Crowdfunding Creativity

While it has its rewards in innovation, equity crowdfunding in Ireland can be risky for investors due to the lack of regulation in the industry.

Claire Lord, Partner, Mason Hayes & Curran

Conall Geraghty, Associate, Mason Hayes & Curran

Crowdfunding was thrust into the public spotlight in June 2014 when the Irish Central Bank published a notice alerting consumers to the fact that crowdfunding was not a regulated activity in Ireland. We look at the risks and opportunities for founders and investors of crowdfunding in an unregulated environment.

What is Crowdfunding?

Crowdfunding involves raising money from a large number of people to fund a business or project. It can be divided into two general categories:

1. Project crowdfunding involves providing supporters with fixed rewards for their contributions, usually on a tiered basis. Small contributions may merit personalised thank you messages, while large contributions may provide exclusive, early-access to the final product.

2. Equity crowdfunding and peer-to-peer lending involve supporters making a contribution by way of a fixed-rate loan or for a direct equity stake in the business.

Crowdfunding is a complement to, rather than a substitute for, other forms of funding, especially for early stage start-ups. Although some campaigns have enjoyed considerable success – Pebble notably raised over $10m to develop its smartwatch – such success stories remain the exception to the rule. Successful campaigns in the US raise, on average, about $7,000. Similarly, the campaigns with the greatest success rates in Ireland have targets of less than €10,000.

Regulation Required?

The project crowdfunding model is easy to understand. Investors receive a pre-agreed reward in return for their support. It is, in many ways, identical to any other online retail transaction in which founders and investors are protected by existing sale of goods regulation.

Equity crowdfunding is more complicated. Investments may involve loan notes, share options or other complex instruments. While seasoned investors will be comfortable with these forms of investment, smaller investors often do not receive advice on crowdfunding investments and may not understand the risks. For this reason, countries such as the US and the UK regulate equity crowdfunding to protect investors. Equity crowdfunding in Ireland, however, is largely unregulated.

Industry or Investor Protection?

Ireland's inaction has prompted competing calls between those seeking regulation to protect consumers and those resisting regulation to avoid stifling this still-nascent industry. The latter view seems to be prevailing among regulators and law-makers both in Ireland and at European level, as there appear to be no immediate plans for regulation.

The Irish government has acknowledged the role equity crowdfunding has to play in financing SMEs, but is conscious that Irish crowdfunding platforms have not yet matched international levels. For now, the Government and the Central Bank will continue to monitor developments in this area and engage with their counterparts at European level. The Commission, in its recent communication on crowdfunding within the EU, has also stated that it does not intend to come up with legislative measures. It will instead focus on raising awareness and encouraging best practice, but will continue to monitor the situation to see if further action is needed.

Risks and Opportunities

Lack of specific regulation is not of itself a bad thing, provided those involved understand the risks and opportunities. Indeed, the current environment presents a number of opportunities for founders and investors.

There are no restrictions on who may invest through equity crowdfunding in Ireland. This provides founders with a much wider pool of potential investors and, as a result, the ability to raise more funds than would otherwise be possible. This contrasts with the current position in the US where only "accredited" investors – individuals who satisfy the Securities Exchange Commission's financial means thresholds – may participate in equity crowdfunding. The US will move closer to the Irish position when the JOBS Act is implemented and restrictions on investing are relaxed.

Freedom of communication is another key benefit. Crowdfunding campaigns seeking less than €100,000, as is the case for most seed rounds in Ireland, are not required to have a prospectus. Furthermore, founders may use social media – a key factor to a successful crowdfunding campaign – without worrying about constantly including legal disclaimers. In the UK, the Financial Conduct Authority has recently raised concerns that social media posts do not include risk warnings.

Such advantages invariably come with a price and this price is paid by investors. The lack of regulation means that many investor-protection mechanisms are simply not available. For example, the Irish Central Bank's codes of conduct and client asset rules do not apply to crowdfunding platforms nor are investors protected by the deposit guarantee scheme or the Investor Compensation Act.

In summary, while the current environment gives start-ups a great opportunity to raise needed funding, investors contemplating an equity crowdfunding investment should take advice to understand the risks involved.