FEEDBACK ON CP NO. 124
PROPERTY CROWDFUNDING

27 AUGUST 2019

PREFACE

Why are we issuing this Feedback?

In December 2018, the DFSA published Consultation Paper 124 (CP124) and consulted on changes to the crowdfunding regime to accommodate the activities of Property Investment Crowdfunding Platforms (PICPs) in the DIFC.

We received a number of responses to CP124, many of which – we felt - did not appreciate what our PICP regime was trying to achieve. Therefore, we decided to issue this Feedback on the finalised regime to explain the rationale behind our position and the reasons why we imposed certain conditions as part of the regime.

Who would be interested in this Feedback?

This Feedback may be of interest to Relevant Persons, including Authorised Firms, Persons who intend to operate a PICP in the DIFC, Persons providing legal, accounting, audit, oversight of compliance services in the DIFC or who wish to provide such services; and potential Investors.

Terminology

In this Feedback, defined terms are identified by the capitalisation of the initial letter of a word or of each word in a phrase, and are defined in the Glossary Module (GLO). When acronyms are used, they are defined in the GLO. In all other cases, the expressions used have their natural meaning.

What happens next?

The positions discussed in this Feedback, arising from CP124, were made by the DFSA Board. They took effect on 1 July 2019 and can be found here.

DFSA response to public comments on CP124 – Property Crowdfunding

Background

1. The DFSA regime for loan and investment crowdfunding came into force in August 2017. Crowdfunding, like many financial services, has evolved and, in addition to providing financing to Small and Medium Enterprises (SMEs) and start-ups, it is now providing financing of assets, such as property.

2. We have had much interest from those wishing to facilitate the financing of property, or to carry out Property Investment Crowdfunding. Property Investment Crowdfunding allows multiple investors to come together and purchase a property. Typically, the investors are investing in an apartment or house via a special purpose vehicle (SPV) that holds title to the property. This investment generally offers the investors a rental return, which provides a regular income, as well as the potential for capital appreciation, which is determined by market forces.

3. A PICP operates in a similar manner to an Investment Crowdfunding Platform, but with some differences. For example, third parties will need to be appointed to value the property and a property manager will need to be appointed to manage the property.

4. However, when we looked at the regime we had put in place for crowdfunding, we realised that PICPs also presented different risks that our crowdfunding regime did not address. This is because, when we established our regime for crowdfunding, the regime focused on the risks of lending to, or investing in, SME businesses, not the financing of real estate assets associated with Property Investment Crowdfunding.

5. We took the view that, in order to accommodate these types of platforms and the different risks they presented, our regime needed to be adapted. In December 2018, we issued CP124, which set out our proposed changes to accommodate the activities of PICPs.

ISSUES RAISED

6. We received many responses to CP124, several of which raised questions as to why we proposed to impose certain conditions on the PICPs. The main issues raised were:

   a) the inability of PICPs to invest in, and/or manage, multiple Properties on behalf of Investors; and

   b) the inability of PICPs to offer investments into off-plan Properties.

7. This Feedback will explain the rationale behind our proposals, the final regime and the reasons why we have imposed certain conditions in these areas.

Inability of PICPs to invest in, and/or manage, multiple Properties on behalf of Investors

Managing assets, portfolio management and/or providing advice

8. As we outlined in CP124, we believe it is possible for an Operator of a PICP to carry out activities that stray into other types of financial services activities, such as managing assets, providing portfolio management or providing advice. We are not comfortable with an Operator of a Crowdfunding Platform carrying out these activities, for example, providing advice, given the potential bias that might influence Investors to take part in certain investments. In order to address this, we prohibited Operators of Crowdfunding Platforms from managing assets and providing advice. This prohibition applies to all types of Crowdfunding Platforms.

9. We do not believe that these restrictions cause detriment to Investors or stop them from investing in many properties offered on a PICP (subject to investment limits), or indeed offered through other investment vehicles, such as Real Estate Investment Trusts (REITs) or Property Funds. Investors can build and manage their own portfolios and achieve a balanced portfolio that meets their requirements.

10. We remain of the view that if Operators of PICPs find the regime too restrictive and wish to offer diversification, and/or manage portfolios, then they should establish a Property Fund.

Operating a Collective Investment Fund

11. A further reason for imposing these conditions is due to the potential arbitrage between PICPs and Collective Investment Funds (CIFs). For example, the set-up of a PICP, establishing a SPV to hold and manage the investment property, looks like a typical CIF set-up. In order to address this, we had to exempt PICPs from the CIF regime, and provide exclusions whereby a crowdfunding arrangement made on a PICP was not considered a CIF if certain conditions are met.

12. We do not believe that this gives CIFs an unfair advantage. If anything, we have given PICPs a unique opportunity to offer investments to Investors that would not be possible if we did not carve them out of the CIF regime.

13. The CIF regime imposes far greater requirements on CIF operators in line with the International Organisation of Securities Commissions (IOSCO) standards, with associated higher costs and capital, so it is only right that these operators can carry out a broader range of activities and elect to offer and manage diverse portfolios.

Inability to offer investments into off-plan properties

14. As explained in CP124, we had strong concerns about PICPs offering investments into off-plan units, especially to Retail Clients, and the complexities around these investments. For example, what the investor is and is not getting, and what happens if a developer defaults and the development is unfinished. In order to explore this further, we asked a variety of questions to better understand how a PICP would deal with off-plan properties.

15. It was clear from the responses we received that this is an extremely complex market, with many parties involved, and conflicting interests. We felt that the simple PICP regime we had proposed was not sufficient or appropriate to support this type of activity. Although we remain sceptical, if PICP Operators show they can operate successfully in the market for the sale of completed properties, we may reconsider in the future whether it is appropriate to allow the provision of off-plan properties on PICPs.