MFSA MALTA FINANCIAL SERVICES AUTHORITY

Circular

31 May 2024

Circular on European Crowdfunding Service Providers for Business Regulation ('ECSPR')

Updated ESMA's Questions and Answers on the European Crowdfunding Service Providers for Business Regulation

This Circular is being addressed to the general public, market participants and Crowdfunding Service providers (CSPs).

This circular shall be read in conjunction with ECSPR, the delegated regulations and previous circulars issued by the Authority.

Purpose of the Circular

The Authority would like to inform market participants that on the 27 May 2024, the European Securities and Markets Authority ('ESMA') has issued a number of new Q&As on its website providing clarifications relating to the risk management framework and prudential requirements.

The purpose of the Q&As is to provide common supervisory approaches and practices in the application of ECSPR. It provides responses to questions posed by the general public in relation to the practical application of the ECSPR.

New Questions and Answers

ESMA_QA_2199 - Risk Management Framework

Question: Are all CSPs that facilitate granting loans required to have a risk management framework? Shall such a framework be based on risk categories for the loans offered by the CSP?

Answer: Article 4(1)3 of the ECSPR introduces general organisational and internal governance requirements for all CSPs, which implies, inter alia, that the management body in its supervisory function carries out an effective oversight of the management decision-making process, and the risks involved in the activity provided.

According to Article 12(2)(e) of the ECSPR, the application for the authorisation as CSP shall provide the authorising NCA with a description of the prospective CSP's governance arrangements and internal control mechanisms to ensure compliance with the ECSPR, including risk-management and accounting procedures.

In addition to these general duties, paragraph (2) of the same Article 4 establishes more specific obligations regarding the management body of all CSPs which intermediate loans and requires to establish, and oversee the implementation of, appropriate systems and controls to assess the risks related to the loans intermediated. More detailed requirements are provided in paragraph (4) for the assessment of credit risk and relevant risk-management framework of CSPs which determine the price of the offers. This framework is complemented by the organisational requirements established in Article 6 of the ECSPR for lending-based CSPs which also provide the individual portfolio management of loans.

Since Article 20(1)(b) of the ECSPR requires all CSPs that facilitate the granting of loans to annually publish an outcome statement indicating the expected and actual default rate of all loans facilitated by the CSP by risk category and by reference to the risk categories set out in the risk management framework, ESMA considers that the risk management framework of (all) lending-based CSPs should assess the risks of loans intermediated on their platform by classifying them into risk categories which correspond to the risks /probabilities of default of such loans.

This would allow CSPs to soundly assess the risks of the loans that they offer on their platform in accordance with Article 4(2) of the ECSPR and at the same time to comply with Article 20(1)(b) of the same regulation and provide accurate outcome statements on actual and expected default rate of such loans by reference to same risk categories used in their risk management framework.

Based on the above, ESMA believes that all CSPs shall establish – in the context of their organisational arrangements – a risk management framework whose complexity is also determined by the various provisions which are applicable to the specific activities provided by the CSP taking into account the nature, scale and complexity of such activities. When CSPs intermediate loans, such risk management framework shall at least assess the risks related to the loans intermediated on the crowdfunding platform (Article 4(2) of the ECSPR).

In case of CSPs that determine the price of crowdfunding offers, the risk management arrangements shall also comply with the specific additional requirements set out in Article 4(4)(f) of the ECSPR.

ESMA_QA_2200 - Prudential Requirements

Question: What should be done with a possible own risk excess of the insurance policy that CSPs subscribe to comply with the prudential safeguards established under Article 11 of the ECSPR?

Answer: According to Article 4(3) of the ECSPR, the management body of a CSP shall review, at least once every two years, taking into account the nature, scale and complexity of the crowdfunding services provided, the prudential safeguards referred to in point (h) of Article 12(2) of the same regulation, which requires perspective CSPs to provide the authorising competent authority with (inter alia) a description of the prospective CSP's prudential safeguards in accordance with Article 11 of the ECSPR.

According to Article 11(2) of the ECSPR, CSPs' prudential safeguards (as defined in paragraph (1) [4] of the same article) shall take one of the following forms:

1. own funds
2. an insurance policy covering the territories of the Union where crowdfunding offers are actively marketed or a comparable guarantee; or
3. a combination of points (a) and (b).

Article 11 of the ECSPR provides the minimum characteristics that the insurance policy shall have in paragraph (6) and the list of risks that such insurance policy shall (at least) cover in paragraph (7).

ESMA believes that, where the insurance policy used by a CSP to fulfil the prudential safeguards leaves some risks related to the provision of crowdfunding services uncovered, the CSP shall complement the coverage of such risks using own funds, as required in point (c) of Article 11(2) of the ECSPR.

ESMA_QA_2201 - Prudential Requirements

Question: What is the seniority between the own funds and the insurance policy in case of losses for the CSP whose prudential safeguards are a combination of own funds and insurance policy (as allowed in point (c) of Article 11(2) of the ECSPR)?

Answer: The ECSPR does not provide any specific indication on how occurred losses should impact the prudential safeguards of a CSP (i.e., whether such losses should be deducted from the own funds at first level and then from the insurance policy or differently). ESMA notes that such impact will often depend upon the terms and conditions of the insurance policy subscribed by the CSP.

ESMA is of the view that a CSP whose prudential safeguards are a combination of own funds and insurance policy shall pay specific attention to the terms and conditions of its insurance policy to ensure that in case of occurred losses the portion meant to be covered by the insurance policy can be made available without undue delay.

ESMA would also like to remind that, in case of losses, CSPs shall put in place actions to continue to comply with Article 11(1) of the ECSPR, according to which CSPs shall, at all times, have in place prudential safeguards equal to an amount of at least the higher of the following:

(a) EUR 25 000; and

(b) one quarter of the fixed overheads of the preceding year, reviewed annually, which are to include the cost of servicing loans for three months where the crowdfunding service provider also facilitates the granting of loans.

Please be reminded that Q&A documents issued by ESMA, are no longer being updated after 31 December 2023. Any Q&As issued from 01 January 2024, are being added within the ESMA Q&A IT-Tool.

Contacts

Any queries or requests for clarifications on the contents of this Circular should be addressed to the Authority via email on Crowdfunding@MFSA.mt.