Engagement Paper 5

The Public Offer Platform

July 2023

Contents

Public Offers & Admissions to Trading

This paper is part of the series of engagement papers on the new Public Offers and Admission to Trading regime. These papers set out our emerging policy thinking on how the FCA may use its rule-making powers under the new regime. Feedback on these papers is intended to create a dialogue between us and stakeholders which will inform further development of proposed rules, which the FCA will consult on formally during 2024.

Other papers in the series are available on the FCA's website:
www.fca.org.uk/markets/new-regime-public-offers-and-admissions-trading

The FCA is seeking comments and suggestions on our initial thoughts as set out in this paper

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Introduction

1. At present, the Prospectus Regulation ensures that, either when an issuer's securities are admitted to a regulated market or when a public offer of securities is made with a prospectus, an issuer must disclose all necessary information to allow investors to make an informed decision. It also applies liability to those responsible for the prospectus if misleading statements or material omissions occur. To meet these obligations and to mitigate the liability, issuers typically engage professional advisors such as lawyers and accountants to help prepare and provide assurance over the information it produces. A prospectus must be approved by the FCA, which provides further oversight of disclosure supporting a public offer of securities or the admission of securities to a regulated market.

2. By comparison, there is relatively little regulation or oversight that applies to public offers that are made outside of the current Prospectus Regime. Such offers can pose significant risks to investors e.g. if those public offers are fraudulent or highly speculative, which was the case with a number of mini-bond offers in the recent past. Meanwhile, for offers of securities by genuine smaller businesses seeking seed funding or growth capital, the full cost of producing a prospectus and FCA approval of such a document may be disproportionate for issuers and prospective investors. We think there is scope to improve regulation and create better-functioning markets that enable legitimate offers outside of markets by companies seeking to raise capital within a more proportionate regime. This would also provide more appropriate opportunities for investors who wish to take risk.

3. Following the Gloster Report, UK Listing Review and HM Treasury's Prospectus Regime Review, the Government is legislating for a new public offers and admission to trading regime (POATR) that allows for the regulation of public offers to be treated separately to admissions to regulated markets. Starting from a general prohibition on public offers of securities, the legislation provides exemptions for public offers made outside of public markets, which will not be subject to a prospectus requirement. However, the FCA will have powers to create rules for such offers. For larger offers made to the public, the key exemption allows for such offers to be made via a Public Offer Platform, the operation of which will be a new regulated activity and therefore be subject to FCA authorisation, rules and oversight.

4. Under the Public Offer Platform regime, we want to expand the opportunities available to retail investors, where they can invest with confidence, understand the risks they are taking and the regulatory protections that are provided. We do not want to restrict consumers if they want to invest, but we do want them to be able to access and identify investments that suit their circumstances and attitude to risk.

Summary of our approach to Public Offer Platforms

5. This paper sets out our initial thinking on the development of rules for the new regulated activity of operating a Public Offer Platform, under the new regime. Overall, our aim is that the framework we create for Public Offer Platform operators should ensure that:

a. sufficient due diligence and checks on companies are conducted to prevent fraud and facilitate genuine capital raising, which will strengthen investor protection and support market integrity for such offers
b. investors have sufficient, accurate, and useful information, on both the company and the securities being offered, to understand the opportunity and risks when investing in securities on a platform, and
c. companies can raise capital efficiently and effectively through such platforms, subject to appropriate scrutiny and transparency

6. Our approach to regulation of platform operators will reflect the fact that, based on the current crowdfunding market, offers made via Public Offer Platforms are likely to be largely directed at retail investors. We will also reflect the fact that the new public offer framework extends to non-transferable debt securities (mini-bond type securities) following the Gloster report.

7. A key consideration of our regulatory approach will be to focus on the risk of fraud and how to address the information asymmetry and risks that are inherent where smaller / non-publicly traded companies are seeking to issue securities to potentially less sophisticated investors, as well as the limited liquidity and transparency post-issuance.

8. Whilst we have presumed a largely retail investor base, we are also interested to hear if some business models may consider undertaking the new activity with a focus on companies seeking capital from professional investors, potentially as companies look to scale up beyond 'seed' funding. It would be helpful to understand what type of professional investor is envisaged in this circumstance.

9. These proposals are intended to further our operational objectives of consumer protection and market integrity. However, we are also mindful of the need to consider competition and therefore we are proposing a regime that would set a level playing field across all operators.

10. In addition, with the Financial Services and Markets Bill being granted Royal Asset, we note we are likely to be required in due course to consider our proposals in light of the secondary objective of international competitiveness and growth.

11. With regards to the wider growth agenda, whilst we recognise that additional regulation can be seen as a barrier to growth, we consider a well-designed regime that provides a well-understood but proportionate framework will provide confidence to the market and facilitate the attraction of capital investment as well as support the financial services that support that capital raising.

12. To minimise the cost to companies and platforms, where possible, we intend to harness existing industry best practice and / or standards that are tailored to the risks of this activity, while ensuring markets also work well for businesses seeking funding.

13. As a starting point, we are therefore focusing on a proposed regime that will impose requirements on platform operators in the following areas:

- Due diligence requirements, including systems and controls to ensure that platform operators undertake appropriate due diligence on companies and

prospective offers and that investors are clear about the due diligence that has been undertaken and the risks that remain.
- Disclosure requirements for platform operators to provide or ensure an company provides key information to ensure that investors get the information they need to assess the securities
- Liability for, and the potential for redress from, platform operators.
- The role of the financial services compensation scheme (FSCS).

14. We set out here our initial thoughts on how we will set rules in these areas to ensure they are effective and that the design and interaction of these rules promotes a regime which is workable and proportionate. Our intention is to focus any new rules on those elements of the operation of a Public Offer Platform which are either not appropriately addressed by existing rules (which could be extended to Public Offer Platforms) or where a specific approach is required in relation to Public Offer Platforms (e.g. by reference to the particular risks associated with the platform's role)

Questions on which we seek feedback

15. We would welcome views on the following questions based on the discussion in the remainder of this paper:

Q1: **Do you agree with our analysis of potential harm and the key outcomes we identify as a focus for regulation in this area? Is there anything else we should consider or prioritise?**

Q2: **Do you agree with the outcomes we are proposing for operators of the Public Offer Platform, including linking the Public Offer Platform with the work on consumer investments? Are there any other outcomes that we should consider as part of this work?**

Q3: **What due diligence is currently conducted by crowdfunding platforms, and should we consider certain existing practices or other due diligence approaches to inform our rules?**

Q4: **Do you agree with the scope of the due diligence requirements we are proposing? What estimates do you make on the costs of complying with these proposals?**

Q5: **Are there any alternative approaches we could consider when designing due diligence requirements?**

Q6: How do current platforms communicate the due diligence that has been undertaken? Are there any other ways in which the due diligence that has been undertaken could be communicated with investors?

Q7: What risks do these different approaches to due diligence create?

Q8: Do investors feel that they are currently getting the appropriate level of information around due diligence. What additional information do investors need around due diligence to make an informed decision?

Q9: Do you agree with our proposed approach to the disclosure of information under the Public Offer Platform regime? Are there further disclosures that investors would find useful?

Q10: Do you agree with the categories of information that we have proposed including as part of the disclosure regime? Are there other pieces of information that investors would find useful?

Q11: How do current crowdfunding platforms approach ongoing disclosures?

Q12: Do you agree with our analysis and preferred option?

Q13: Do investors feel that they are currently getting the correct level of information about the security they are purchasing or the company that they are investing in? What additional information do investors need to make an informed decision?

Q14: What information is needed by investors to be able to make an informed investment decision? How should this be communicated to investors?

Q15: What would be the anticipated cost of producing the disclosures outlined above? Are there any foreseeable problems in producing certain types of information?

Q16: Do you have any comments on our approach to liability under the public offer platform regime?

Q17: Do you have any comments on our proposed initial approach to setting requirements in relation to liability and redress?"

Q18: Do you agree that the activity of operating a Public Offer Platform should fall within the compulsory jurisdiction of the Financial Ombudsman Service?

Q19: Do you agree that the scope of FSCS protections should be the same as apply in relation to current crowdfunding platforms?

Q20: Do you agree with our approach or the alternative options that we set out, is there any other way in which these types of offers could be differentiated?

Harms we are trying to address

16. Seed funding and investment in early-stage companies are important components in the development of viable businesses. Currently 53% of crowdfunded companies are in the seed round of funding and 39% of companies are in the venture stage.

17. However, investment in companies at this stage is risky. Data from Beauhurst demonstrates that 1 in 5 companies that used crowdfunding platforms failed in the 10 years between 2011 and 2021, with only 18% of companies progressing on from the stage at which they sought funding.

18. There are also inherent information asymmetries for investors seeking to invest in smaller companies, as they may have limited track record and / or publicly available information on which to assess their prospects. This also provides an opportunity for fraudulent activity, whereby individuals set up a company and issue securities (whether transferable or non-transferable) with the intention of taking the capital raised out of the business or siphoning if off via related parties for personal benefit, rather than funding genuine commercial activity. Such schemes can result in significant or complete loss for investors.

19. These risks are present in the current investment-based crowdfunding space but will be more prominent due to the increased size of offers that it will be possible to make through Public Offer Platforms and due to the inclusion of non-transferable securities in the regime. The recommendations of the Gloster review also clearly anticipate greater regulation around the offering of non-transferable securities to the public.

20. Regulation cannot reduce high risks of losses or illiquidity, which are inherent in legitimate investments in start-up or smaller companies, but it can seek to ensure a robust gateway to prevent fraud and that investors have sufficient information to make an informed judgement of the risk / reward profile.

21. At the same time, non-transferable debt securities are being brought into scope of the public offer regime and an effective disclosure regime will need to reflect the challenges and particular risks that are contained within this market.

22. We are interested to understand how the market expects business models to develop with regulation, but our working assumption is that Public Offer Platforms will facilitate significant numbers of offers of securities in companies that are in the early stages of their development.

23. This business model could result in risks to consumer protection or market integrity. In summary, these include but are not limited to:

- **Investors being exposed to scams/fraud:** Investors may be at risk of exposure to fraud and investment scams, due to inadequate due diligence when platforms host investment offers and approve financial promotions.
- **Investors not receiving adequate or timely information on which to base their investment decision.** Investors in these types of investments will receive significantly less information about their investment compared to more traditional investment products. Companies may not have audited financial statements, which further increases the information asymmetries between the company and the investor.
- **Investor loss:** Investors do not understand the risks to which they will be exposed. Investing in early-stage companies is a high-risk activity, and as such, these high-risk investments should only be invested by those who understand both the risks and opportunities. Even when the risks are well understood, these smaller offerings tend to be higher risk than large, better supported offerings in the public market. Investing in high-risk propositions comes with the risk of losing some, or even all, of the initial investment.
- **Investors being unable to sell the securities and recover their investment** High-risk investments typically offer lower levels of liquidity than mainstream investments, so, particularly if something has gone wrong and performance has not met expectations, getting access to the initial investment may be difficult. High-risk investments are suitable for a minority of consumers, so are likely to be less actively bought and sold by investors than mainstream products.

Q1: **Do you agree with our analysis of potential harm and the key outcomes we identify as a focus for regulation in this area? Is there anything else we should consider or prioritise?**

Existing regulation

The Prospectus Regulation

24. Under the existing prospectus regime, it is a criminal offence to make a public offer or to request admission of transferable securities to trading on a regulated market without an FCA-approved prospectus, unless a relevant exemption applies. The regime includes detailed content requirements for prospectuses and a statutory liability regime.

25. In practice, at present many companies make use of relevant exemptions to make public offers without an FCA-approved prospectus. These include offers of transferable securities to less than 150 investors, offers to Qualified Investors, and offers in denominations above 100,000 EUR. A consequence of these exemptions is that they generally result in offers being made to institutional investors only.

26. Companies may also make public offers up to a total consideration of €8million over a 12-month period without producing an FCA-approved prospectus. This exemption allows companies to make offers of transferable securities (such as transferable 'mini-bonds') directly to retail investors or via existing investment-based crowdfunding platforms without an FCA-approved prospectus. It also effectively 'caps' these offers to below €8m given the cost and time required to produce a prospectus.

Investment-based crowdfunding and financial promotions

27. In the UK, the FCA regulates investment-based crowdfunding. Many of the rules relating to this type of crowdfunding came into force in 2014. Operating an investment-based, crowdfunding platform does not currently constitute a standalone regulated activity in the UK. Instead, it is addressed by existing regulated activities under the RAO, including "arranging (bringing about) deals in investments" and "making arrangements with a view to transactions in investments".

28. Many of the rules associated with crowdfunding stem from our broad financial promotion rules. In 2022, we published PS22/10: Strengthening our financial promotion rules for high-risk investments and firms approving financial promotions. This included enhanced rules for those firms approving investment-related financial promotions and strengthening the customer journey around promotions of non-readily realisable securities.

29. At present, firms which communicate or approve direct offer financial promotions relating to non-readily realisable securities (including crowdfunding platforms) are subject to specific rules defining the consumer journey in COBS 4.12A. We will need to consider how those rules apply to offers made by way of the Public Offer Platform in the context of the new proposals which are discussed in this paper.

30. In considering our approach in this area, we are basing our proposals on an analysis of potential harm when we take account of this existing regulation.

How the regime is changing

31. As part of the [Edinburgh Reform package], the Government announced that it will maintain the right of companies to offer securities to the public without requiring them to be admitted to a stock market and at the same time will look to increase the capital raising options available to private (i.e. unlisted) companies, enabling them to grow their businesses quicker.

32. The government has therefore proposed to remove the current requirement for an FCA-approved prospectus to be published for offers of transferable securities with a total consideration of more than €8million. Instead, it will be possible for securities to be offered to the public in reliance on a number of exemptions, including if the offer is made through a platform operated by a firm specifically authorised for this purpose.

33. In connection with this, the government intends to create a new regulated activity covering the operation of an electronic platform for the public offering of securities. Under legislation, offers with a total consideration below a certain level are expected to be exempt from the public offer restriction. Offers above this threshold (£5m) will need to be made by means of a Public Offer Platform unless another exception applies.

34. This paper explores and discusses the policy options we have when designing the Public Offer Platform regime. We are seeking views on what that regime could look like, the policy choices that we face, and the rationale behind those choices.

Outcomes we wish to see

35. Ensuring good consumer outcomes in how the Public Offer Platform operates and interact with (retail) clients is our primary focus of the framework we will design.

36. In designing this framework we are seeking to balance giving investors access to higher risk, less liquid investment opportunities where it fits their needs or objectives and risk tolerance and creating conditions for effective capital raising through platforms by companies to support growth, subject to an appropriate regulatory framework that ensures confidence and investor participation in the market (i.e. preventing fraud).

37. This new regime aims to be consistent with the Consumer Duty and our strategy regarding consumer investment which are described below.

38. However, we also want to ensure that companies seeking to raise capital can do so in a cost and time efficient way. Therefore we will be mindful to ensure that any regulation is proportionate to the risks. We explore this further below.

The new consumer duty

39. In July 2022, we introduced a new Consumer Duty that requires firms to act to deliver good outcomes for retail customers. The Duty is made up of an overarching principle and new rules firms will have to follow.

40. It will mean that consumers should receive communications they can understand, products and services that meet their needs and offer fair value, and they get the customer support they need, when they need it.

41. Under the Consumer Duty firms will have many obligations to their clients. We anticipate that the following areas will be particularly relevant to operators of Public Offer Platforms (although every aspect of the consumer duty will apply).

- provide timely and clear information that people can understand about products and services so consumers can make good financial decisions, rather than burying key information in lengthy terms and conditions that few have the time to read
- provide products and services that are right for their customers
- focus on the real and diverse needs of their customers, including those in vulnerable circumstances, at every stage and in each interaction

Consumer investment/consumer journey

42. In considering the framework for the Public Offer Platform, we are linking this work with the consumer investment/ consumer journey work.

43. As indicated in our policy statement on an authorised fund regime for investing in long term assets, we consider investments in long term illiquid assets including securities in private companies, to be a viable option for investors with long term investment horizons. In considering this, investors should also understand and should be able to bear the risks of such investments, who seek the potential for higher long-term returns in exchange for less or no immediate liquidity.

44. As part of the consumer investment/ journey work, there is a much broader debate under way about how to reform retail investor access to investments, following the Edinburgh reforms. In that context, there may be further questions about how best to facilitate access for retail investors to investment opportunities, including higher-risk investments that can be appropriate as part of a diverse portfolio and / or where investors understand the risk / reward profile of such securities.

45. In line with the consumer journey framework, the objectives of this new regime will be to protect investors from scams, and unsuitable investments, and ensure that investors are receiving accurate and timely information to allow them to make properly informed decisions about the securities that they are investing in. Together, this should substantially mitigate the potential for consumer harm and protect market integrity.

Proportionate regulation and promoting competition and growth

46. At the same time we need to balance these outcomes with the cost of regulatory compliance for both companies wishing to use the platform and for the platform itself whilst also remove unnecessary barriers to entry to promote competition. We do not wish to cut access to the existing legitimate portion of the market, nor do we want to limit the capital raising opportunities for companies.

47. One of the key challenges is striking this balance between investor protection and market efficiency. This involves finding the right balance of disclosure and due diligence requirements to ensure that investors have the information that they need to make informed decisions, while at the same time minimising the burden on companies.

48. This also applies to platform operators who will provide the conduit between potential investors and companies seeking capital. It is important that we, as a regulating body, strike the right balance between regulating the platform operators, ensuring that they act in a proper way, but ensuring that they are not subject to unnecessary burden, so that the regulatory burden does not unduly discourage firms from operating Public Offer Platforms.

49. By finding this balance, we hope to encourage growth though companies being able to source appropriately priced capital to grow and develop and investors benefitting from their investment in those firms. We would also hope to promote growth in the supporting financial service sector.

Q2: **Do you agree with the outcomes we are proposing for operators of the Public Offer Platform, including linking the Public Offer Platform with the work on consumer investments? Are there any other outcomes that we should consider as part of this work?**

Proposed rules framework

50. For the purposes of the new regime this exemption from the public offer restriction will mainly be relied upon where an issuer:

a. seeks a broad, less sophisticated investor base (i.e. a significant proportion of individual investors classified as 'retail' clients) and
b. is seeking to raise more capital than is permitted under a separate proposed exemption in the regime, which will still allow up to £5m to be raised within a 12-month period outside the prohibition on the public offer of securities.

51. The new regulated activity covering the operation of an electronic platform for the public offering of securities may be attractive to existing platforms such as investment-based crowdfunding platforms. We anticipate that other types of firms (for example corporate finance firms) may choose to take up the permission. We therefore are keen to ensure consistency between the two regimes, where appropriate. We anticipate that other types of firms (for example corporate finance firms) may also choose to take up the permission.

52. Under the Public Offer Platform regime, liability for offers would primarily sit with platform operators who would be responsible for conducting proper due diligence and providing disclosure on offers hosted on their platform.

53. Under the current regulation of investment-based crowdfunding platforms, consumer protections for parts of the consumer journey are largely left to the discretion of platform operators to define, subject to general conduct rules such as those applying to financial promotions or arranging and dealing in investments.

54. We recognise the benefits of this approach where the regulated activity of "arranging" covers a wide range of activity across the market including that of crowdfunding platforms. However, for the more narrowly defined activity of operating a public offer platform", we believe creating a tailored regime will promote a level playing field for competition and deliver more consistent outcomes for consumers. Where possible, we propose to continue to apply existing regulation as indicated in the table below.

Table 1: Current broad conduct rules associated with investment-based crowdfunding

Activity	Description	Current Rules	Approach in new regime
Client (investor) onboarding	Ensure that the type of investment is appropriate for a client and that they understand the general features and risks associated with such securities	Existing appropriateness tests in COBS.	Apply existing rules and requirements
Company onboarding	Undertaking checks to ensure a business is legitimate	At the discretion of firms / Financial Promotion Rules	New rules
Campaign Setup	Undertake checks to ensure that communications comply with rules on content and disclosures	Discretion of firms / Financial Promotion Rules	New rules
Funding Round	The firm promotes the offer to its investor base	Discretion of firms / Financial Promotions Rules	New rules
Fund Collection	The firm will collect and process funds on behalf of the company	Existing Rules Apply	Apply existing rules and requirements

55. Our initial view is that the best way to address the potential harms arising from the activity, is to maintain the current framework but augment it with additional rules which will focus on:

a. due diligence performed by platforms in onboarding companies and assessing the securities to be offered; and
b. information and disclosures designed to inform investors of the key features and risks associated with offers of 'off-market' securities, typically by smaller companies.

56. The creation of a new regulated activity will in practice mean the FCA will authorise and approve all firms that intend to run a relevant platform by reference to the Threshold Conditions. This will include considering a firm's ability to comply with the specific rules that we choose to impose on the conduct of this activity and whether the firm has adequate resources to meet these obligations.

57. For the purpose of a new rule framework for Public Offer Platforms, our intention is that platform operators would be required to treat investors and prospective investors as clients for regulatory purposes. We do not envisage an approach equivalent to the current corporate finance regime under which prospective investors may be treated as mere 'contacts' where certain conditions are satisfied.

Embedding investor protections without a prospectus

58. In our Engagement Paper 1 on Admissions to Trading and Regulated Markets, we explained that under the existing framework, there are potential legal repercussions for companies which do not provide accurate or complete information in a prospectus. There is statutory liability under Section 90 of FSMA. The "persons responsible" for a prospectus are liable to pay compensation to any person who has acquired securities and suffered loss because of any untrue or misleading statement in the prospectus or the omission of any matter required to be included.

59. In addition, under Section 398 of FSMA, it is an offence for a person to provide the FCA with information which they know to be false or misleading, or to provide information recklessly which is false or misleading, in connection with, inter alia, an application for admission to the Official List or in compliance with any other requirement of FSMA.

60. In addition, a director may be liable in respect of information that is fraudulently or negligently included in, or omitted from, a prospectus.

61. It would not be proportionate to apply the same information or verification standards to offers made by way of a Public Offer Platform as would have been required in preparing a prospectus. However, we can use these three elements (disclosures, due diligence, liability) to create a bespoke regime that is appropriate to the types of securities that will be offered through the Public Offer Platform.

62. Further, by focusing on due diligence and disclosures, we also recognise that these two activities are interconnected. Good high-quality information, which is verified through robust due diligence by platforms, allows for investors to make informed decisions based upon defined key information that they can place confidence in when making investment decisions.

63. Also key to the public offer platform regime is appropriate liability and redress that ensure that consumers have access to appropriate redress where they suffer loss because of firms' failure to meet their obligations.

Due diligence

What we mean by due diligence

64. Due diligence (the checks made on a company seeking funding) is undertaken by platforms before hosting offers of securities and approving financial promotions. Even though these parts of the due diligence regime fall into two distinct parts, they complement each other, with proper due diligence before the hosting stage feeding into later due diligence on financial promotions that accompany the funding campaign.

65. Persons undertaking the new regulated activity of operating an electronic system by means of which a qualifying public offer is made will play a crucial role in a funding campaign by admitting companies to their platform and connecting potential investors and offers. Therefore it is essential that operators conduct proper due diligence on the companies and their offers that are admitted to their platforms.

66. By conducting proper due diligence, platform operators can ensure that the offers on their platforms are legitimate and that the funds raised will be used for the purposes stated in the offer. Platforms in this sense function as gatekeepers, and the due diligence they undertake acts as the first barrier to potentially unsuitable or fraudulent investments being offered via platforms.

67. Due diligence also helps to reduce information asymmetry between potential investors and companies. If due diligence is not conducted properly by the platform operator or not properly used to inform disclosure, investors may lack the ability or means to find this information and may make inappropriate investment decisions.

The current application of due diligence

68. Firms currently operating crowdfunding platforms need to ensure they have appropriate processes to manage risks in their business models, including by undertaking appropriate due diligence before enabling securities to be offered by means of their platforms.

69. Through our new rules and guidance contained in PS 22/10, we have strengthened the obligations on, and expectations of, firms approving investment-related financial promotions. These changes are particularly designed to mitigate the risks of firms approving financial promotions which fail to meet the standards of our rules. The extent and substance of the analysis and diligence needed to be able to confirm that a promotion is fair, clear, and not misleading will vary from case to case and will depend on the form and content of the promotion. Our rules are supported by non-Handbook guidance which sets out various implications of our rules, including in relation to due diligence.

70. However, our rules for operators of crowdfunding platforms are not currently prescriptive as to the level of due diligence required before securities are made available to investors, leaving it at the discretion of platforms to determine what is appropriate for that particular asset class. This has led to a broad range of approaches to due diligence emerging across the industry.

71. As we have discussed previously, many investors in this space are non-professionals and as such they lack the expertise, and do not allocate the time, to conduct proper due diligence on companies that have started funding campaigns. Some academic research indicates that many of the investors on crowdfunding platforms are so called 'free-riders' of investment decisions and support the campaigns that have the greatest number of backers (Vismara, 2016).

Creating a framework for effective due diligence

72. We believe this "gateway" due diligence is a key mitigant to fraud/scams as well as providing crucial information for investors in their investment decision. Therefore, we propose to mandate certain minimum standards that operators of Public Offer Platforms must meet when performing due diligence on potential offerors and their securities.

73. This would set a baseline expectation of the level of due diligence that we would require of firms operating a Public Offer Platform. However, we are keen to understand the cost of this proposal and impact on business models for both companies and platforms and whether the objectives of protecting investors could be achieved through alternative options.

74. In constructing these minimum standards for due diligence, we are considering the following areas that would address key risks in the types of securities to be offered on a Public Offer Platform:

- **The details of a company's incorporation and business registration**, as well as the identity and place of domicile of each director, officer, and controller of the company. This information can help to identify potential legal or financial risks associated with a company. This also gives an insight into the company's management and ownership structure, which is important to assessing a company's governance and decision-making processes. Overall understanding of a company's incorporation is critical for understanding a company's overall stability and is an early indicator of any risks that could emerge.
- **The fitness of senior management and key persons**, for example checking if there have been any director disqualifications. Checking for example, any director disqualifications is an important aspect of due diligence because it provides insight into the individuals who are responsible for making decisions for the company. If a director has been disqualified in the past, it can indicate a higher risk of similar occurrences in the future, and impact on the company's reputation – this can have a significant impact on company performance and the risk profile of the potential investment.
- **The financial strength and past performance of the company**, and if the company is a start-up, its financial projections. Financial projections provide an estimate of a company's financial performance. This information can be used to determine the potential value of the company as well as identifying any potential risks or challenges that may impact its performance. Additionally, financial projections can be used to compare the company's potential performance to that of other companies across the industry that they are operating in – providing insights into growth potential and informing disclosures to prospective investors.
- **The valuation of the company's business**, its current borrowing levels, and the source of any existing borrowing (if applicable). Due diligence around the valuation of a company helps determine fair value, which in turn can be used to assess the potential return of the security being offered including any differences between its valuation as part of the offering of securities and its current market value. Due diligence around valuations can also be used to compare with competitors, again providing insights into growth prospects and ensuring fair disclosures.

Q3: What due diligence is currently conducted by crowdfunding platforms, and should we consider certain existing practices or other due diligence approaches to inform our rules?

Q4: Do you agree with the scope of the due diligence requirements we are proposing? What estimates do you make on the costs of complying with these proposals?

Q5: Are there any alternative approaches we could consider when designing due diligence requirements?

Systems and controls needed for effective due diligence

75. When considering the requirements that we place upon firms, it is important that they have the correct systems and controls to undertake proper due diligence.

76. To ensure that firms have adequate systems and controls we are minded to broadly mirror the expectations we have outlined in CP22/27 for firms seeking permission to approve financial promotions. Under this regime, firms will need to demonstrate that they have adequate systems, controls, and processes in place to ensure that the promotions which they approve or create comply with our rules.

77. We would expect a large proportion of operators of crowdfunding platforms to apply for, and be granted, permission to approve financial promotions under the new gateway. In designing rules for the Public Offer Platform we will build on the financial promotions regime so that firms meet the standards we would expect with regards to systems and controls around both the due diligence performed when onboarding a security and the approval of financial promotions.

78. In addition to this, the new consumer duty requires firms to provide products that are right for their customers. Firms must take proactive and reactive steps to avoid causing harm to customers through their conduct, products or services where it is in a firm's control to do so. This includes ensuring that no aspect of their design, terms and conditions, marketing, sale of and support for their products or services cause foreseeable harm.

79. We would expect the first step, to achieving compliance with this requirement when offering securities to the public would be through proper due diligence and the onboarding of securities onto the platform. It is only through proper due diligence that platform operators can be aware of the risks associated with a security and whether these are appropriate investments for their clients.

80. This will mean in practice that we will look to ensure that the operator of a Public Offer Platform has the individuals, as well as the systems and controls, it needs to onboard securities, as well as approve financial promotions. This includes having sufficient individuals with appropriate competence and expertise, both to provide initial approval and then to monitor the compliance of an approved offer on a continuing basis as well as clear lines of responsibility for approving an offer.

81. In undertaking due diligence on an offer of securities on a Public Offer Platform, we would expect that operators take a risk-based approach to due diligence, considering not only the size of the offer, but also the structure of the security and the industry they are operating in.

The communication of due diligence

82. Communicating the due diligence that has been undertaken with regard to specific companies is the last step in the due diligence process and is important to allow the potential investor to evaluate what due diligence has been conducted on the company and the outcome of the verification. This is important as it allows a potential investor to understand what checks have been performed on the company issuing the security and what further due diligence could or should be undertaken by the investor.

83. We see different standards of due diligence communications across the crowdfunding industry, and we will create a bespoke framework that platform operators will need to adhere to.

84. Proper communication of the due diligence that has been performed also allows the investor to assess the risk that they may be exposed to when making the investment. There are several ways that we consider that a firm could communicate the due diligence that it has conducted.

i. Prepare a detailed written report

85. Platform operators could summarise the due diligence that they have undertaken in a written report that accompanies the funding campaign and the offer of securities. This could include such information as the scope of the due diligence undertaken, the methodologies used (including where third-party verification has occurred), results of the due diligence process and any conclusions that the platform operator has drawn from this process.

86. We would expect that this document should contain clear and concise language, which avoids the use of technical jargon. Key findings should be highlighted and the significance of these findings – allowing the potential investor to understand the importance of the relevant information to their decision-making process. In undertaking this, the report should also be transparent about the limitations of the due diligence process, highlighting where assumptions have been made and the limitations of the verification that has taken place.

87. We would also expect this document to be updated if there were any significant changes or developments.

ii. Prepare a due diligence attestation

88. Instead of preparing a detailed written report, we could require platform operators to prepare a due diligence attestation. This would complement their due diligence process by providing a signed record of the fact that the due diligence had been conducted and that the offer had been subject to the procedures outlined by the platform.

Q6: How do current platforms communicate the due diligence that has been undertaken? Are there any other ways in which the due diligence that has been undertaken could be communicated with investors?

Q7: What risks do these different approaches to due diligence create?

Q8: Do investors feel that they are currently getting the appropriate level of information around due diligence. What additional information do investors need around due diligence to make an informed decision?

Disclosures

Introduction

89. An effective disclosure regime should accommodate the different types of securities that can be offered through a Public Offer Platform while maintaining a coherent approach. This means that we do not necessarily wish to see a bespoke approach for each individual security that may be offered through a Public Offer Platform, but instead a framework that can be applied consistently across each type of security which ensures that investors are provided with the information they need to make properly informed investment decisions.

90. When investors are provided with clear and useful information, they can make informed investment decisions that are appropriate to their lifestyle, risk tolerance and investment goals. In creating a disclosure framework for offers made by way of Public Offer Platforms, we can meet this objective by setting appropriate standards that ensure consumers are supported in their decision-making.

91. In this section we discuss how disclosures will interact with existing reforms including what information consumers need and ongoing and initial disclosures.

92. In the case of a Public Offer Platform, there are potentially 2-3 strands of 'initial' disclosure.

- general disclosures on the services and products offered by the platform and the generic risks, typically informing a client's 'onboarding' decision.
- disclosure around the policies and procedures of the platform, which may include their due diligence approach as discussed elsewhere; and
- information specific to an issuer and its securities which enable an informed decision to be made in relation to a specific transaction.

93. We recognise that the first two strands of disclosures are covered by general rules and as such this regime will focus on specific information [provided by the issuer] about the issuer and the security that they are offering whilst supplementing general MiFID-derived rules where they already apply.

Reform of PRIIPs

94. At the same time as designing the regime for Public Offer Platforms we are also reforming The Packaged Retail and Insurance-Based Investment Products Regulation' (PRIIPs). We have always supported the aims of PRIIPs and continue to believe disclosure can support retail investors to make informed decisions. We have sought input from firms and consumers about the regime. This provided us with evidence that the one-size fits all approach taken by the PRIIPs Regulation was not conducive to good outcomes.

95. Even though PRIIPS does not cover shares in private companies, there are direct comparisons that we can make between the Public Offer Platform and this regime. As the framework for the PRIIPs regime is focused on the communication of information, we will be using this, and the lessons learnt, to help inform our approach to the public offer regime. This will ensure consistency of approach across a range of similar products.

The type of information that investors require

96. When investing in securities it is important for investors to have access to a wide range of information to make informed decisions. This falls under the third strand of disclosures that a platform can make: information specific to an issuer and its securities which enable an informed decision to be made in relation to a specific transaction.

97. As part of their compliance, firms subject to the Consumer Duty should support customers' understanding by ensuring:

- communications meet the information needs of customers,
- that these communications are likely to be understood by customers intended to receive the communication
- investors are equipped to make decisions that are effective, timely and properly informed.

98. Communications should be understandable by the intended recipients and enable them to evaluate their options by assessing the benefits, risks and costs associated with those options, and how those options relate to their needs and financial objectives.

99. Firms subject to the Consumer Duty will need to think more widely about the purpose of their communications, and the outcomes they are focused on, to meet our expectations under the consumer duty.

100. In line with our ongoing work on retail disclosures we will adopt a similar approach where the delivery of information is aligned with the consumer journey, ensuring information is provided when it will be most useful to consumers. It may be appropriate that disclosure is presented in a modular format so that the most valuable information for decision-making is disclosed to consumers earlier. We will consider any feedback to DP22/6 when preparing draft rules for consultation.

101. Where firms must communicate information to comply with other disclosure requirements (as is intended under the Public Offer Platform regime), they should consider what additional steps they can take to support consumer understanding. For example creating a summary or providing key information at the start.

102. In recognising that Public Offer Platforms will provide a primary market mechanism for offers of securities, it is important to look at the current information requirements under the existing prospectus regime as well as the current disclosure requirements for investment based crowdfunding platforms. Having regard to the requirements of both regimes will allow us to calibrate rules which are appropriate for offers made by way of Public Offer Platforms.

103. It is envisaged that in calibrating these rules we would impose more detailed requirements for disclosure than those to which crowdfunding platforms are currently subject, but which are lighter than the requirements under the prospectus regime.

104. Under the existing prospectus regime companies are required to provide investors with all the information necessary for them to be able to make an informed assessment as to the securities being offered or admitted to trading. The Prospectus Regulation and the PR Regulation specify the contents which companies need to include in the prospectus by way of necessary information.

105. However, this information may vary depending on the nature of the company, the type of the transferable securities and the circumstances of the company and whether the company's securities are admitted to trading, or seeking admission to trading, on a regulated market or an MTF.

106. By evaluating these distinct factors, investors can make informed decisions about whether an investment in a company is right for them.

107. We need to ensure a balance between providing information that is useful to a consumer in their decision making and not providing too much information which is either unhelpful and/or clouds a consumer's decision making. Too much information (particularly in regulated disclosure) can cause consumers to disengage due to information overload or be unable to decipher the most important pieces of information.

Q9: Do you agree with our proposed approach to the disclosure of information under the Public Offer Platform regime? Are there further disclosures that investors would find useful?

Q10: Do you agree with the categories of information that we have proposed including as part of the disclosure regime? Are there other pieces of information that investors would find useful?

Initial disclosures

108. We use the term "initial disclosures" to mean information that is provided to a potential investor prior to the investment decision being made. This may be information that is provided on a platform that is available to all potential investors or information that is only viewable by account holders. We anticipate that this information could include, but is not limited to, the information categories set out above.

109. The importance of initial disclosure is discussed in DP22/6, where we discuss anchoring bias whereby consumers tend to give more weight and prominence to information received at the start of the investment journey to that information received at the end of their research and the decision-making process. The information received in the initial disclosures plays an important part in ensuring that potential investors have the right information and at the right time to make an informed decision about the investment opportunity that they are considering.

110. For context, it is worth noting the disclosure regime under the Prospectus Regulation where there is a requirement to provide necessary information to enable an informed assessment of:

- the assets and liabilities, profits and losses, financial position, and prospects of the company and of any guarantor.
- the rights attaching to the securities.
- the reasons for the issuance and its impact on the company.

In addition, information that is required as part of the prospectus summary, must include:

- an introduction, containing warnings
- key information on the company
- key information on the securities
- key information on the offer of securities to the public and/or the admission to trading on a regulated market

Post-offer disclosures

111. Current crowdfunding platforms and the new Public Offer Platform are designed to facilitate primary offers. Against this backdrop this section discusses the need for ongoing disclosures requirements for the public offer platform.

Current practices

112. We note that crowdfunding platforms currently offer 'updates' through their platforms. However, where platform operators approve financial promotions relating to the offers which they facilitate, they will need to ensure they comply with their ongoing obligations to monitor the continuing compliance of approved promotions.

113. The absence of a continuing obligation to disclose information to investors could create a potential barrier for investors to monitor investments post-offer, in a context where there may be no easy means to find publicly available information directly and there is limited secondary market liquidity (i.e. there is no price discovery generated from regular trading of securities on a public secondary market).

Potential benefits

114. We seek views on the importance to companies and/or investors of ongoing disclosure by the company and seek views on the costs associated with that.

115. Ongoing disclosures give investors a clear and up to date picture of their investments. They can see how their investment is being deployed and how their investment is performing.

116. Regular disclosures help investors monitor the performance of their investments. They provide key metrics that can be used to evaluate whether an investment is meeting the expected goals and returns. These disclosures also provide information about any new risks or challenges that may affect the performance of an investment.

117. Ongoing disclosures also allow investors to make an ongoing informed assessment of their investment.

Q11: How do current crowdfunding platforms approach ongoing disclosures?

Q12: Do you agree with our analysis and preferred option?

Q13: Do investors feel that they are currently getting the correct level of information about the security they are purchasing or the company that they are investing in? What additional information do investors need to make an informed decision?

Options that we are considering

118. The options that we are considering are outlined below:

I – Creating a requirement of 'information needed to make an informed decision.'

119. This would allow platform operators to take a bespoke approach to each individual security that is offered through the platform.

120. Following this approach, it would be up to the discretion of platform operators, to decide on what information is to be provided to enable investors to make an informed decision, ensuing that it is in a clear and understandable format. Given the broad range of securities that could be offered through the platform regime it would be up to the platform operators to take a product specific approach and decide what information was needed for each type of security that might be offered through their platform.

121. As part of this approach, we would not necessarily mandate the types of information that were needed to make an informed decision and would leave this at the discretion of platform operators.

122. In adopting this approach, platforms would need to consider the information that they were providing to investors, ensuring that a potential investor had enough information to make an informed decision, without providing so much information that the investment decision became so complex that either the investor felt unable to make an informed decision or proceeded to invest without engaging with the information.

123. Such an approach would be consistent with some feedback, discussed in DP 22/6, that firms are best placed to know what information their customers want and need to make effective financial decisions, as they are closer to the investment process.

124. Alternatively, there is a view, contrary to the view outlined above, that there should be a prescriptive standard to ensure consistency for consumers and effective competition. We explore below two options for ensuring that there are set standards of information to ensure some degree of consistency in the information that is communicated to potential investors.

II – Outlining minimum requirements of information that should be provided to investors.

125. This would place a requirement on platform operators to disclose certain information that we consider necessary for investors to make an informed investment decision. However, this would be accompanied by a requirement for the platform to provide all other information needed to make an investment decision in line with the consumer duty. As a consequence, we would expect operators to go beyond this minimum requirement and provide further information where it is in the best interests of investors.

126. By outlining minimum standards, we would create a degree of standardisation and aid comparability. We recognise that comparability can be useful in many instances to enhance consumer understanding, support competition, and reduce manipulation of data or information gaming. However, across a potentially diverse market, we recognise such comparability may not be possible across different product types.

127. In adopting this framework, we accept that some information is more important to a potential investor than others. We seek feedback on what categories of information could be included in a minimum disclosure requirement. Please find a non-exhaustive list at the end of this section of the categories of information that investors might find useful.

128. It may be the case that there is certain information that is so essential to a consumer's ability to make an informed investment choice, that the method of calculation and presentation should be prescribed. For example, for a consumer to make an informed decision about an investment product, they should be able to understand the difference in cost structure or risk exposure between those investments that they may be considering. The prospectus regime contains similar provision to this.

III – Creating a bespoke disclosure document with specified information that needs to be provided to investors.

129. Creating a bespoke disclosure document would be the most prescriptive of options and would impose on platform operators a requirement to produce a bespoke and tailored document that contained specific information that would have to be disclosed to investors where an offer to the public is made.

130. However, although it may be appropriate for the Public Offer Platform, this approach goes against the outcomes-based approach to retail disclosures under the new consumer duty (although for such high-risk products this method of disclosure could be appropriate). In our approach to the consumer duty, we say that the introduction of flexibility can enable disclosures that are tailored to different product types and consumer groups, reflecting the changes in the distribution of investments.

131. In terms of the Public Offer Platform the bespoke approach could provide a standardised document that could be compared across competing platforms and could reflect the different types of securities that could be offered by means of the platform regime. This would also have the effect of standardising the information that is required from companies.

Types of information

132. This is a non-exhaustive list provided to promote discussion with regards to the options above. We seek feedback on the categories of information that would be useful to investors and the cost to platforms and companies of providing such information.

133. Some of the disclosure requirements, that we are considering, replicate the areas where due diligence should be conducted. This is intentional as these areas are crucial to both understanding the suitability of the issuer and information required to make an informed investment decision. We recognise that it is only through proper due diligence that meaningful disclosures can be made. In this context these two important parts of the public offer regime complement each other.

- **Company overview:** Basic information about the company including its background, objectives and the leadership team**.**
- **Financial Information:** Access to the company's financial information, which may include balance sheets, income statements, forward looking information, and cash-flow statements. These documents provide a snapshot of the company's financial health and performance and can help investors to understand the company's, revenue, expenses, and profitability.
- **Business Model:** A clear overview of the company's business model and its place in the market. This may include information on the company's target market, customer base, competitors and market trends and the opportunities that the company is looking to exploit.
- **Management Team:** The management team is a key factor in the success or failure of any company or project, particularly in the initial stages. Investors should be able to evaluate the track record of the management team, as well as their vision for the company including the overall strategy for achieving this.
- **Product or services:** An understanding of the product or service offered by the company including its place within the current market. It is also important to understand how the company is looking to generate revenue.
- **Market research:** Details of the market that the company is operating in, details of competitors and the growth potential for this segment.
- **Valuation:** How the company is valued, enabling a prospective investor to assess whether the valuation is reasonable in the context of the company, the market, and the growth and performance prospects.
- **Terms of the investment:** such as the type and structure of the security and the potential return, whether this is fixed in relation to a debt-based investment, or the prospects of the company if it is an equity security.
- **Exit strategy:** details of how the company intends to provide a return to investors. This could be through an acquisition, an IPO, or other methods.

- **Risks:** No investment is without risk and uncertainty, and it is important for investors to be aware of the potential risks and uncertainties they face. The risk profile of a product can inform consumer decision making and support them in purchasing a financial product that is appropriate to their risk tolerance and their financial aims. We would expect the transparent disclosure of risk which can build consumer trust in markets and financial institutions. Platform operators should be able to identify and communicate key risks and disclosures which are relevant to these risks.

Q14: What information is needed by investors to be able to make an informed investment decision? How should this be communicated to investors?

Q15: What would be the anticipated cost of producing the disclosures outlined above? Are there any foreseeable problems in producing certain types of information?

Our current preferred option for initial disclosure would be to either create a category of information needed to make an informed decision and/or setting out minimum requirements for information disclosure. This would allow platform operators to be flexible in the types of information that they disclose and the way that they disclose it whilst ensuring investors get the information that they need.

It is not our proposed approach to mandate a highly prescriptive offer document containing specified information. Our current thinking is that outlining minimum requirements would help us best meet the aims of the regime for enabling offers by means of Public Offer Platforms, whilst being proportionate to the needs of investors and the burden this will place on platform operators.

Further requirements

A new authorisations gateway and permission

134. HMT will amend the Regulated Activities Order to define a bespoke new regulated activity. This activity is expected to be described as 'operating an electronic system by means of which a public qualifying public offer is made'. Due to the nature of this activity, we would expect that applications would come from, but not be limited to, investment based crowdfunding platforms. We also recognise that other market participants such as corporate finance firms may also wish to undertake this activity.

135. A specific permission for platforms facilitating public offers which would otherwise be subject to the new public offer restriction will enable the FCA to frame specific rules and supervisory practices to ensure appropriate standards of disclosure, due diligence and verification apply in relation to the companies offering securities on such platforms.

136. A specific new permission will also give the FCA a 'gateway' check as firms will have to seek authorisation, or vary existing permissions, to conduct this new activity, with an expectation they would have commensurate management expertise, systems, and controls appropriate to this activity. There will also be a further benefit for the FCA's supervision of this activity of providing clearer data indicating which firms are conducting this activity, as opposed to other regulated activities which might otherwise be regulated as 'arranging.'

137. This will enable the FCA to supervise the offering of in scope securities in a consistent way, cognisant of industry trends and developments. The FCA could also consider tailored reporting requirements such that it has visibility on the number and values of offers being facilitated by such platforms to identify potential concerns.

138. For completeness, our initial thinking is that the new permission for operating a Public Offer Platform will not necessarily provide a 'one-stop-shop', covering all of the activities which the operator of such a platform might undertake. We expect that many platform operators will also require at least permission for the existing regulated arranging activities. For offers below the monetary threshold (at which an offer must be made through a Public Offer Platform unless another exemption applies), a platform will continue to be able to facilitate offers of securities in reliance on existing permissions.

139. The FCA is likely to introduce new chapters and amendments to the FCA Handbook and create an authorisations process for participating firms. Platform operators would have to seek authorisation or vary existing permissions to conduct the activity and the FCA will need to ensure that any applicant will satisfy, and continue to satisfy, the Threshold Conditions in carrying on the new activity.

Liability and redress

140. Liability and redress plays a crucial role in protecting investors. If a platform operator breaches the requirements and rules that we are considering in this paper, then this can lead to significant financial losses for investors.

141. Liability provides a mechanism for consumers to seek redress when they have suffered harm, such as incurring losses due to the actions of a firm. It allows consumers to seek compensation for damages.

142. This not only helps individuals recover losses caused by firms' non-compliance but also acts a deterrent against future misconduct.

Current arrangements for crowdfunding platforms

143. Investors who are unhappy with the service they receive from a crowdfunding platform have the right to complain. In the first instance, they should complain to the firm running the platform and, if unhappy with the response, they are able to take the complaint to the Financial Ombudsman Service. As part of existing rules within DISP 3.7, where a complaint is upheld by the Ombudsman, the Ombudsman can order that the firm pays redress to the investor.

144. Currently there is no express statutory liability attached to the issuer of securities on crowdfunding platforms equivalent to that under Part VI of FSMA.

How liability is evolving for prospectuses

145. Under the Prospectus Regulation, persons who are responsible for a prospectus are potentially liable to pay compensation to investors for loss suffered due to any untrue or misleading statement in the prospectus or the omission of any necessary information from the prospectus. This essentially therefore applies a negligence test to claims for compensation in relation to liability for prospectuses. A person is not liable for loss caused by a statement in a prospectus if they can show that at the time the prospectus was submitted to the FCA, the person reasonably believed that the statement was true and not misleading or that the relevant matter was properly omitted from the prospectus. The liability regime under section 90A of FSMA (liability in connection with published information), on the other hand, is essentially defined by reference to whether an issuer knew that a statement was untrue or misleading or was reckless as to whether it was untrue or misleading. We need to consider to what extent liability arises under the new regime and whether this is by reference to a negligence or recklessness standard.

Q16: **Do you have any comments on our approach to liability under the public offer platform regime?**

Applying this to the Public Offer Platform

146. "Section 138D of FSMA provides a broad right of action for damages for losses caused as a result of breaches of FCA rules. We will need to consider to what extent this right of action applies in relation to operators of public offer platforms in relation to statements made, and disclosures provided, about offers made by way of their platforms.

147. In this regard, we could consider whether to apply a defence to any claim for damages, for example, by reference to whether the platform operator can show that it took all reasonable steps to ensure that any statements were not misleading.

148. In any event, the offences in sections 89 and 90 of the Financial Services Act 2012 are relevant to issuers regarding misleading statements. It would be an offence for issuers of securities to provide misleading statements in relation to the securities that they are offering.

Q17: **Do you have any comments on our proposed initial approach to setting requirements in relation to liability and redress?"**

The Financial Ombudsman Service

149. The Financial Ombudsman Service is an informal and free alternative to the courts. It was set up by Parliament to resolve certain financial services disputes quickly and with minimum formality.

150. Under its compulsory jurisdiction (CJ), the Financial Ombudsman Service can consider a complaint if it relates to an act or omission by an authorised firm when carrying out a regulated activity (or one of the other activities specified in DISP 2.3.1R), or any ancillary activity (including advice) carried on in connection with such an activity. Operating a Public Offer Platform will be a regulated activity and, as such, unless we decide otherwise, complaints will be covered by the CJ.

151. Under the CJ, a complaint must be determined by reference to what is, in the opinion of the Ombudsman, fair and reasonable in all the circumstances of the case. This means that the outcome of a complaint referred to the Financial Ombudsman Service may be different to what a court would decide applying legal rules. However, under DISP 3.6.4, when considering what is fair and reasonable in all the circumstances of the case, the Ombudsman will take into account a range of factors, including relevant regulators' rules, guidance and standards. For example, our proposed rules for Public Offer Platforms.

152. When an Ombudsman decides to uphold a complaint, they can order the firm to make a money award to the complainant for an amount it considers gives fair compensation for the loss or damage suffered. An Ombudsman can also direct the firm to take such steps in relation to the complaint that it considers 'just and appropriate'. An Ombudsman's power to make money awards or issue directions does not depend on whether a court could award compensation or require certain steps to be taken.

> **Q18: Do you agree that the activity of operating a Public Offer Platform should fall within the compulsory jurisdiction of the Financial Ombudsman Service?**

The role of the Financial Services Compensation Scheme

153. We intend to replicate the current Financial Services Compensation Scheme (FSCS) protections that are available to investors who use investment-based crowdfunding platforms. FSCS protections in this area are limited and they are unable to cover poor investment performance.

154. As outlined in FS22/5, we remain open to exploring further opportunities to restrict the scope of protection to potentially exclude certain activities or product types in the future. However, we are clear that before we can make any such changes, we need to ensure that all the appropriate regulatory safeguards are in place to protect consumers from harm.

> **Q19: Do you agree that the scope of FSCS protections should be the same as apply in relation to current crowdfunding platforms?**

Offers that fall outside the public offer regime

155. We recognise that platforms may wish to facilitate offers of securities that fall within the new regime and those that do not. Although we foresee no problem with platform operators facilitating offers captured by the Public Offer Platform regime and those that are not (because they are under the threshold amount), we think this should clearly be communicated to investors. In this segment we explore some ideas that could be used to communicate this difference in regulatory treatment to investors, and/or deal with the competing regulatory regimes.

- **Option one** would involve allowing both exempt and non-exempt offers to be shown alongside each other with clear marking to show how the offers differ in their regulatory treatment.
- **Option two** would involve segmenting on the platform those offers that fall under the Public Offer Platform regime and those that are exempt offers.
- **Option three** would involve treating offers outside the Public Offer Platform the same way if facilitated by a firm with permission to operate a Public Offer Platform.

Our initial view is that option one would allow products to be viewed alongside each other while distinguishing the two types of offers that a platform could facilitate. We feel that this is important due to the differing regulatory regimes that the offers would fall under.

Option two would clearly communicate those offers that fall within the platform regime and would not allow investors to browse exempt and non-exempt offers alongside each other. However, we recognise that segmenting in this way could produce segments of limited offers or at times even null sets. We feel that option three, although the least prescriptive would lead to consumer misunderstanding of the regulatory protections from which they were benefiting and the potential mis selling of securities.

Q20: Do you agree with our approach or the alternative options that we set out, is there any other way in which these types of offers could be differentiated?

Secondary trading

156. Some crowdfunding platforms operate 'bulletin boards' or functionality to allow investors the possibility of exiting their investments early and for other investors to invest post-offer. Investment-based platforms may offer a facility that receives, pools, aggregates, and broadcasts indications of interest (i.e. a Bulletin Board). Some investment-based platforms provide more extensive secondary market facilities and are authorised as Multilateral Trading Facilities.

157. As the activity of operating a Public Offer Platform is defined in relation to the primary offering of securities, it will not incorporate rules for the 'secondary trading' of securities per se. Platform operators may nonetheless still wish to consider facilities that allow for investors to exit their investments. These will need to be considered under existing rules and permissions and will need to comply with the relevant law and regulation associated with those activities.

158. Our Policy Statement on the trading venue perimeter guidance acknowledges feedback from crowdfunding platforms in respect of operating a secondary market. In response to this feedback we intend to explore this issue further as part of our wider consideration of potential regulatory reforms in primary and secondary markets. In the meantime, we expect firms to operate in accordance with the guidance.

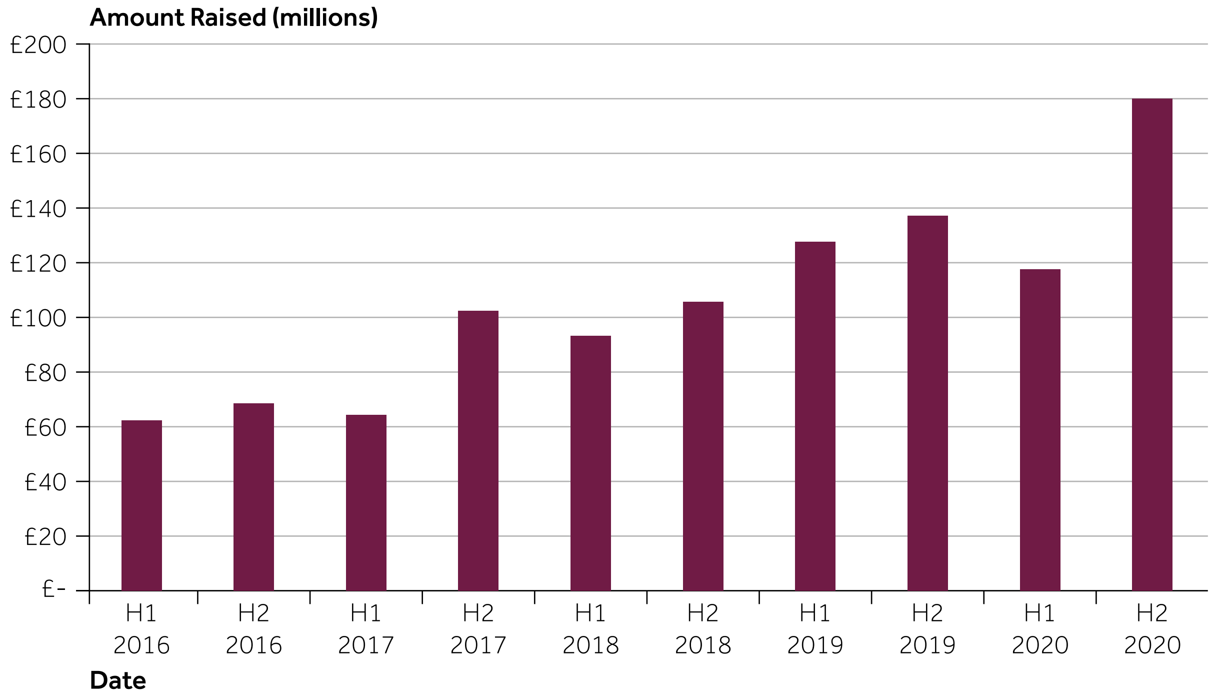
Annex 1

Annex 1: The current Market

Investment-based Crowdfunding

1. Investment based Crowdfunding typically involves small amounts of capital being deployed by a large pool of investors. Crowdfunding is becoming a more popular form of equity investment in the UK as demonstrated by Chart 1, and an increasing proportion of later-stage businesses are now turning to this collective form of finance. In 2013, 82% of crowdfunding deals went to seed-stage start-ups but, in 2021, this figure had dropped to just 39%.

Chart 1: The amount raised through crowdfunding from 2016 to 2020



Corporate Finance Firms

2. Corporate finance firms offer a broad range of services including in relation to the raising of capital by companies through the issue of unlisted securities. These firms tend to have permissions for, at least, arranging (bringing about) deals in investments and making arrangements with a view to transactions in investments. Corporate finance firms' business models can include the offering of securities to a broad range of investors who can include institutional investors or individuals such as high net worth and sophisticated investors. As such it could be possible that there are corporate finance firms that would be interested in operating a Public Offer Platform. However,

while these firms might currently deal with investors in the capacity of corporate finance contacts, as explained above, we are proposing that operators of Public Offer Platforms would need to treat investors as their clients.

Private offers

3. The extent of offers made in reliance on exemptions from the requirement to publish a prospectus is difficult to assess as there is little data on such offers. HMT analysis of crowd funding by transaction sizes shows that deal size is clustered around the threshold limits set out in the Prospectus Regulation.

4. It can be concluded that this limit acts as a barrier to larger deal sizes by SMEs. Investment-based crowdfunding has grown to be a credible source of corporate finance (given its focus on SMEs) during a period which has seen little activity in the space above the prospectus threshold. The likely cause of this pattern is the additional cost of preparing a prospectus relative to the deal size.

5. Estimates for the cost of preparation of a prospectus vary significantly. However, with an 8 million EUR deal size, the cost only needs to exceed 80,000 EUR to add 1% to transactions costs.

Annex 2

Annex 2: Policy Context

1. There are several policy documents that give context to the new regime for making offers by means of a Public Offer Platform. These are summarised below.

HMT Prospectus Review

2. HMT presented options on how the ability of unlisted companies to offer securities to the public could be maintained and improved under a reformed prospectus regime. It questioned whether prospectuses (which companies must prepare and provide to investors when making offers of transferable securities to the public over an existing threshold value of €8 million) are the appropriate means of delivering regulatory protection in relation to offers of securities in unlisted companies and asked whether they are too long and detailed for use by retail investors.

3. The Prospectus Regime Review consultation document also presented evidence that showed that fundraisings by unlisted companies over the threshold are rare, indicating that the threshold to publish a prospectus is operating more like a cap on the size of offers.

4. Instead of preparing a prospectus, HMT proposed that an unlisted company offering securities to the public over a threshold amount (£5m) would be required to make that offer via a firm authorised to conduct a new, bespoke regulated activity of operating a platform for the public offering of securities. The outcome also outlined that a range of investor protection measures would replace the prospectus obligation for these types of securities.

HMT Review into the regulation of non-transferable debt securities

5. In the response to its review into the regulation of non-transferable debt securities HMT concluded that these securities should be brought into scope of the public offer regime. In doing this, HMT stated that "the new public offerings regime should ensure that investors receive specific and proportionate information about the products to make informed investment decisions."

6. Including non-transferable debt securities within the scope of the new public offer regime also responds to Dame Elizabeth Gloster's recommendation to include non-transferable securities in the scope of regulation.

Meeting the requirements of the Gloster Review

7. Including non-transferable debt securities within the scope of the new public offer regime is equivalent to extending the scope of the Prospectus Regulation to cover non-transferable debt securities, given it will replace the obligation to provide a prospectus. The recommendation to subject non-transferable securities to the prospectus regime

focussed on providing additional information to investors when deciding to invest. Dame Elizabeth Gloster recommended that the Government consider expanding the scope of the UK Prospectus Regulation to non-transferable securities. The approach of including non-transferable debt securities within the new public offer regime responds to this recommendation through the new regime.

8. The new public offer regime should ensure that investors participating in offers made by way of Public Offer Platforms receive specific and proportionate information about securities offered to enable them to make informed investment decisions.

9. The review of the prospectus regime offers an opportunity to enhance consumer protections in the retail portion of the market. Depending on our design choices, which are discussed in this engagement paper, such new rules could require a platform operator to meet prescribed standards of disclosure and require the platform operator to conduct some form of due diligence and verification in relation to the companies' offering securities on their Public Offer Platform.

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