theguardian

New crowdfunding rules: implications for small businesses

If you're looking to crowd fund money for your business, find out how the new regulations might affect you

SMEs are increasingly looking at crowdfunding as a way of raising finance without dealing with bureaucratic banks and fickle investors. However, new rules by the Financial Conduct Authority (FCA), which came into force recently, regulate certain types of crowdfunding.

Crowdfunding involves raising finance by taking small investments, loans or donations from a large number of people. Depending on who you believe, the new FCA rules have either "taken the crowd out of crowdfunding" or "represent the right balance between the freedom to invest and investor protection".

Ironically, both those quotes come from the founders of crowdfunding businesses. With such a range of views, it's probably fair to assume that the FCA has got it about right.

What the FCA has done is to to regulate loan-based crowdfunding (also known as peer-to-peer lending) and investment-based crowdfunding.

Loan-based crowdfunding, as the name suggests, involves the lending of money. Investment-based crowdfunding usually involves subscribing for shares or some other form of securities.

Traditional pledge-based crowdfunding remains unregulated. So if you're looking to raise money by donation or rewards-based crowdfunding, you can breathe a sigh of relief. The regulations don't cover you.

The FCA believes that loan-based crowdfunding, often called peer-to-peer lending (P2P), is less risky than investment crowdfunding and P2P lending will be more lightly regulated. These regulations require P2P platforms to carry a certain amount of capital, to describe risks accurately and to have a resolution plan in place in case the platform fails.

These rules may raise costs and make P2P slightly less attractive in terms of lending rates. However, borrowers do not generally have to worry about the administration of multiple loans – this is all handled by the platform and their technology.

If you want to raise equity investment there is an additional layer to the loan-based rules. Generally these equity-based investments come from either "high net worth" individuals or investors who confirm they will invest no more than 10% of their net investible assets - this excludes their home, pension funds and insurance.

Most criticism of the rules has focused on this "10% rule". Compared to the existing legislation this rule actually expands the number of people that the crowdfunding platforms can promote itself to. But from a purist perspective, it restricts the crowd to a relatively narrow category of people and limits the amount of money the vast majority of ordinary people can invest.

The fact is that crowdfunding is here to stay but, like all investing activity, it isn't for everyone. The FCA noted that nobody who responded to their consultation argued with the statistic that between 50% and 70% of startup businesses fail, and numbers of respondents suggested the failure rate was much higher. Given that the FCA's core duties are to protect consumers and to promote competition in the interests of consumers, the balance it has struck is probably about right.

If you are looking to crowd fund money for your business, don't be put off. There are lots of crowd funders out there, the regulations should simply keep them on the straight and narrow.

Jonathan Thornton and Guy Wilmot are partners in the corporate and commercial team of Russell-Cooke LLP

www.russell-cooke.co.uk