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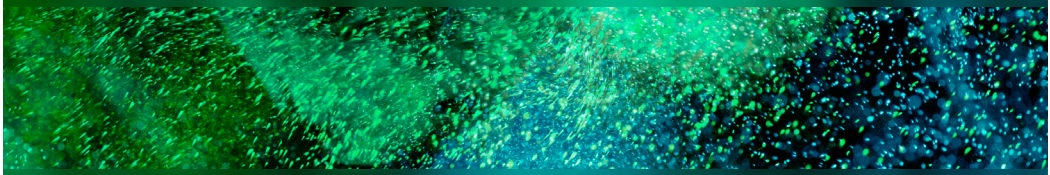

APPENDIX 1
SUMMARY OF BEST PRACTICES

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Clifford Chance and the EBRD have conducted an in-depth review of certain key jurisdictions to assess the different approaches taken to managing the development and regulation of crowdfunding platforms. Through this review, we have identified important differences, trends, and commonalities between jurisdictions and their approaches to regulating crowdfunding platforms.

This companion guide is designed to accompany our report "*Best Practices for Regulating Investment-Based and Lending-Based Crowdfunding*", and sets out our key recommendations given in the report. The full analysis underpinning these recommendations can be found in the main report, along with a description of our approach, and broader considerations which should be borne in mind when considering our conclusions.

It is important to acknowledge the backdrop to any regulatory framework for crowdfunding. It may, therefore, be appropriate to identify and address certain pre-existing contextual elements which present barriers to the development of crowdfunding in a given jurisdiction. In addition to the regulatory framework governing lending-based and investment-based crowdfunding, we have taken into account the views of a number of regulators and platform operators active in the jurisdictions examined. What constitutes a best practice for the regulatory framework applicable to crowdfunding in any specific jurisdiction must necessarily take account of, and be informed by, the broad context particular to that jurisdiction. Consequently, there is unlikely to be a single regulatory framework that provides best practice for all jurisdictions and all contexts.

Furthermore, it is clear from the range of platforms surveyed that there is a significant degree of variation in operating model even between crowdfunding platforms of the same type. A key design principle which has been reiterated by a number of regulators and platforms is the need for flexibility within the regulatory framework to accommodate this variance. In this vein, we make a series of recommendations which draw upon best practices identified from across jurisdictions on the following principal themes: (i) type of authorisation(s) required for the operation of platforms; (ii) capital and liquidity requirements; (iii) KYC rules and AML checks required; (iv) maximum size of offer/loan; (v) maximum investable amount; (vi) consumer protection measures, including type of investor disclosures; (vii) risk warnings; (viii) due diligence/pre-funding checks.

In conducting our analysis, we have identified commonalities which we consider should be treated as "mandatory", and others which are "additional tools" to be employed in regulating platforms. These are set out here, in full.

Mandatory Best Practices:

Area	Best Practice
Authorisation and licensing	• The financial services regulator should be required to authorise the operator of a crowdfunding platform. • Whilst it is possible to tailor jurisdictions' existing authorisation regimes for lending and investment services to regulate crowdfunding platforms, the platform operator authorisation framework would ideally be a bespoke regime. • Authorisation of a platform should: (i) indicate whether it is for a lending-based or investment-based platform, and (ii) be made by reference to product categories and investor types, e.g. institutional or retail investors. • Where an existing authorisation regime is to be used, it should be adapted to take into account the nature of crowdfunding business. Unduly burdensome requirements should be identified and eliminated or mitigated. • The assessment of an operator should be based on criteria prescribed by the financial services regulator. These criteria should focus on the platform's: (i) safety, (ii) soundness, (iii) proposed systems, (iv) controls, and (v) personnel. The assessment of the operator should be tailored to the platform type, a well as product categories and investor types. • Product categories and investor types should not be unduly narrow and any proposed expansion of product categories or investor types by the platform should require further regulatory approval. • Where existing platforms are already operating, the introduction of the authorisation regime should be managed over a transitional period.

Area	Best Practice
Ongoing administration plans	• Platforms should be required to put in place a credible ongoing administration plans. • Platforms should have flexibility to determine the measures to be taken as part of their ongoing administration plans. This should be on the basis of achieving given outcomes prescribed by a regulator. These outcomes should provide guidance in the form of an indicative and non-exhaustive set of suggested measures which may be taken. • When a platform originates an investment, it is necessary to draft ongoing administration plans and the measures required for their involvement. • Platforms should submit ongoing administration plans to the financial services regulator, who will assess their credibility.
Minimum prudential standards	• The financial services regulator should require minimum capital requirements for both investment-based platforms and lending-based platforms. • Alternatives to capital should be permitted, e.g. insurance or guarantees. • Additional capital requirements should be based on the nature and scale of the activities undertaken by the platform and commensurate with their attendant risk. • If a platform must remain functional with respect to investments it has originated, any additional capital requirements should relate to the extent that the platform needs to play a continuing role following investment.

Area	Best Practice
Systems and controls	• Platforms should be required to maintain such systems and controls as are necessary for their business. These systems should identify, manage, track, mitigate and report risks within and to their business, including operational risk, cybersecurity, protection of personal data and the risk that the platform may be used in the furtherance of financial crime. • These risks should be identified, managed and tracked by platforms themselves as part of their overall risk management framework • Financial services regulators should perform periodic and *ad hoc* assessments to ensure that outcomes are being achieved and platform systems and controls are adequate. This could be as part of their usual supervisory function, a thematic industry-wide review or as a result of any specific concerns.
Employees/ officers	• Platforms should be required to have suitable processes to ensure that their employees and officers are fit and proper relative to their roles. • To ensure that senior management has proper oversight and control of the activities of the platform, the platform should require senior management to be suitably experienced and qualified. • Financial services regulators should conduct an assessment of senior management to satisfy themselves of experience and qualification as well as the effectiveness of its oversight and control. This could be as part of its usual supervisory function, a thematic industry-wide review or as a result of any specific concerns. Guidance on criteria for suitable qualification, for example relevant skills, knowledge and experience, may be published by the regulator. • Platforms should be required to ensure that employees/officers have appropriate training and are made aware of their roles, responsibilities and any policies and procedures that apply to them. What training is appropriate would fall to platforms to determine. • Financial services regulators should perform periodic and *ad hoc* assessments to ensure the adequacy of training. This could be as part of its usual supervisory function, a thematic industry-wide review or as a result of any specific concerns.

Area	Best Practice
Record-keeping	• Platforms should be required to retain records of the business they undertake, including all contracts entered into, and all transactions and services. • The records retained must be sufficient to enable the relevant financial services regulator to monitor and supervise the platform's compliance with the regulatory regime. • There should be a minimum retention length to be determined by the financial services regulator. However, the platform should provide sufficient records for the financial services regulator to investigate compliance. Record-retention should run from the end of the relevant relationship or following the completion of the relevant investment.
Outsourcing	• Platforms should be permitted to outsource functions, subject to taking all necessary steps to avoid undue risk when outsourcing functions to a third-party. These steps should include: (i) putting in place an agreement with the third-party establishing respective responsibilities, (ii) having appropriate resources to monitor and manage the outsourced functions, and (iii) maintaining the ability to insource the functions in case of third-party failure or deficiency, when functions are critical to the performance of the platform and its business. • Platforms should be prohibited from outsourcing critical functions where to do so would (i) materially impair the ability of a regulator to monitor the platform's compliance with its regulatory obligations or (ii) result in the platform becoming a "virtual entity". These critical functions include management and risk functions of the platform.

Area	Best Practice
Conflicts of interest	• Platforms should be required to identify, manage, mitigate and report conflicts of interest that arise between the platform and a client, or between clients of the platform. This may be done by balancing the potential risk of conflicts with the benefits of allowing the investment. • Platforms should be required to have a conflicts of interest policy which is reviewed regularly and made easily available to clients, e.g. on the platform website. • Platforms should be required to disclose to clients how the fees and costs associated with investments on the platform are earned/levied. • Platforms should disclose potential conflicts of interests to platform participants. • Employees/officers (and their close family members) should be prohibited from investing in investments offered via the platform.
Disclosures to clients about the platform	• Platforms should be required to make certain information about the platform available to clients. This includes: (i) basic details about the platform, e.g. its legal name, contact details and regulated status, (ii) the platform's conflicts of interest policy, (iii) how client-assets and money are safeguarded (if relevant), (iv) how clients can make complaints, (v) how the platform earns its revenue (particularly with a view to identifying any conflicts of interest), and (vi) the nature and extent of the due diligence it undertakes in respect of borrowers/issuers. • It is not necessary to mandate the means by which such information is made available but it should be easily accessible and written in a way which is fair, clear and not misleading. The financial services regulator may, however, provide a non-exhaustive "menu" of communication channels which are acceptable in a given jurisdiction, e.g. a dedicated web page, or email communication. • Platforms should be required to disclose to clients the fees and costs associated with the investments they make/offer on a platform prior to such an investment being made or offered.
General Principles	• Platforms should be required to pay due regard to the interests of their customers, treat their customers fairly and communicate with clients in a way that is fair, clear and not misleading.

Area	Best Practice
Risk warnings/ disclosure to investors	• Prospectuses should not be required for investment-based crowdfunding (with the parameters of the exemption to be determined by the financial services regulator in line with existing exemptions from prospectus requirements). This does not obviate the need for disclosure, the level of which should be commensurate with investor sophistication. • Financial services regulators should have the ability to require certain information to be provided instead of a prospectus. Investors should have sufficient information to make a reasonable assessment of the likelihood of repayment or return. Financial services regulators should test this information provision and provide guidance to this effect. • Platforms should be required to provide risk warnings to investors regarding the nature, and the key risks, of an investment as well as how the platform has assessed the risk. We take the view that the risk warnings that the FCA sets out provide a good base level of disclosure. • Risk warnings should be clear, fair and not misleading, and should be prominently displayed. • Given their importance, platforms should be required to display risk warnings to investors at least at the inception of the relationship and, at least, prior to each investment made thereafter. • Risk warnings should be tailored to the relevant product category, whether loans or securities. Such warnings should be generic and not individualised to a particular customer, but rather to a customer group. As a minimum, this should amount to a distinction between retail and institutional customers, but may reflect existing customers' segmentations in the relevant market. • Financial services regulators should provide guidance on the information to be included in risk warnings without prescribing precise wording. • For certain fundamental risks (such as that an investor may lose some or all of its investment), the financial services regulator should provide standardised wording to ensure consistency across platforms.

Area	Best Practice
Differing treatment of retail investors vs. institutional investors	• Platforms should not be permitted to maintain structures that would result in higher-quality investment opportunities being made available to one class of clients (e.g. institutional investors) to the detriment of another class (e.g. retail investors). • Platforms should provide information which is suitable to the needs of its clients in general. We do not consider that mandating identical information requirements for all clients is appropriate, nor do we recommend an individualised approach to each client. Rather, a commensurate level of information provision based on each customer category should be mandated. This should be outcome-based and left to platform discretion as to how customers are appropriately informed, but subject to review by the regulator and sanction in the event of failure.
Investor suitability	• Financial services regulators should set certain categories of investor based on factors that may include investor knowledge and experience and/or investible assets/income. These categories could be designed by reference to existing financial services categorisation approaches (if appropriate). • Categories should not be overly complex (they could be as simple as retail and non-retail). • Platforms should be required to assess investors and categorise them in accordance with the categories set by the financial services regulator. • Platforms should be permitted to re-categorise if the investor's knowledge and experience change. • Once investors are categorised, applicable investor protection measures should be tailored accordingly, (e.g. information and communication restrictions), with limits to the amount able to be lent to retail investors (if deemed appropriate by the financial services regulator).

Area	Best Practice
	• Platforms should be required to take into account the client categories to which it provides services. This includes overall platform design, (e.g. investment process), information availability, content, and availability of support. In broad terms, the ease of access to information, (and the extent to which detailed investment information is provided), should be determined by the degree of sophistication of the investor.
Due diligence on investments or borrowers / issuers	• Platforms should be required to disclose clearly to investors the level of due diligence that has been performed (with a focus on investor understanding including how the platform has assessed the risk of the investment).
Restrictions on product type	• Financial service regulators should authorise the scope of activities offered by platforms by reference to product.
Contracts	• Platforms should be required to put agreements in place with their clients, setting out the relationship between the platform and the client. Such agreements should set out at the minimum the key terms, including (i) the parties, (ii) the nature and duration of the relationship, (iii) a description of the services provided and any limitations thereto, (iv) fees and costs to the investor, e.g. interest payments in the case of loans, (v) any rights to complain, and (vi) appropriate risk warnings. • In the case of both investment-based and lending-based platforms, platforms should be required to take reasonable steps to ensure that transaction documentation is (i) legal, (ii) valid, (iii) binding, and (iv) enforceable, or otherwise make clear the risks of non-enforcement assumed by the investor.
Loan enforcement	• Lending-based platforms that intermediate between lenders and borrowers should be required to have arrangements or to make arrangements for the enforcement of loans on behalf of platform investors whether by the platform or by a third- party on behalf of investors. • These arrangements should be described to both borrowers and lenders and any additional costs of enforcement disclosed. Where the platform itself may be a lender, should regulations permit platform co-investment, this may give rise to a conflict of interest. Such conflicts should be managed in accordance with the platform's conflicts of interest policy.

Area	Best Practice
Diversification	• Investor disclosures should include information on the importance of diversification of investments. • Platforms should be permitted to offer automated diversification tools that should be made available and recommended to clients at the outset. Diversification tools should only permit platform discretion where asset management and/or investment advice is also authorised.
Default funds	• Platforms using default funds should ensure that default rates published to investors remain accurately described; the default fund should not be used as a means of obscuring actual underlying default rates. • Platforms using default funds should accurately describe: (i) how and when the default fund will pay out (and when not), (ii) how the default fund is funded, (iii) the funding level. • Default funds should be held in a way which ensures that they are ring-fenced from insolvency of the platform.
Client-assets	• A framework should be established to ensure that client money and client assets are protected on the insolvency of a platform. • Platforms permitted to hold or handle client money or client assets must do so in a way which ensures the protection of such client money or client assets in accordance with the relevant framework. • Platforms holding client money should be required to hold that client money with an appropriately authorised entity that is sufficiently insolvency remote from the platform.
Cooling-off periods	• Some form of "cooling off period" should be offered to (at least retail) investors in both lending-based and investment-based platforms. • The precise parameters of such period should not be mandated, but any required period could be relatively short, e.g. 48 hours, as in the DIFC regime. • A required "cooling-off" period could be curtailed at a certain point in the investment timeline where withdrawal could prejudice other investors or lead to undue uncertainty, etc.

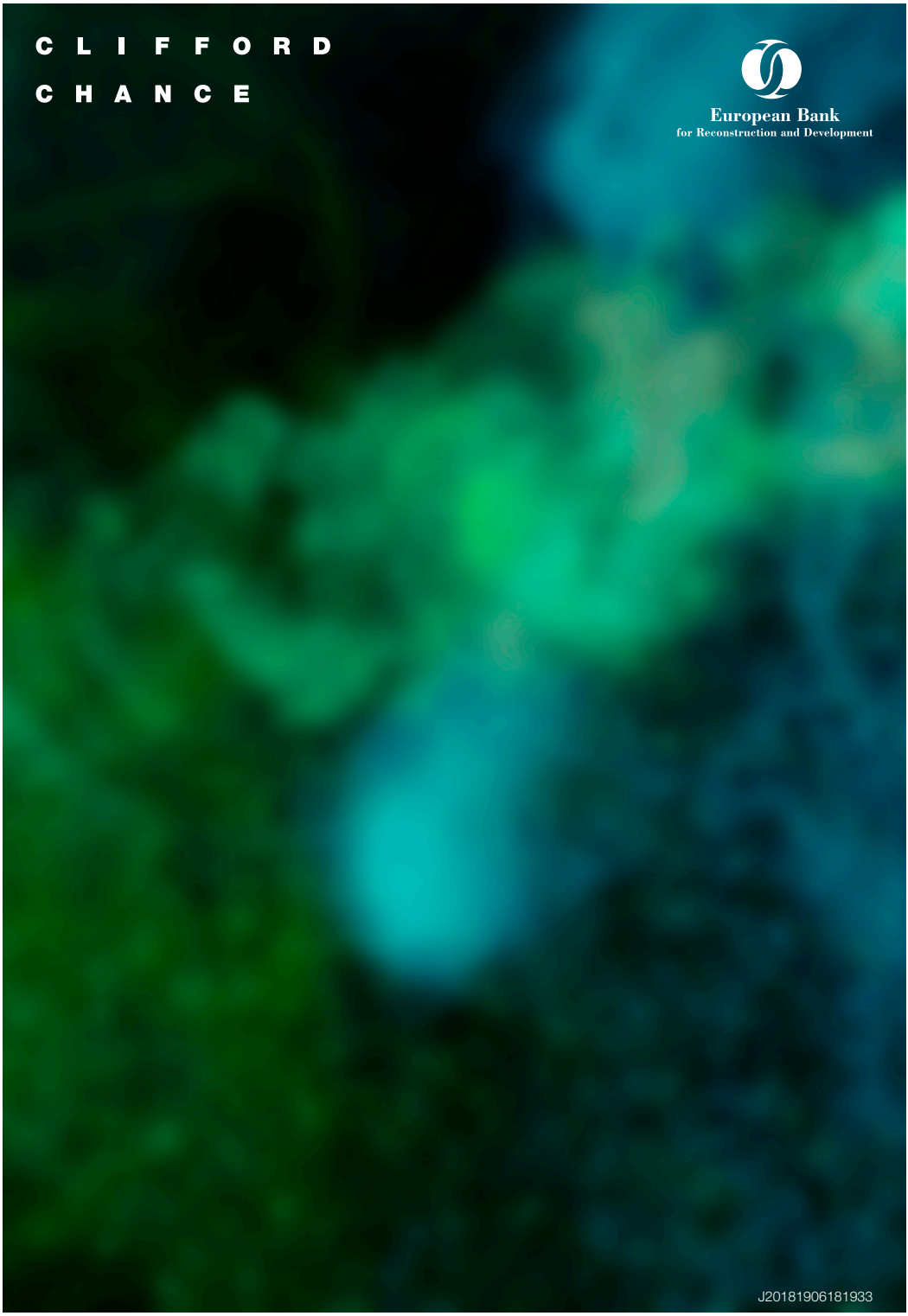
Area	Best Practice
Post-investment arrangements	• Platforms should be required to provide information to investors which includes a clear and understandable explanation of the investor's post-investment rights. • Investment-based platforms should be required to disclose to investors the implications of the platforms' arrangements for holding the shares and exercising the rights.
Market abuse	• A market abuse or similar framework should be established that covers at least fraud and the dissemination of false or misleading information in relation to investments offered through a crowdfunding platform. This may be narrower in scope than regulations which are generally applicable outside of the crowdfunding context.
Countering financial crime	• Platforms should be required to perform customer due diligence checks on all clients. • Customer due diligence checks should be tailored to a risk-assessment performed by the platform using guidance set by the financial services regulator. Guidance should be based on the factors that may be taken into account when formulating an appropriate customer due diligence process. More enhanced due diligence could be applied subsequently based on risk factors such as size of transactions, source of funds, etc. • The risk-assessment and guidance should take account of client and activity type. This need not be tailored to each individual client but rather risk categories. These categories could be designed by reference to existing financial services categorisation approaches (if appropriate), set by the regulator. • Platforms should be required to perform a certain level of ongoing monitoring commensurate to risk of both its customers and transactions in order to identify suspicious activity. • Platforms should be required to promptly notify financial services regulator (or other appropriate authority) in the event that it identifies any suspicious activity.

Area	Best Practice
Regulatory engagement	• Platforms should be subject to a general obligation to deal with regulators in an open and cooperative way and should disclose to the regulator appropriately anything relating to the firm of which that regulator would reasonably expect notice. • Platforms should provide specific reporting as set out below: (i) Regular reporting on key metrics to be specified by the financial services regulator with a view to identifying either systemic or idiosyncratic risk. For example, this might include reporting on capital, level of default fund, number and type of complaints, etc. (ii) *Ad hoc* reporting on specific eventualities to be specified by the regulator with a view to identifying either systemic or idiosyncratic risk. For example, this might include cyber-breach, platform failure, breach of regulatory rules, client-money reconciliation breaks.
Shaping the market in favour of SME Investment	• No specific best practice. These tools have been used by jurisdictions to shape their regimes towards (or away from) certain market participants. The use of these tools will heavily depend on the aims and desired outcomes of a particular jurisdiction's crowdfunding regime. The starting point should be the macro-level design considerations.
Ability of investors to dispose of / transfer their investment	• Platforms should be required to ensure disclosures or risk warnings to investors address the liquidity of investments. Such disclosures may be different for retail investors vs. non-retail investors and retail risk warnings may require more description of any restrictions on the transfer/disposal of securities. • The duration of loans should be clearly disclosed to investors.
Barriers to entry for new platforms	• No specific best practice is recommended. However, market competitiveness is an important design principle and crowdfunding regulatory frameworks should not overly favour existing market participants over new entrants.

Additional tools:

Area	Best Practice
Record-keeping	• The financial services regulator should have the power to determine a minimum period for retention of records. • The financial services regulator should provide guidance of the types of records that platforms should be required to retain. These should include contractual arrangements and details of transactions at a minimum. The financial services regulator may also stipulate retention of correspondence relating to complaints, for example.
Outsourcing	• The financial services regulator should determine the scope of functions which are likely critical to the performance of the platform and its business. The regulator should also issue non-prescriptive guidance on the reasonable steps that platforms could take.
Conflicts of interest	• Platforms may be permitted to invest in investments offered by the platform, however financial services regulators should have the ability, (through powers of direction), to prohibit such investments, where the regulator identifies material risks to customer outcomes as a result of conflicts of interest.
Disclosures to clients about the platform, e.g. fees	• Financial services regulator should have the ability to require additional information to be provided.
Caps on investors	• While we recognise that caps can be an effective tool that helps restrict an investor's investment amount, we do not consider that it is best practice in all cases. Caps can hamper the development of the marketplace and bar suitable investments. • Financial services regulators should be permitted to introduce caps if they identify poor investment behaviours that are not sufficiently addressed by risk warnings/disclosures. • Caps could be applied to retail investors only (or to sub-groups within the retail investor category). • Any introduction of caps should have regard to the adaptation of the technical and operational build of the platform, i.e. time should be provided to adapt.

Area	Best Practice
Due diligence on investments or borrower/ issuers	• Financial services regulators should have the ability to require due diligence on investments and/or issuers/borrowers, when they consider it appropriate to do so. • Financial services regulators should have the ability to require platforms to make certain basic or standard form credit information on borrowers/investees available to lenders/investors or, at least, to provide lenders/investors an indication on how to obtain such information.
Diversification	• Financial services regulators should be permitted to require that platforms monitor investors' diversification and deliver risk warnings or engage with investors when they consider that the portfolio is not sufficiently diversified.
Post-investment arrangements	• Financial services regulators should be permitted to require that securities offered via crowdfunding platforms should have certain rights attached, e.g. voting rights or pre-emption rights (where the class of shares issued have such rights). • Other innovative tools, e.g. levels of minimum investment or required co investment by platforms should be permitted. From our review, these appear to be relatively untested, and financial services regulators would therefore benefit from consulting market participants on these measures prior to their adoption.
Buy-side vs. sell-side balance	• Platforms who set pricing must: (i) completely asses credit risk in a systematic and methodical way; and (ii) set prices to reasonably reflect such credit risk. • Use other transparency tools to aid investors to understand possible future returns on investment based on historical data, including default rates, with a clear indication that historical performance is no guarantee of future returns.
Ability of investors to dispose of or transfer their investment	• Policy makers may wish to consider making regulator provision for secondary market trading in the context of crowdfunding platforms.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