEs’ access to risk capital. The lessons from China may be useful to legal scholars in this regard.

Investment-based crowdfunding also enjoys the most attention of legislators and the preponderant part of legal research is devoted to the US legal framework in this regard. The recent EU regulation of ECSPs is largely unaddressed in the literature at this point. The legislative roadmap from domestic law into the harmonised EU regulation is not described by scholars, despite it being valuable to the interpretation and critique of the regulation.

In summary, it can be concluded that the comprehensive overview of the state of the art of legal science on crowdfunding reveals several concerns that legal scholars may address. While many key concepts of crowdfunding are somewhat established in the literature, the legal scholarship seems not to take full comparative advantage of the fact that many concerns are common across jurisdictions, such as encouraging SME development through access to risk capital or ensuring the protection of the unsophisticated investor. To stimulate further development of the legal aspects of crowdfunding, a categorised bibliography is attached below.
5. BIBLIOGRAPHY ON LEGAL SCHOLARSHIP

To support and foster new legal scholarship, we provide a bibliography of legal scholarship relevant to each of the four crowdfunding types. It should be noted that while many listed publications are concerned with one type of crowdfunding, there are several publications concerned with several of the crowdfunding types. Hence, these latter materials are categorised under each of the relevant crowdfunding types. Materials published after 1 May 2021 have not been considered.154

5.1. SCHOLARSHIP ON DONATION CROWDFUNDING

‘Review of Crowdfunding Regulation 2017: Interpretations of Existing Regulation Concerning Crowdfunding in Europe, North America and Israel’ (2017)


Buyse K et al., ‘A Framework for European Crowdfunding’ (2012)


Clarke O, ‘Regulation of CrowdFunding in Germany, the UK, Spain and Italy and the Impact of the European Single Market’ (European Crowdfunding Network (ECN) 2013)


Durdenic K, ‘Crowdfunding - Croatian Legal Perspective and Comparison to Other Sources of Financing’ (2017) 41 Public Sector Economics 259

Esposito L, “Il crowdfunding, uno strumento alternativo di finanziamento” (2019) 1 Rivista Bancaria Minerva Bancaria 97


154 For the most updated bibliography, we kindly refer to the online version accessible at www.theCLEARproject.dk.
Fialkow Z, ‘Crowd-Fundamentals: Balancing Rapidly Advancing Crowdfunding Innovation with Protections for Consumers’ (2017) 4 Emory Corporate Governance and Accountability Review 391

Furnari SL, ‘Equity-Based Crowdfunding: The Issuer’s Perspective’ (Master of Laws, 2015)


Møller Toftegård P and Krull MC, Netværksfinansiering - En guide til crowdfunding (LETT)


Shneor R, Zhao L and Flåten B-T (eds), Advances in Crowdfunding: Research and Practice (Springer International Publishing 2020)


5.2. SCHOLARSHIP ON REWARD CROWDFUNDING


Buyser e K et al., ‘A Framework for European Crowdfunding’ (2012)


Clarke O, ‘Regulation of CrowdFunding in Germany, the UK, Spain and Italy and the Impact of the European Single Market’ (European Crowdfunding Network (ECN) 2013)

Durdenic K, ‘Crowdfunding - Croatian Legal Perspective and Comparison to Other Sources of Financing’ (2017) 41 Public Sector Economics 259

Esposito I, “Il crowdfunding, uno strumento alternativo di finanziamento” (2019) 1 Rivista Bancaria Minerva Bancaria 97


Fialkow Z, ‘Crowd-Fundamentals: Balancing Rapidly Advancing Crowdfunding Innovation with Protections for Consumers’ (2017) 4 Emory Corporate Governance and Accountability Review 391

Furnari SL, ‘Equity-Based Crowdfunding: The Issuer’s Perspective’ (Master of Laws, 2015)


Møller Toftegård P and Krull MC, Netværksfinansiering - En guide til crowdfunding (LETT)


Shneror R, Zhao L and Flåten B-T (eds), Advances in Crowdfunding: Research and Practice (Springer International Publishing 2020)


5.3. SCHOLARSHIP ON DEBT-BASED CROWDFUNDING


Amajuoyi UC, ‘Online Peer-to-Peer Lending Regulation: Justification, Classification and Remit in UK Law’ (Doctor of Philosophy in Law, University of Exeter 2016)


Chandupatla S and Shah M, ‘Peer-to-Peer Lending and Equity-Based Crowd Funding - Status Quo and the Leap Forward’ (2019) 9 Nirma University Law Journal 97


Cicchiello AF, ‘Harmonising the crowdfunding regulation in Europe: need, challenges, and risks’ (2020) 32(6) Journal of Small Business & Entrepreneurship 585


Cox J, ‘Does This Sound Familiar? Peer Lenders Are Packaging Loans and Selling Them to Wall Street’ CNBC (9 February 2017)


De Quesada CE, ‘Crowdfunding in Europe’, in European Contract Law in the Digital Age, vol 3 (Intersentia 2018) 103


Dierks A, ‘The Regulation of Peer-to-Peer Lending Platforms in the Consumer Credit Market’ (PhD in Law, Juristischen Fakultät der Humboldt-Universität zu Berlin 2018)


Esposito L, “Il crowdfunding, uno strumento alternativo di finanziamento” (2019) 1 Rivista Bancaria Minerva Bancaria 97

Farrell S, ‘Former City Regulator Warns of Potential Peer-to-Peer Lending Crisis’ The Guardian (10 February 2016)

Feng E, ‘Chinese Government Faces Peer-to-Peer Lending Scandals Dilemma’ Financial Times (12 November 2018) <https://www.ft.com/content/c71eea4a-c198-11e8-84cd-9e601db069b8> accessed 4 February 2021

Gajda O (ed), Review of Crowdfunding Regulation: Interpretations of Existing Regulation Concerning Crowdfunding in Europe, North America and Israel (Brussels: European Crowdfunding Network 2017)


Houssa C, ‘Le peer to peer lending: un disrupteur innovant à l’avenir encore incertain’ (2016) 2 Droit Bancaire et Financier 24

Jones R, ‘Quakle Collapse Serves as Warning to Peer-to-Peer Investors’ The Guardian (15 February 2014)


Lee A, ‘China’s P2P Lenders Face Tough 2020 amid Tighter Regulation’ South China Morning Post (7 January 2020)


Lynn T et al. (eds), Disrupting Finance: FinTech and Strategy in the 21st Century (Springer International Publishing 2019)


Minupuri N, ‘Rushing to Regulate: Rethinking the RBI’s Directives on Peer-to-Peer Regulations in India’ (2019) 33 Emory International Law Review 433

Mitchell T, ‘Chinese Ponzi Scheme Sparks Calls for Protests’ The Financial Times (2 February 2016)


Perkins DW, ‘Marketplace Lending: Fintech in Consumer and Small Business Lending’ (Congressional Research Service 2018)


Slatteryt P, ‘Square Pegs in a Round Hole: SEC Regulation of Online Peer-to-Peer Lending and the CFPB Alternative’ (2013) 30 Yale Journal on Regulation 233


Shneor R, Zhao L and Flåten B-T (eds), Advances in Crowdfunding: Research and Practice (Springer International Publishing 2020)


Tsai C-H, ‘To Regulate or Not to Regulate? A Comparison of Government Responses to Peer-to- Peer Lending among the United States, China, and Taiwan’ (2019) 87 University of Cincinnati Law Review 1077


SCHOLARSHIP ON EQUITY CROWDFUNDING


Alvisi P, ‘Equity crowdfunding: uno sguardo comparatistico’ (2014) 3 Rivista di diritto bancario | Dottrina e giurisprudenza commentata 1


Catalini C, Fazio C and Murray F, ‘Can Equity Crowdfunding Democratize Access to Capital and Investment Opportunities?’ [2016]
Chandupatla S and Shah M, ‘Peer-to-Peer Lending and Equity-Based Crowdfunding - Status Quo and the Leap Forward’ (2019) 9 Nirma University Law Journal

Cicchiello AF, ‘Harmonising the crowdfunding regulation in Europe: need, challenges, and risks’ (2020) 32(6) Journal of Small Business & Entrepreneurship 585


Esposito L, “Il crowdfunding, uno strumento alternativo di finanziamento” (2019) 1 Rivista Bancaria Minerva Bancaria 97


Ferguson T, ‘Private Equity Crowdfunding’ SUS6175: Capital Markets, SP12 21

Falkow Z, ‘Crowd-Fundamentals: Balancing Rapidly Advancing Crowdfunding Innovation with Protections for Consumers’ (2017) 4 Emory Corporate Governance and Accountability Review 391

Freedman DM and Nutting MR, Equity Crowdfunding for Investors (2015)


Gajda O (ed), Review of Crowdfunding Regulation: Interpretations of Existing Regulation Concerning Crowdfunding in Europe, North America and Israel (Brussels: European Crowdfunding Network 2017)


Heminway JM, ‘Selling Crowdfunded Equity: A New Frontier’ (2017) 70 Oklahoma Law Review 26

Ho JKS, ‘Regulating Equity Crowdfunding in Hong Kong: Appreciating Anglo-American Experiences and Recognising Local Conditions’ (2016) 45 Common Law World Review 30


Isaacson ME, ‘The So-Called Democratisation of Capital Markets: Why Title III of the JOBS Act Fails to Fulfill the Promise of Crowdfunding’ (2016) 20 North Carolina Banking Institute 440


Loughran PJ et al., ‘The SEC Hands Out a Halloween Treat to Crowdfunding Supporters’ [2015] Business Law Today 1

Lukkarinen A, ‘Success Drivers of Online Equity Crowdfunding Campaigns’ (2016) 87 Decision Support Systems 26

Lukkarinen A, Drivers of Investment Activity in Equity Crowdfunding (Aalto University 2019)


McMahon A, ‘It Takes a Village to Fund a Start-up: How an Electronic Community for Early-Stage Investments Can Bring
Democracy Back to Equity Crowdfunding’ (2016) 84 University of Cincinnati Law Review 66
Møller Toftegård P and Krull MC, Netværksfinansiering - En guide til crowdfunding (LETT)
Pierce-Wright CH, ‘State Equity Crowdfunding and Investor Protection’ (2016) 91 Washington Law Review 41
Rau PR, ‘Law, Trust, and the Development of Crowdfunding’ (Social Science Research Network 2020) SSRN Scholarly Paper ID
Santoro V and Tonelli E, ‘Equity Crowdfunding Ed Imperdimentalità Innovativa’ (2014) 7 Rivista di diritto bancario | Dottrina e giurisprudenza commentata
Shneor R, Zhao L and Flåten B-T (eds), Advances in Crowdfunding: Research and Practice (Springer International Publishing 2020)
Stemler A, ‘Equity-Based Crowdfunding: Allowing the Masses to Take a Slice of the Pie’, in Méric J et al. (eds), International Perspectives on Crowdfunding: Positive, Normative and Critical Theory (Emerald Publishing Limited 2016) 219

Tsai C, ‘Legal Transplantation or Legal Innovation? Equity-Crowdfunding Regulation in Taiwan after Title III of the U.S. Jobs Act’ (2016) 34 Boston University International Law Journal 233


Young KA, ‘Compliance with the Securities Laws in Crowdfunded Securities Offerings: Startups It’s Your Responsibility!’ (2014) 34 Review of Banking & Financial Law 581