



European Securities and
Markets Authority

Questions and Answers

Investment-based crowdfunding: money laundering/terrorist financing



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1 Background

1. In December 2014 ESMA published an Opinion to national competent authorities and Advice to the EU institutions, setting out the results of its analysis of the business models of investment-based crowdfunding platforms, their regulatory treatment under the current EU rules and the issues for consideration by policymakers.¹
2. In the course of that work, ESMA identified a need to clarify the extent of the risks involved in investment-based crowdfunding relating to the potential for money laundering and for terrorist financing. In order to do so it has sought expert input from the Joint Committee's sub-committee on Anti-Money Laundering.
3. Not all investment-based crowdfunding platforms have the same regulatory status. Some are within the scope of the Markets in Financial Instruments Directive (MiFID); others fall within the optional exemption provided by Article 3 of that Directive where they may be regulated under specific national regimes; others may fall outside the scope of MiFID and of those some are regulated under national law, while others are not. There are also other EU rules potentially relevant to investment-based crowdfunding platforms, such as the Payment Services Directive (PSD).
4. Those platforms which operate within MiFID are automatically subject to rules designed to combat money laundering and terrorist financing under the Third Anti-Money Laundering Directive (3AMLD). ESMA has sought to clarify the status of the other platforms, by analysing the potential risks and issues arising in different cases and their treatment under the applicable EU rules.
5. In order to promote supervisory convergence, ESMA has agreed to publish these Questions and Answers in order to promote the sound, effective and consistent application of rules on anti-money laundering and terrorist financing to investment-based crowdfunding platforms.

2 Purpose

6. The purpose of this document is to promote common supervisory approaches and practices in the application of anti-money laundering rules to investment-based crowdfunding. It provides responses to questions posed by national competent authorities in the course of ESMA's work on investment-based crowdfunding, drawing on expert input from the Joint Committee sub-committee on Anti-Money Laundering.
7. The document is therefore aimed at national competent authorities to support them in ensuring that their supervisory approach is effective, taking into account the characteristics of and risks associated with different aspects of investment-based

¹ ESMA/2014/1378 and ESMA/2014/1560

crowdfunding. However, it should also help market participants by providing clarity on the issues involved.

3 Status

8. The Q&A mechanism is a practical convergence tool used to promote common supervisory approaches and practices under Article 29(2) of the ESMA Regulation.²
9. In preparing the Q&A, ESMA has sought and obtained expert input from the Joint Committee sub-committee on Anti-Money Laundering, which is reflected in the Q&A.
10. We do not expect to issue any further Q&A on this topic. However, we will consider at the appropriate time whether any aspects of these Q&A need to be revised in the light of the application of new legislation³ or significant developments in the investment-based crowdfunding market.

4 Questions and Answers

List of acronyms used

3AMLD	Directive 2005/60/EC of the European Parliament and of the Council on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing
MiFID	Directive 2004/39/EC of the European Parliament and of the Council on markets in financial instruments
PSD	Directive 2007/64/EC on payment services in the internal market

Question 1: What are the risks in relation to terrorist financing and money-laundering related to investment-based crowdfunding and how could they be mitigated?

11. Investment-based crowdfunding carries a risk of misuse for terrorist financing, particularly where platforms carry out limited or no due diligence on project owners and their projects. Project owners could use investment-based crowdfunding platforms to raise funds for terrorist financing, either overtly or secretly. This risk can be mitigated if platforms apply due diligence checks on the project owner (including the project itself) and on investors,

² Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority)

³ A new Directive has recently entered into force, which will replace the 3AMLD from 26 June 2017 (Directive (EU) No 2015/849 of the European Parliament and of the Council of 20 May 2015 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing)

to identify situations where the risk of terrorist financing is increased. The platform can then take appropriate measures to manage the terrorist financing risk (e.g. monitor transactions, submit a suspicious transaction report). Where a platform is within the scope of the 3AMLD, it has obligations to carry out such due diligence checks on its customers, which would in most cases include project owners as well as investors, and to take follow-up actions in certain circumstances.⁴

12. As regards potential use for money laundering, investment-based crowdfunding platforms present a risk because they can, for example, be used to disguise the illicit origin of funds, where investments are made in projects which do not successfully meet their fundraising target, with a view to the funds being returned to the investor, or by collusion between the project owner and investors, or between investors and platforms owners, in order to launder money. The potential for money laundering is increased where there is limited or no due diligence undertaken on project owners or their projects.
13. Not all business models carry the same risk in relation to money laundering. Platforms that collect funds for later onward transmission are particularly vulnerable to abuse for money laundering purposes, including business models where
 - a. money is held in individual client accounts from which funds are transferred to the issuer once an investment is decided upon; or
 - b. money is collected and held while the fundraising campaign is ongoing, but may be returned to those who committed them where the campaign's fundraising target is not met.
14. Where an investment is made, a longer holding period for instruments may reduce the attractiveness of investment-based crowdfunding relative to other potential avenues for money laundering purposes, but opportunities and incentives to launder money through investment-based crowdfunding still exist. Further, if the potential for early redemption of investments and/or sale through secondary markets were to increase, so would the potential attractiveness for money laundering.
15. In practice, the risks associated with investment-based crowdfunding may be mitigated where other parties involved in the transfer of funds are responsible for anti-money laundering/terrorist financing controls, even where the platform itself is not. For example, it is likely that where the investor's funds are exchanged for securities issued by the project owner, a regulated credit institution or PSD payment institution would be involved in the transfer of funds. Where the credit institution or payment institution is based in the EU, it would have responsibilities, among other things, in relation to the customer due diligence checks on the parties involved.⁵ Lawyers involved in the securities transaction would also have responsibilities to carry out customer due diligence checks and take

⁴ In many cases the investor would also be a customer of the platform. In cases where the investor became a beneficial owner of 25% or more of a project owner who was a customer of a platform (or exercised control through other means), 3AMLD would also require checks on the investor. See eg 3AMLD Articles 3(6), 7-9, 13, 22, 24 for examples of the obligations

⁵ See eg Articles 2(1)(1), 2(1)(2), 7-9 3AMLD

appropriate action if such checks raised concerns.⁶ Under 3AMLD, platforms may be able to rely on that customer due diligence.⁷

Question 2: Is the risk profile of the platform affected by whether it is regulated under MiFID or not?

16. The business models and activities of platforms operating inside and outside MiFID scope are often similar and so the potential for terrorist financing and money laundering through platforms does not depend on whether they are inside or outside MiFID scope. However, the attractiveness of using investment-based crowdfunding for terrorist financing or money laundering may be increased if there is an understanding that the platforms are operating outside any regulatory regime and therefore the measures which would otherwise be in place to detect and mitigate potential use for terrorist financing and money laundering may not be in place. There is therefore no basis in terms of level of risk for a less rigorous treatment of platforms operating outside MiFID in relation to anti-money laundering and terrorist financing.

Question 3: How should investment-based crowdfunding be treated under the Third Anti-Money Laundering Directive (3AMLD)?

17. Where investment-based crowdfunding platforms are operating as MiFID investment firms or as the tied agents of such firms, the investment firm will be within the scope of the 3AMLD and will therefore be responsible for customer due diligence checks which should contribute to mitigating these risks.

18. As many platforms are currently operating outside the scope of MiFID they would not be automatically captured by the 3AMLD. However, the definition of 'financial institution' also includes those carrying out any payment services, as defined in the Payment Services Directive [Directive 2007/64/EC Art. 4(3)]. Some investment-based platforms may provide certain payment services, depending on the extent to which they are involved in the transfer of funds (in some cases the platform is not involved at all in collecting payments). The extent to which platforms are already subject to 3AMLD obligations will therefore depend in part on the extent to which they are regarded by NCAs as providing payment services. Where firms are carrying out payment services within the meaning of the PSD, they are subject to the 3AMLD even if they fall within one of the various exemptions to the PSD.⁸ 3AMLD would also cover participation in

⁶ See eg Articles 2(1)3(b), 7-9 and 22-24 3AMLD.

⁷ See Articles 14-19 3AMLD.

⁸ Exemptions from the PSD of potential relevance to investment-based crowdfunding platforms are listed in paragraphs 94-98 and 103 of ESMA's Opinion on Investment-based Crowdfunding, ESMA/2014/1378. Art 3(2a) 3AMLD as amended by Article 91(1) PSD and subsequently by Art. 19(1) of Directive 2009/110/EC [E-money] applies the 3AMLD to any undertaking other than a credit institution (credit institutions being covered already by virtue of Art 3(1) 3AMLD) that carries out one or more of the activities listed in points 2 to 12, 14 and 15 of Annex I to Directive 2006/48/EC (henceforth Annex I to Directive 2013/36/EU). That list of activities does not contain any of the 'negative scope' provisions set out in Article 3 PSD, and Art 26(6) PSD confirms that the waiver from certain PSD requirements available under Art 26 does not allow for 3AMLD requirements to be waived.

securities issues and the provision of services related to such issues, and safekeeping and administration of securities.⁹ This may bring certain additional platforms within scope, given that the scope of this provision is not limited to the instruments covered by MiFID.

19. In other cases the extent to which platforms are required to have in place anti-money laundering and counter-terrorist financing measures would depend on the scope of national law. However, 3AMLD Art 4(1) requires Member States to extend some or all of the 3AMLD provisions to other professions and categories of undertakings than those explicitly listed in the Directive, which engage in activities “which are particularly likely to be used for money laundering or terrorist financing purposes”. Member States and competent authorities may therefore wish to consider whether platforms which fall outside the scope of MiFID and PSD and to which money laundering requirements are not already applied under national law fall into this category.

Where a firm provides payment services, Regulation (EC) No. 1781/2006 on information on the payer accompanying transfers of funds would, with certain exceptions, also be applicable.

⁹ See points 12 and 14 of Annex I to Directive 2006/48/EC (henceforth Annex I to Directive 2013/36/EU), which according to Article 3(2)(a) 3AMLD as amended by Article 91(1) PSD and subsequently by Art. 19(1) of Directive 2009/110/EC [E-money] are within the scope of 3AMLD.