

# The (new) Portuguese crowdfunding regime - European Regional Forum, July 2018

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The Portuguese crowdfunding regime was approved by Law no 102/2015, of 24 August 2015 and is regulated by the Portuguese Securities' Market Commission Regulation no 1/2016 of 5 May 2016 (applicable to investment crowdfunding).

However, the entry into force of this regime was conditional upon the approval of the applicable penalty regime, which only occurred in 2018.

With its definitive entry into force, there is already an initial public offering (IPO) in progress. This involves a Portuguese crowdfunding company dedicated to peer-to-peer lending. In this article we review the main features of this new legal framework and the associated contractual challenges.

## Types of crowdfunding

The Portuguese crowdfunding regime (PCR) defines crowdfunding as a type of financing directed to entities, activities and/or projects that are registered in electronic crowdfunding platforms (CPs) accessible online, funds being provided by one or more individual investors. Crowdfunding is divided into:

1. social/non-financial crowdfunding, in the form of  
:

(i) donation, in exchange or not of a certain asset attributed to the investor (donation-based crowdfunding); and

(ii) the provision of assets/services financed through crowdfunding (reward-based crowdfunding); or

2. investment crowdfunding, in the form of:

(i) acquisition of beneficiary's shareholdings, rights to dividends (*equity-based crowdfunding*);  
[1] and

(ii) loans and bonds remunerated with fixed interest rate(s) (loan-based crowdfunding).

Rules applicable to crowdfunding are those generally applicable to the underlying agreement that may be deemed as automatically terminated if a deadline is reached without obtaining the envisaged investment amount.<sup>[2]</sup>

## CPs registration and formalities

To start operating, donation and reward-based CPs must be registered with a public agency, the Economic Activities General Directorate (*Direção-General das Atividades Económicas*).<sup>[3]</sup> Equity and loan-based CPs must be registered with, and are supervised by, the Portuguese Securities' Market Commission (CMVM).

Pursuant to CMVM's Regulation no 1/2016 ('Regulation'), the CMVM may refuse a CP's registration if the documents are insufficient, incorrect or false and/or if it concludes that the directors of a CP's managing entity (ME)<sup>[4]</sup> good repute requirements are not fulfilled or the means/resources for the activity to be implemented or carried out are inadequate/insufficient.<sup>[5]</sup> Upon CMVM's registration, CPs shall have to be operating within 12 months, otherwise the registration may be suspended.

The adhesion of a beneficiary (individual or company) to a CP depends on the execution of a written agreement, which may be electronically signed and made available in the CP by its ME. The agreement must include a reference to the form/forms of crowdfunding, amount and deadline of the campaign and the financed project/activity.

The Regulation imposes on CPs duties:

1. to provide information to investors on the financed products/activities;
2. to hold confidential (non-public) information disclosed by investors and beneficiaries; and
3. to ensure compliance of conflicts of interest rules, namely preventing CPs' directors from acquiring financial interests in offers made available.

Prior to an offer, beneficiaries must provide the CP with information to be disclosed to investors (named the IFIFIC),<sup>[6]</sup> namely on the financed activity/product, the investment's estimated return as well as on any caveats on the investment risk of total or partial loss and the applicable tax regime.

To complete an offer's subscription, investors are requested to acknowledge their comprehension and agreement with the IFIFIC and other offer's conditions, namely on the involved risk and the relationship established with the CP and the beneficiary. They must also execute the underlying agreement, observing any applicable formalities.<sup>[7]</sup>

## Investment and offer limits

Each offer may only be available in one CP. Whilst the PCR refers that each social/non-financial crowdfunding offer is limited to a maximum of ten-times the global amount of the financed activity, the Regulation sets forth limits and legal specificities applicable to investment crowdfunding:

1. Investors/investments:<sup>[8]</sup>
  - €3,000 per offer; or
  - €10,000 considering all offers during a 12-month period.

Neither limit

applies to:

- (i) companies;
- (ii) individuals with an annual income of € 70,000 or more; and
- (iii) to some qualified investors, such as banks and other financing entities.<sup>[9]</sup>

## 2. Beneficiaries/offers:

€1m fundraising limit per offer or several offers within a 12-month period;

The fundraising limit is of €5m when exclusively directed towards subscription of companies and/or individuals with an annual income of at least €70,000.<sup>[10]</sup>

To ensure compliance with the limits referred to in investors/investments, investors must declare the amount invested in CPs in the last 12 months, or that any of the exceptions apply if such limits are exceeded.<sup>[11]</sup>

## Penalties

PCR's penalty regime was approved by Law no 3/2018, of 9 February 2018. The exercise of crowdfunding activity without prior registration qualifies as 'very serious infringement' (fines range between €5,000 and €1m); the breach of information and confidentiality duties or conflicts of interest rules as a 'serious infringement' (fines range between €2,500 and €500,000). 'Minor infringements' are the breach of other legal obligations not qualified as very serious or *serious infringements* (fines range between €1,000 and €200,000).

Other penalties may apply, such as the temporary interdiction of the activity or cancellation of a CP registration.

## Legal and contractual limitations and investors' protection

Concerning the acquisition of shareholdings through equity-based crowdfunding, offers of financial instruments<sup>[12]</sup> through CPs are qualified as financial intermediation activities when involving the reception and issuance of orders of securities' investors, which may exclusively be undertaken by financial intermediaries.

Since not all types of shareholdings qualify as financial instruments, and since CPs may be 'match-makers' between beneficiaries and investors, the PCR seems to enable financing through the issuance of non-financial shareholdings, thus creating a disintermediated alternative secondary market open to public investment.

It is, however, doubtful that this regime would be an option with regard to other sorts of vehicles such as quota companies which still represent the overwhelming majority of Portuguese companies where the capital is represented by quotas which are nominative and registered at the commercial registry.

In crowdfunding transactions, the identity and number of individual investors is unknown prior to the offer and pursuant to Portuguese Companies' Code (PCC), the acquisition of shareholdings through equity-based crowdfunding only seems possible through share capital increases in public offerings (*subscrição pública*) which are limited to share companies.<sup>[13]</sup>

The good news is that the transformation of quota companies into share companies, thus allowing access to this regime, is simple and inexpensive, as a rule.

Another challenge will be to align simplicity/dematerialisation commonly associated to crowdfunding investments and legal form constraints associated with underlying agreements, the creation of adequate security and ensuring investors' protection.

In Portugal, in the case of loan-based crowdfunding investments, the underlying agreement usually sets forth personal guarantees from the debtors/beneficiaries as well as bills of exchange issued by the beneficiary (or beneficiaries) and sometimes personally backed by their directors for protection of the investors in case of default or insolvency of the beneficiary,<sup>[14]</sup> being the MEs responsible for leading all credit recovery efforts and proceedings.

Furthermore, mortgages (on real estate assets and certain movable assets that are registered) are an alternative, since their creation is mandatorily subject to registration. Likewise, the pledge of shares and other movable assets may attract a form of registration and, as a rule, the pledged assets are kept by the pledgee to secure enforcement. In any case, these guarantees will give rise to significant stamp duty costs and registration fees.

An agreement secured by an in rem guarantee must be notarised and both mortgagees and pledgees should be identified as such in the security creation deeds so that they may benefit from priority enforcement with regard to other creditors in case of default or insolvency of a beneficiary.

As such, the way to have investors recognised as beneficiaries of in rem guarantees is to register them as holders of the secured obligations and corresponding guarantee, which, given the possible vast number of individual investors, may be complex.

Choices will have to be made, but right now crowdfunding is a very interesting option in Portugal.

## Final remarks

As a reaction to the difficulty of accessing more traditional ways of financing, crowdfunding has become a relevant reality to Portugal's business environment, enabling entrepreneurs and non-profits to find capital for a variety of projects.

The scale of CPs is still small as their activity is confined to national markets with little cross-border activity. This is mainly due to differences in national regulations, which increases transaction costs.<sup>[15]</sup>

As the most common type of crowdfunding beneficiaries are small businesses and CPs' MEs have to disclose to investors' information to undergo the relevant loan-selection. This means that securitisation could attract larger investment volumes and hence increase CPs scale and financed amounts.

## Notes

[1] Equity crowdfunding does not currently seem possible for the purposes of incorporation of companies since only fully-operating companies may qualify. However nothing appears to prevent a company being set up, with a low equity, starting operations and then being subject to a crowdfunding programme.

[2] The PCR provides that prior to any offer, the beneficiaries may define the offers as 'keep-it-all offers' or 'all-or-nothing offers'. The purpose is to allow (or disallow) the possibility of changing its conditions, namely regarding offer's amount and deadline extension. In the first case, if so initially communicated to possible investors, the offer may be changed and such fact notified by the CP's managing entity to investors as well as the deadline to cancel any envisaged contributions. In the second case, agreements are considered ineffective if amounts are not obtained until the campaign deadline and beneficiaries obliged to payback any amounts received.

[3] Ministerial Order no 344/2015, of 12 October 2015, as amended, and Ministerial Order no 131/2018, of 10 May 2018.

[4] Responsible for the *activity of intermediation of investment crowdfunding*.

[5] Minimum share capital of €50,000 and indemnity insurance coverage of at least €1m per occurrence and global amount of €1.5m for occurrences within one year or an equivalent guarantee.

[6] Article 16 of the Regulation and 17 of the PCR.

[7] The intermediation of payment transactions between investor and beneficiary is based on the provision of payment services (Article 4 of the Regime on Payment Services and Electronic Money). Thus, in their crowdfunding activities, MEs must retain authorised payment institutions or obtain an authorisation from the Bank of Portugal.

[8] Article 12(1) of the Regulation.

[9] Article 12(2) of the Regulation.

[10] Articles 12(2)(a)(b) and 19(2) of the Regulation. Investment crowdfunding offers limited to €5m are excluded from the standard and burdensome distribution public offerings regime. In this regard, IFIFIC substitutes the need of issuing a prospectus (Article 134 et seq of the PSC) in these offers.

[11] Article 17 of the Regulation.

[12] For example, shares of public limited liability companies (*sociedades anónimas*).

[13] Articles 85(1) and 87(2) of the PCC.

[14] Loan agreements under €2,500 are not subject to any formal requirement; between €2,500 and €24,999 have to be recorded in writing and above €25,000 through public deed or certified private deed, except otherwise provided for in special law.

[15] In this regard, please refer to legislative proposal for an EU framework on crowd and peer-to-peer finance, of 30 October 2017, which is part of the European Commission's priority of establishing a Capital Market Union (CMU) in the EU, coordinated by the Directorate-General for Financial Stability, Financial Services and Capital Markets Union.

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