



LEGALINK
INTERNATIONAL BUT PERSONAL

EQUITY CROWDFUNDING & PEER-TO-PEER LENDING

2019 1ST EDITION



INTRODUCTION

Crowdfunding has already an established and proven recognition worldwide as a powerful alternative financing tool. Three main points should be signaled in this respect. On the one hand, the volume of the crowdfunding market keeps increasing sharply at global level. On the other hand, the crowdfunding market is very dynamic as new crowdfunding platforms have recently started to operate. Finally, the projects to be financed through crowdfunding platforms are more and more diverse.

In this context, at a time when crowdfunding regulation is subject to discussion around the globe (namely in the context of the Proposal for a EU Crowdfunding Regulation), it seems important to assess the legal responses from various relevant jurisdictions, in respect to Equity Crowdfunding and Peer to Peer Lending. Such is the purpose of this publication.

This book is dedicated to the memory of Georg Van Daal, Former Deputy Head of Legalink FinTech Forum. Georg was a brilliant lawyer and a partner at Ekelmans & Meijer from 2014 to 2018. He was key to the structuring and to the development of this project but unfortunately could not live to see its final form. He is dearly missed.

October 2019

Paulo Câmara
Managing Partner of Sérvulo & Associados
Leader of the Legalink FinTech Forum

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Equity Crowdfunding

For the purposes of the following, 'equity crowdfunding' means raising capital in an offering of shares (or instruments convertible into shares) through an online platform.

1. Has your country introduced specific laws or regulations governing equity crowdfunding, or is it regulated under general securities or other laws?

On March 2018, the Law to Regulate Financial Technology Institutions (the Fintech Law) came into force, which regulates, among other things, crowdfunding institutions.

Fintech law distinguishes three kinds of crowdfunding institutions:

› Collective debt financing.

- Peer to peer lending.
- Peer to business.
- Lending
- Leasing
- Factoring
- Real estate financing.

› Equity

› Co-ownership and royalties.

2. If your country regulates equity crowdfunding, what are the names of the government agencies responsible for regulating it?

Mainly the National Banking and Securities Commission.

Other relevant government agencies:

› Bank of Mexico, in everything related to the use of cash, virtual assets and foreign currencies.

› Secretariat of Finance and Public Credit, in everything related to tax and anti-money-laundering policies.

3. Are there limits on the amounts that can be raised by crowdfunding companies?

The regular limit that can be raised by a company in equity crowdfunding is 1,670,000 investment units (approximately USD 545,667). Special authorisation can be requested to increment the limit up to 6,700,000 investment units (approximately USD 2,189,201).

4. Are there restrictions on the types of purchasers to whom shares can be offered?

There are no restrictions regarding to whom equity can be offered. However, crowdfunding institutions must establish in their platforms controls that prevent the same investor from making investment commitments that exceed the percentages established by the Fintech Law (15% individuals/20% legal entities in case of equity crowdfunding), once the indicated formula has been applied:

\$ to invest in the project

The sum of ALL the past and x 100 <= 15% in case of individuals, 20% in case of legal entities present investments

For example:

John wants to invest MXN 2,000 (approximately USD 102) in project C (the amount of money that the project is asking for does not matter). In his previous investments (projects A and B), he invested MXN 15,000 (approximately USD 772). Since applying the formula, the result of John's investment commitment is less than 15% as required by the Fintech Law, John can invest in project C.

MXN 2,000

MXN 15,000 x 100 = 13.3%

These limitations were created for the purpose of protecting retail investors from possible loss by obliging them to diversify their investments in different projects.

There are some exceptions to these rules:

- › When the sum of all the previous investments is lower than 8,300 investment units (approximately USD 2,673), the investor can spend 4,150 investment units (approximately USD 1,356) in the new project without following the formula.
- › When there are 25 or less crowdfunding applications published on the platform, the investment commitment to be made by the same investor to an applicant may not exceed the maximum between 5% of the amount of financing required or the equivalent in national currency to 167,000 investment units (approximately USD 54,567).
- › When the crowdfunding institution, as part of the schemes to share risks with the investors, makes investment commitments in an applicant or project, it may increase the percentages referred before by adding the percentage of investment that the own Institution is engaging in such applicant or project, or 25%, whichever is less.
- › No limitation will be applied to accredited (experienced) and institutional investors.
- › No limitation will be applied to related investors. According to Fintech Law a related investor is anyone who demonstrates to the crowdfunding institution to have kinship with the applicant by consanguinity, affinity or civil to the fourth degree, or be their spouse or concubine.

5. What information needs to be disclosed to potential purchasers, and are offer documents or marketing materials required to be registered or approved by your country's regulators?

In addition to diversification, the investor protection framework relies on the disclosure of information that platforms must perform at various times: before establishing a contractual relationship with the investor, before they choose any of the financing options offered, and during the time their resources are invested in these financing options.

1. Proof of knowledge of risks:

Crowdfunding institutions must obtain electronic evidence that investors know the risks they assume by investing through their platforms, for which they will be required to fill out a form (annex 8 of the General Dispositions of the Fintech Law published by the National Banking and Securities Commission).

2. Initial information

They must make known, through the platform, at least the following:

- › Characteristics of the project to be financed, differentiated by type of financing (debt, equity or co-

ownership):

- Financing destination.
 - Information about the applicant (identity and technical knowledge of the individuals behind the company).
 - General conditions of the offer.
- › Specific risks of each financing option offered.
 - › The type of information and documentation that will be collected to carry out the analysis and the respective assessment of the potential applicants and, where appropriate, the activities to verify the veracity of said documentation and information.
 - › the form to verify the identity and location of the potential applicants.
 - › the criteria that will be used to select the applicants and the projects subject to financing.
 - › Methodology of risk rating of applicants or projects and the meaning of each rating.
 - › Obligations and limits of liability towards investors.
 - › Any other information necessary for decision-making.

3. Continuous information

- › Payment behaviour/performance of funded projects: payments, defaults, debt collection actions, etc.
- › Annual report on the performance of the project with unaudited financial information.
- › Statistical information added in the platform:
 - Financing granted: quantity and amount
 - Number of registered and active investors
 - Total expired portfolio broken down by financing destination.

The information disclosed to investors must comply with the following minimum characteristics:

- › Use clear and easy-to-understand language.
- › Avoid the use of superlative terms and value judgements.
- › Ensure that the information that is intended to be transmitted includes graphic or symbolic representations that facilitate its understanding.
- › Use a font size similar to the text of the main contents of the publications made through the platforms.
- › Include a section of frequently asked questions regarding the operation of the crowdfunding institution, the applications and projects published therein, as well as, where appropriate, the methods for resolving disputes or clarifications among the applicants, the investors and the crowdfunding institution.

6. Is there any requirement for an equity crowdfunding platform and/or its operator, or a crowdfunding company, to be licensed or registered or to comply with any particular rules?

For the crowdfunding platform to operate as such, they must obtain an authorisation to operate as a crowdfunding institution. This authorisation is granted by the National Banking and Securities Commission, with the previous agreement of the Interinstitutional Committee, which is formed by representatives from the National Banking and Securities Commission, the Bank of Mexico and the Secretariat of Financing and Public Credit.

They need to comply with all the technical, operative and legal requirements established by the Fintech Law. Any platform that performs any of the activities reserved to crowdfunding institutions in Mexican territory, even if registered outside of Mexico, is subject to be fined and criminally prosecuted.

The Fintech Law gave a safe conduct to all the crowdfunding companies that were operating before the law came into force (March 2018). These platforms may operate, even without authorisation, to

the extent that they submit their request for authorisation before September 2019. As long as they do not receive the respective authorisation, they must publish on their website or platform that the authorisation to carry out this activity is in process, so it is not an activity supervised by the Mexican authorities.

7. Please provide any additional information you feel is important to understanding the regulation of equity crowdfunding in your country.

The regulation is based on six guiding principles: 1) financial innovation and inclusion; 2) consumer protection; 3) promotion of competition; 4) preservation of financial stability; 5) prevention of money laundering; and 6) technological neutrality.

The regulation can be summarised in the following elements:

› Solvency and operation requirements:

- Minimum and net capital.
- Investment and financing limits.
- Limits for reception and delivery of cash.
- Accounting regulation, financial information and valuation.
- Methodologies for evaluation and qualification of applicants and projects.
- Mandates or commissions.
- Proof of knowledge of risks for investors

› Robust regulation framework in the following topics:

- Use of electronic means.
- Provision of third-party services.
- Security of information and operational continuity (plan against technological risks).
- Application Programming Interface (API).
- Anti-money-laundering/Know Your Customer policies.

› Regulatory sandbox

8. Please identify a point of contact at your firm for equity crowdfunding-related enquiries.

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Peer-to-Peer Lending

For the purposes of the following, 'peer-to-peer lending' means lending by individuals to businesses or other individuals where an online platform is used to match lenders with borrowers.

1. Has your country introduced specific legislation or regulations governing peer-to-peer lending, or is it regulated under generally applicable laws?

Fintech law distinguishes three kinds of crowdfunding institutions:

› Collective debt financing.

- Peer to peer lending.
- Peer to business.
- Lending
- Leasing

Factoring

- Real estate financing.

› Equity

› Co-ownership and royalties.

2. If your country regulates peer-to-peer lending, what are the names of the government agencies responsible for regulating it?

Mainly the National Banking and Securities Commission (CNBV).

Other relevant government agencies:

- o Bank of Mexico (Banxico), in everything related to the use of cash, virtual assets and foreign currencies.
- o Secretariat of Finance and Public Credit (SHCP), in everything related to tax and anti-money-laundering policies.

3. Are there any limits on the amounts that can be lent?

When the loan is to an individual who is not registered with the tax administration system as a person with business activity (peer to peer), the limit that can be lent is 50,000 investment units (approximately USD 16,337).

When the loan is to a legal entity or to an individual who is registered with the tax administration system as a person with business activity (peer to business), the limit that can be lent is 1,670,000 investment units (approximately USD 545,667). Special authorisation can be requested to increment the limit up to 6,700,000 investment units (approximately USD 2,189,201).

4. Are there any restrictions on the types of persons who can lend and/or borrow, or restrictions on the rate of interest that can be charged?

In general, there are no restrictions on the type of persons who can lend and/or borrow.

To be a borrower, the platform must evaluate in depth their credit history, job, salary, reports, income and more to determine their level of risk and to attend and prevent vulnerable operations and money laundering.

In the case of a lender, there are no restrictions if they sign a specific contract acknowledging that the investment is not guaranteed by the platform, and they operate at their own risk. However, crowdfunding institutions must establish in their platforms controls that prevent the same lender from

making investment commitments that exceed the percentages established by the Fintech Law (7.5% individuals/20% legal entities in case of peer-to-peer lending and 15% individuals/20% legal entities in case of peer-to-business lending), once the indicated formula has been applied:

\$ to invest in the project

The sum of ALL the past and x 100 \leq 7.5%/15% in case of individuals, 20% in case of legal entities present investments

For example:

John wants to lend MXN 1,000 (USD 51) to Maria (the amount of money the borrower is asking for does not matter). In his previous commitments of investment (money lent to other borrowers), John lent MXN 15,000 (USD 772). Since, applying the formula, the result of John's investment commitment is less than 7.5% as required by the Fintech Law, John can lend the MXN 1,000 to Maria through the platform.

MXN 1,000

MXN 15,000 x 100 = 6.7%

These limitations were created for the purpose of protecting retail investors from possible loss by obliging them to diversify their investments in different projects.

There are some exceptions to these rules:

- › When the sum of all the previous commitments is lower than 2,000 investment units (approximately USD 653), the investor can lend 667 investment units (approximately USD 218) in the new project, without following the formula.
- › When there are 25 or less crowdfunding applications published on the platform, the investment commitment to be made by the same lender to a borrower may not exceed the maximum between 5% of the amount of financing required or the equivalent in national currency to 167,000 investment units (approximately USD 54,567).
- › When the crowdfunding institution, as part of the schemes to share risks with the lenders (skin in the game), also lends (investment commitments) to the borrower, it may increase the percentages referred to before, by adding the percentage of investment that the own institution is engaging with the borrower, or 25%, whichever is less.
- › No limitation will be applied to accredited and institutional investors.
- › No limitation will be applied to related investors. A related investor, is anyone who demonstrates to the crowdfunding institution to have kinship with the applicant/borrower by consanguinity, affinity or civil to the fourth degree, or be their spouse or concubine.

The rate of interest in peer-to-peer lending depends on the level of risks that each borrower has. Each borrower is classified by a letter and a number.

5. Is there any requirement for the online platform and/or the lenders to be licensed or registered or to comply with any particular rules?

The lenders do not need a licence or permission as such. They only need to sign a contract with the crowdfunding institution, have a bank or electronic funds account and follow the rules that are applicable to them (limits of investment and AML/KYC provisions, among others).

For the online platform to operate as such, they must obtain an authorisation to operate as a crowdfunding institution. This authorisation is granted by the National Banking and Securities

Commission, with the previous agreement of the Interinstitutional Committee, which is formed by representatives from the National Banking and Securities Commission, the Bank of Mexico and the Secretariat of Financing and Public Credit.

They need to comply with all the technical, operative and legal requirements established by the Fintech Law.

Any platform that performs any of the activities reserved to crowdfunding institutions in Mexican territory, even if registered outside of Mexico, is subject to be fined and criminally prosecuted.

The Fintech Law gave a safe conduct to all the crowdfunding companies that were operating before the law came into force (March 2018). These platforms may operate, even without authorisation, to the extent that they submit their request for authorisation before September 2019. As long as they do not receive the respective authorisation, they must publish on their website or platform that the authorisation to carry out this activity is in process, disclosing that in the meanwhile their activity is not supervised by the Mexican authorities.

6. Are there any requirements applicable to marketing and promotional documents and activities?

In addition to diversification, the investor protection framework relies on the disclosure of information that platforms must perform at various times: before establishing a contractual relationship with the investor/lender, before they choose any of the financing options offered and during the time their resources are invested in these financing options.

1. Proof of knowledge of risks:

Crowdfunding institutions must obtain electronic evidence that investors/lenders know the risks they assume by investing through their platforms, for which they will be required to fill out a form (annex 8 of the General Dispositions of the Fintech Law published by the National Banking and Securities Commission).

2. Initial information

They must make known through the platform at least the following:

- › Information about the borrower (credit history/business history, if applicable).
- › The general conditions of the loan (guarantees, interest rate, etc).
- › The specific risks of each loan offered.
- › The type of information and documentation that will be collected to carry out the analysis and the respective assessment of the potential borrower and, where appropriate, the activities to verify the veracity of said documentation and information.
- › The form to verify the identity and location of the potential borrower.
- › The criteria that will be used to select the borrowers and loans.
- › The methodology of risk rating of borrowers and the meaning of each rating.
- › The obligations and limits of liability towards investors/lenders.
- › Any other information necessary for decision making.

3. Continuous information

- › Payment behaviour: payments, defaults, debt collection actions, etc.
- › Statistical information added in the platform:
 - Financing granted: quantity and amount

- Number of registered and active investors
- Total expired portfolio, broken down by financing destination.

The information disclosed to investors/lenders must comply with the following minimum characteristics:

- › Use clear and easy-to-understand language.
- › Avoid the use of superlative terms and value judgements.
- › Ensure that the information that is intended to be transmitted includes graphic or symbolic representations that facilitate its understanding.
- › Use a font size similar to the text of the main contents of the publications made through the platforms.
- › Include a section of frequently asked questions regarding the operation of the crowdfunding institution and the applications and projects published therein, as well as, where appropriate, the methods for resolving disputes or clarifications among the applicants, the investors and the crowdfunding institution.

7. Are there any particular consumer protection provisions that apply?

There are various consumer protection provisions that the platforms are obliged to apply and integrate. These include:

- › Personal information must be protected and kept private for only the client and the crowdfunding institution, attending normative compliance with the Federal Law of Protection of Personal Data in Possession of Individuals.
- › Facilitate clients (lenders and borrowers) to add or remove available funds in the online platform.
- › Strict policies for segregation of accounts.
- › Disclosure of risks of applicants/borrowers and the platform itself (e.g. if the platform does not explicitly tell the lender that the investment is not guaranteed, then they must pay damages that may occur).
- › Obtaining express consent from clients to assume the risks related to participating in a crowdfunding.
- › They must inform lenders about the borrowers' performance.
- › They must establish mechanisms of skin in the game (e.g. invest own money on borrowers).
- › Prohibition to ensure returns or guarantee the success of investments.
- › Disclose criteria that the platform used to select borrowers and loans.

Also, the Fintech Law enables users to file complaints against crowdfunding institutions before the National Commission for the Protection and Defence of Users of Financial Services.

8. Please provide any additional information you feel is important to understanding the regulation of peer-to-peer lending in your country.

The Law is based on six guiding principles: 1) financial innovation and inclusion; 2) consumer protection; 3) promotion of competition; 4) preservation of financial stability; 5) prevention of money laundering; and 6) technological neutrality.

The regulation can be summarised in the following elements:

- › Solvency and operation requirements:
 - Minimum and net capital.
 - Investment and financing limits.

- Limits for reception and delivery of cash.
 - Accounting regulation, financial information and valuation.
 - Methodologies for evaluation and qualification of applicants and projects
 - Mandates or commissions.
 - Proof of knowledge of risks for investors
- › Robust regulation framework in the following topics:
- Use of electronic means.
 - Provision of third-party services.
 - Security of information and operational continuity (plan against technological risks).
 - Application Programming Interface (API).
 - Anti-money-laundering/Know Your Customer policies.
- › Regulatory sandbox

10. Please identify a point of contact at your firm for enquiries related to peer-to-peer lending.

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