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The Epic Case Study

In order to provide a practical example of a multi-asset investment-based crowdfunding E-platform, this chapter describes the Italian based E-platform Epic (SIM) S.p.A. Epic is an investment company authorized and regulated by Consob and Bank of Italy that started its activity in Italy in 2014. It operates an investment based E-platform managed and founded by a team of professionals from the fields of financial markets, investment banking, and strategic consulting.

Epic is Italy's first FinTech platform where Italian SMEs can present their development projects to a selected audience of institutional investors (investment funds, family offices, banks, insurance companies, investment companies, pension funds) and private investors classified as qualified under MiFID.

Investors, in turn, have the opportunity to evaluate investment opportunities proposed by SMEs in a transparent, prompt, efficient, economic and "social" way, due to the standard information format used on the platform, obtained not only from companies, but also from independent institutions (e.g. credit rating agencies and research/analyst firms) and from other investors interested in the deal. Investments may take the form of bonds, shares, convertible bonds or commercial papers (see Fig. 8.1).

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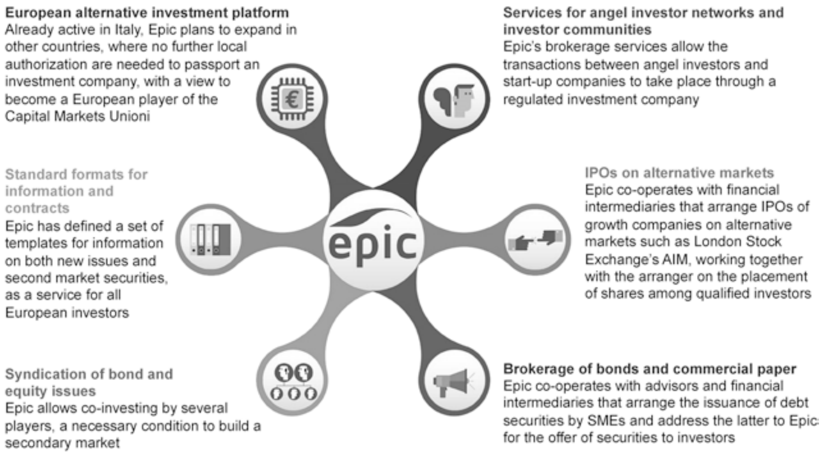

Fig. 8.1 Epic positioning (Source: Epic presentation.)

It was pointed out that E-platforms can operate in many different segments, identified by type of distribution model (lending or investment-based), type of investor (retail or qualified investors only), types of fundraiser (individual consumers, small businesses, or SMEs) and, finally, types of financial instrument (loans, bonds, equities). Epic's positioning in this four dimensional map is as:

- an investment-based E-platform;
- qualified investors only; retail investors that are considered unsuitable for the complexity and lack transparency with regard to investing in SMEs are excluded;
- targeting European SMEs (starting with Italian and subsequently Spanish and Portuguese);
- dealing in securities such as bonds, equity-linked bonds, commercial papers and equities.

In a two-dimensional diagram highlighting the positioning of different investment-based E-platforms with respect to the type of investor (consumers versus professional/qualified) and the type of issuer (start-up companies versus established SMEs), Epic seems to position itself in a

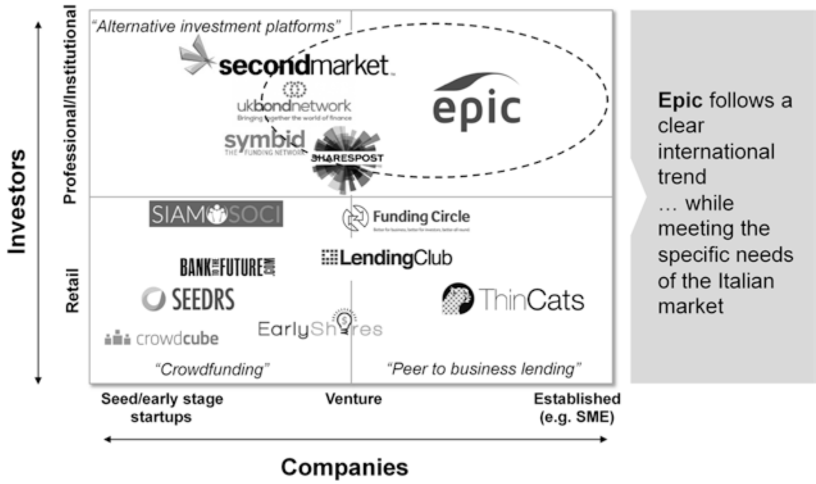

Fig. 8.2 Epic targets (Source: Epic presentation.)

relatively less crowded first quadrant: this quadrant is defined by qualified investors only and established SMEs. Epic is partially stretching its origination focus in the direction of post-seed start-up companies, thus extending its scope towards the left-hand side of Fig. 8.2.

In Italy, SMEs generate more than half of the GDP; these SMEs have historically been financed by banks. In recent years, the economic downturn has made it difficult for banks to support companies as they did in the past. The reduction in the volume of credit that companies receive from banks, however, is dangerously close to becoming a chronic issue, taking into consideration the new capital and liquidity constraints of the Basel III regulatory framework with which the latter must comply. Therefore, the need for a complementary funding channel for SMEs becomes increasingly urgent, taking into account the fact that, for most of them, accessing the capital market has very high fixed costs.

The Italian government, as with many other EU governments, has taken action regarding SME access to capital markets since 2011. Specific issues have been addressed and, in addition to a more SME-friendly regulatory and fiscal framework, systematic moral suasion has been exercised on key players such as funds, insurance companies, SMEs and pension funds. Needless to say, it will take years for the business and financial community to metabolize the required level of change fully. However, significant effects have begun surfacing since 2013, as the new regulations have been refined and have come to the attention of market participants. For example, as of 2015 some 30 specialized SME debt or equity closed-end funds have been launched; the majority of insurance companies have started investing in SME debt, either directly or through specialized funds; and over 100 SMEs have placed their mini-bonds raising over €1 billion, only counting issues of less than €50 million. Today, the Italian market is considered to be at the forefront in Europe and has taken several concrete steps. These include Development, Growth and Competitiveness Decrees, the introduction of so-called *mini-bonds* (security), and the creation of Borsa Italiana's ExtraMOT PRO (transparency of a secondary market). Additionally, the build-up of the launch of many credit funds specialized in SMEs, which act as selectors and risk managers of SME debt, and recent measures enacted by the Italian Insurance Supervisory Authority, (IVASS). The increase of the investment limit for this specific asset class from 2 % to 3 % has allowed for further investment of more insurance reserves in SMEs.

Epic performs a series of KYC and onboarding checks on all potential members that apply to the platform, whether potential issuers or investors. The status of "qualified investor" is verified by either the verification of EU-supervised intermediary status (which automatically grants the qualified investor status to many EU banks, investment companies, fund managers, insurance companies), or via a specific questionnaire, background checks and resumé analysis for HNWIs or directors of smaller non-supervised investment companies such as family concerns (see Fig. 8.3).

Epic is also standardizing the traditional private placement procedure with a more intensive use of the Internet. Multiple investors can share a common information base, will access information in compliance with issuer's confidentiality requirements and in accordance with market rules. Investors can browse a number of possible targets among new issues and secondary market opportunities across equities and mini-bonds; they do so by imposing personalized selection filters in order to focus on targets.

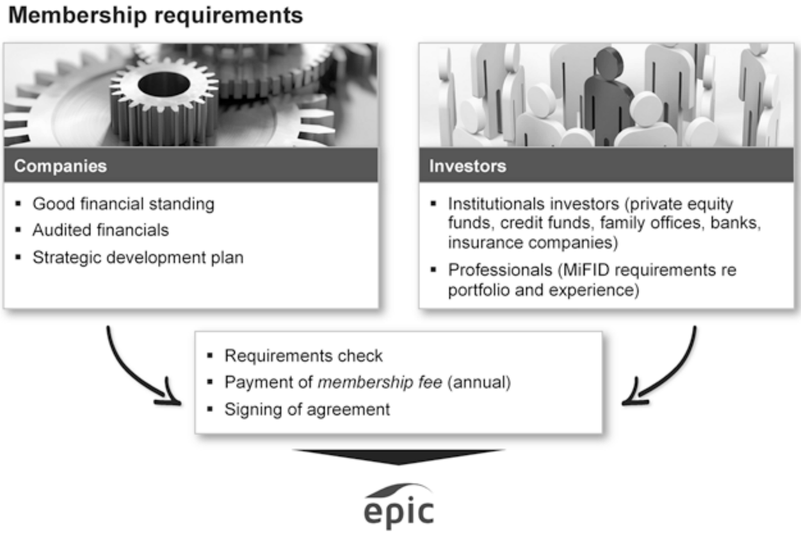

Fig. 8.3 Membership requirements (Source: Epic presentation.)

In many ways, the E-platform turns the investor in to a more active player via access to securities and to issuer's data on a shared infrastructure in totally privacy. This concept of sharing functions within the E-platform allows an investment-based crowdfunding operator such as Epic to achieve a whole series of innovations that offer wider benefits to the market as a whole:

1. Investors can research investment opportunities within a wide and deep information warehouse. As a result, they do not depend on the traditional solicitation of time-wasting securities salesmen, especially in the context of micro-investments. The SME market will tend to become a pull (by investors) market, rather than a push (to investors) market.
2. Investors will optimize their decision-making process because of the more complete and standardized set of preliminary and analytical information found on the platform. This minimizes their need to spend time on peripheral information and allows focus on a smaller number of key issues. Overall, the E-platform model saves time.
3. SMEs can access a higher number of potential investors and rely on Epic's market surveys to calibrate possible offerings and, eventually, to make more informed decisions about launching a deal. As in the case

of P2P platforms, it is likely that the liquidity build-up in Epic will provide progressively better information to issuers with regard to an investor's appetite for deals in general, as well as for key details in the offered terms and conditions, such as tenor, price, covenants.

4. By sharing costs, the model introduced by Epic brings another advantage typical of E-platforms: it minimizes fixed costs, since the platform operator typically absorbs legal, KYC, analytical, settlement and documentation costs. Epic functions like a shared procurement resource for investors. It becomes more valued since deal sizes tend to be smaller and because, in this segment, fixed costs often represent a deal-breaker, or at least discourage many investors to look into small deals.

For Epic, regardless of the product – equities, commercial papers, or minibonds – the operating mechanism is the same, and the same catalogue is shared. This process is set in four separate stages, each triggered by specific decisions made by the parties involved (see Fig. 8.4).

The Preliminary phase offers potential fundraisers a 'trial' experience that remains totally private and supports a more informed choice to move onto the next phase. The E-platform performs KYC checks, an independently managed credit analysis and an anonymous market survey on

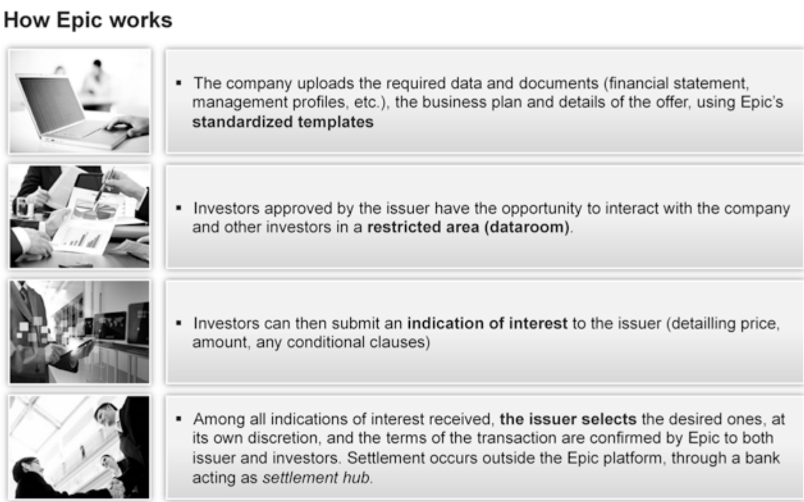

Fig. 8.4 How epic works (Source: Epic presentation)

its investor base. The feedback to the potential issuer and to the issuer's financial advisor consists of the confidential sharing of a proxy rating, as well as reflecting the investor market appetite for comparable issues.

There is then an offering phase, during which the issuer activates the process by becoming a member of the platform, thereby offering Epic an exclusive mandate to broker its offering. The issuer then uploads its financial situation, business plan and the possible terms of the proposed transaction in a dedicated area of the E-platform. Non-public information is stored in a virtual data-room and the issuer grants access to potentially interested investors that want to know more about the proposed deal.

This procedure allows an escalation of confidentiality engagements considering the nature of the information and the possibility that certain potential issuers might have previously issued publicly listed securities. During this phase, investors can interact with the issuer either via the E-platform dedicated chat-line and video-conferencing, or simply offline. Here, the E-platform function is that of facilitating and expediting the decision-making process, but does not exclude traditional methods such as a face-to-face management meetings, or a visit to the company.

Investors make the investment decision and make an offer to the issuer.

The closing phase is where the issuer chooses one or more investors and meets their terms. Transactions are then closed and settled outside the E-platform via a bank acting as a settlement hub.

As stated, Epic's aim is to connect SMEs with private capital in a direct, simple and cost-effective way, reducing intermediaries and bureaucracy; and the essential format is that of a private investment community with specific requirements necessary to join the platform.

The evolution of such private placements as Epic delivers with its "investor community" model, along with the fact that the company does not act as an issuer's advisor or creditor, determines a different brokerage model than that of traditional "one-to-one" chains where the issuer's advisor and investment bank generally contacts the potential investors individually. Investors must be "qualified" under MiFID/Consob regulation (see Fig. 8.5).

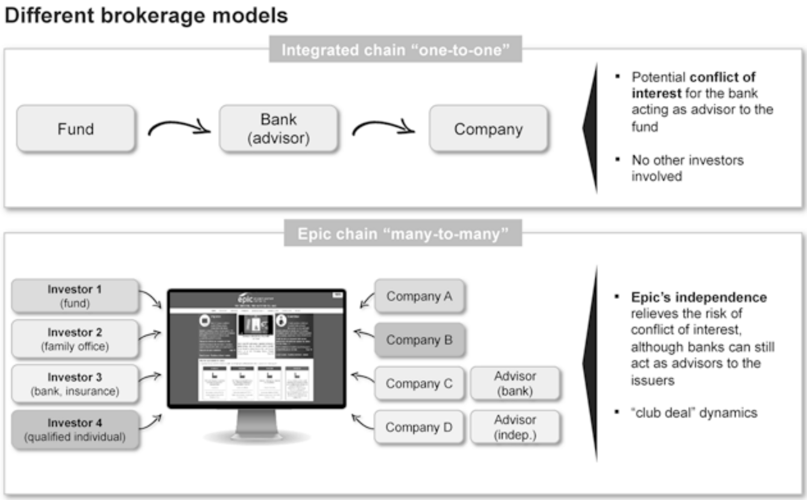

Fig. 8.5 Different brokerage models (Source: Epic presentation.)

Companies must meet the regulatory requirements for the issuance of the proposed financial instruments. Epic excludes SMEs operating in certain industries, such as real estate, financial and gambling industries.

The platform's value proposition lies in facilitating the connection, discussion and exchange of information between SMEs and investors, and participants have complete autonomy. Companies can choose which investors can access their data-room; investors can choose which companies to analyze and potentially fund; and by which amount; companies and investors may be assisted by their own advisers.

Epic's style is similar to most FinTech platforms: it is social and tries to create an ongoing channel for increased contact between SMEs and investors. The platform's technology enables the creation of a true digital network, advancing the dialogue between companies and investors, and making this process more fluid and continuous, thereby creating a community that interacts on a social footing.

This fundamental goal of simplifying the investor's workload is furthered by the adoption of a single platform where participants can find relevant information and analyze offers. The platform is thus about comparison, thereby facilitating the building of a diversified portfolio of securities.

In effect, Epic acts as a pure broker and does not handle post-trading activities. Investors are also not required to open any checking account or securities account with Epic, or with the settlement agent. Once any investment is settled, service on Epic continues. In a restricted area, investors stay in touch with companies and access post-issue updates (e.g. corporate actions, quarterly price indications, new budgets). Indications of interest can also be expressed for securities previously issued, whether originated on the platform or not.

Costs for companies are reduced due to the involvement of fewer intermediaries and to the fact that issuance costs related to bonds are deductible in the year they are incurred, regardless of the accounting policies. Issue costs include all expenses related to the issuance of the bonds – for example, the fees for the rating agency, placement fees, fees for professional services and include Epic's fees.

Epic thus offers a MiFID-regulated environment to host direct opportunities for investors or networks of qualified investors (e.g. business angels, see Fig. 8.6).

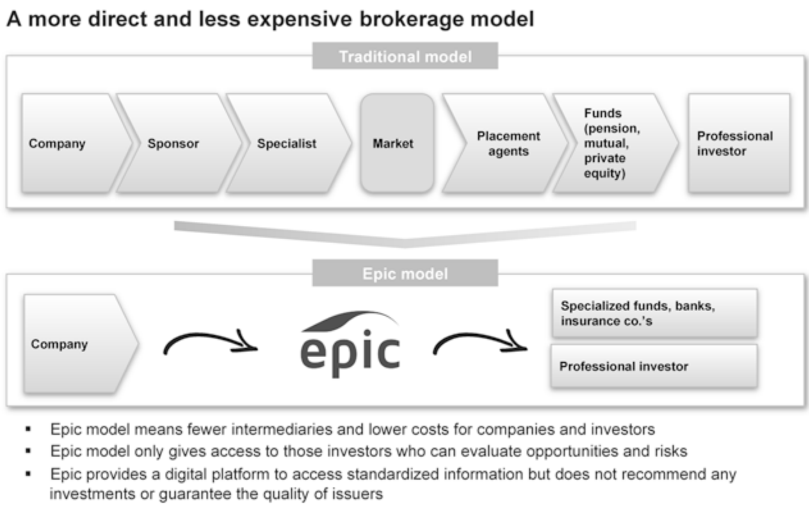

Fig. 8.6 A more direct and less expensive brokerage model (Source: Epic presentation.)

As E-platforms and FinTech market and deliver new solutions, they widen the lending business arena, allowing new investors and fundraisers to join.

Incumbents such as exchanges and banks are (slowly) reacting to the new competitive challenges. Deals such as the Nasdaq's joint-venture with Sharespost, or the partnership between Santander and Funding Circle, signal the incumbents' awareness of the structural changes.

Economic policy and regulation will encourage progressively more long-term investors such as insurance companies and pension funds to provide a structural backing to the alternative funding channel to the real economy. While retail investors' appetite for alternative finance may be subject to market cycles, the slower but steadier interest of institutional investors should grant Fintech a future. This will complement banking as a stable component of the supply chain. In the EU, this is well-defined by the Capital Markets Union's Green Paper published by the European Commission.

Emerging professional players such as specialized funds and robo-advisors will further enrich the ability of professionally managed savings to invest and continue to invest in the real economy.

The syndicate model tends to develop as a key micro-structure feature of investment-based E-platforms.