

Approaches Formation to the Regulation of Crowdfunding Platforms

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ABSTRACT

On the current agenda of most countries in the global economy is the acute problem of financing small and medium-sized enterprises as they provide employment, generate innovation and accelerate economic growth. The article focuses on the analysis of the world practice of approaches transformation to the crowdfunding regulation. The methodological component of the work was general scientific and special methods including statistical and comparative analysis. The purpose of this study is to examine the main approaches to the crowdfunding regulation in advanced economies. The analysis has identified three key approaches to crowdfunding regulation (“prohibited”, “self-regulated” and “regulated”), and it has been concluded that Russian Federation has changed its approach from “self-regulated” to “regulated” since 2020. Changing the regulatory approach may contribute to the development of crowdfunding activities.

Keywords: crowdfunding, platforms, regulation, self-regulation, approaches

1. INTRODUCTION

Access to finance remains one of the most pressing problems facing small and medium enterprises. Experts recognize a wide gap (about 5 trillion US dollars worldwide) between the demand for financing for such enterprises and the fact that these enterprises actually receive [7]. Additionally not only small and medium-sized enterprises, but also consumers, especially in emerging markets, traditionally experience the need for a wider range of financial services. Besides traditional bank loans, crowdfunding is becoming an alternative financing source. Over the past three years, nearly 10000 European enterprises have been able to attract financing from alternative sources worth over 385 million euros.

Modern technology platforms involved in the crowdfunding process significantly increase the efficiency of transactions implemented through them, provide new investment opportunities for consumers and investors, expand the possibility of obtaining loans and promote competition in developed and developing markets. At the same time in world experience, concern about the incompletely understood and conscious risks of the alternative financing process is gradually accumulating. On the other hand, financial providers of alternative financial resources have certain advantages over traditional financial institutions, such as optimization of the process itself, and the ability to implement all the necessary procedures and actions online. All this makes

the issue of alternative financial resources regulation, and especially crowdfunding, particularly relevant.

2. RESEARCH METHODOLOGY

Crowdfunding in the modern world is considered to be one of the ways of alternative financing, which from the point of view of modern international practice in turn include peer-to-peer (P2P) lending, equity-based crowdfunding (ECF) and initial coin offerings (ICOs). In this study special attention is paid to crowdfunding, issues related to initial coin offerings are not considered. The methodological component of the work was general scientific and special methods including statistical and comparative analysis. In preparing the study the analytical data presented in the reports of IOSCO [2], the Cambridge Center for Alternative Finance [7, 8], data published by Russian and foreign scientists [1, 3-6, 9] were used.

3. RESULTS OF THE RESEARCH

Crowdfunding (from the English word “crowd”, “crowdfunding” - financing of the crowd) is considered as an umbrella term describing the using of small money

amounts received from a large number of private persons or organizations to finance a project, business or personal loan through the Internet platform. That interpretation reflects the approach of the International Organization of Securities Commissions (IOSCO). OSCO's report «Crowd-funding: An Infant Industry Growing Fast» notes that crowdfunding, as a form of alternative financing, is a rapidly growing segment of the financial market for lending and investment needs [2].

The first crowdfunding platform for raise funds to the development of musical content was created in the USA by ArtistShare (2000 - 2001), and already in 2008, Barack Obama raised about \$ 272 million from more than two million people via crowdfunding only at the stage of primary elections. The globalization of the economy, as well as the rapidity with which crowdfunding is developing in different countries, highlight the issues of harmonizing conceptual approaches to the regulatory impact on all participants in the crowdfunding process.

Crowdfunding as an economic phenomenon began to develop spontaneously. The main reason for its proliferation was the Internet technologies development. Over time, many countries faced the question of how to regulate the activities of platforms and whether to get involved in their activities in general. Consider the experience of the leading world countries.

France already had a large number of crowdfunding platforms by 2016. The largest and most famous of them are KissKissBankBank & Ulule (charity), Lendix, Unilend, Lendopolis and Lendosphere (P2P lending for legal entities), Anaxago and WiSeed (equity-based Crowdfunding), Prêt d'Union (P2P lending for individuals) [7]. For this reason France is one of the first European countries to apply the regulatory regime for crowdfunding. The French regulatory framework has already implies a clear difference between the two modes depending on the status of the platform itself by 2017. The first mode is related to platforms facilitating access to loan agreements, donations and reward. For such platforms a "unique set of rules" has been formed clearly regulated the actions of all participants. The second mode was designed for platforms implementing equity-based and debt crowdfunding. The development of the legislative framework promotes the use of these tools by companies in the early development stages.

German market is one of the largest in the European Union. At an early stage of the sector development in 2013, more than 20 companies already wished to attract financing through crowdfunding platforms [4]. German crowdfunding market had achieved sustainable growth and become the third market in Europe after the UK and France by 2017. According to experts, not least, the growth was facilitated by the introduction of a special regulatory regime; however, it did not maintain radical changes in the participants' business model. The regulatory framework for crowdfunding regulation began to improve in Germany in 2015. At the same time, no fundamentally new legislation was developed, but amendments were made to the law on the capital market and the legislation

on the protection of consumer rights. A peer-to-peer lending model is usually based on a partnership with a licensed bank. In the case of equity-based crowdfunding, the platforms activities, as a rule (91% of cases out of 100), were licensed [4]. The requirement for a license depends on the type of financial tool generated by the platform. Special attention in German law is paid to protecting the investors' rights and resolving conflicts of interest.

In Finland, regulation was the result of a consensus following a long dialogue between the authorities and industrial companies resulting in enacting of crowdfunding law in 2015. The adopted regulatory act has largely contributed to the development of the equity-based crowdfunding market. Sweden has chosen to find a compromise between the new reality of alternative financing and the existing legislative and regulatory framework in the country. At the same time, many issues related to equity-based crowdfunding have not been solved. In Denmark, at the time of the compilation of the report «SHIFTING PARADIGMS», only peer-to-peer lending to the business was regulated, while equity-based crowdfunding was not covered by smooth regulation [8]. Attracting financing through the share issues proved to be a very expensive tool for young Danish startups. In Norway, the discussion about the need to regulate the crowdfunding market was held in the parliamentary finance committee only in the spring of 2018 resulting in proposing to launch the regulatory process in test mode. And finally, Iceland, in which strict post-crisis laws were still in force in 2017-2018, not only did not deal with the issue of crowdfunding regulation, but not even have corresponding platforms on its territory.

The Benelux alternative financing market (Belgium, the Netherlands and Luxembourg) in 2017 continued its steady growth and grew by 51% compared to 2016 [4]. In the same way as in the Scandinavian region, Belgium, the Netherlands and Luxembourg did not have a common legal framework in addressing the issue of crowdfunding market regulation, and each country addressed these issues exclusively at the national level. In recent years, alternative financial resource providers in the Netherlands have earned 1 billion euros in financing more than five thousand small and medium enterprises. In doing so, legislative initiatives regarding the crowdfunding regulation procedures were constantly improved and were positively received by all participants in the alternative financing procedure. In Belgium, crowdfunding is governed by a law enacted in 2017. Peer-to-peer lending and equity-based crowdfunding in Luxembourg during the same period remained insignificant, which led to the absence of the need to regulate the alternative finance industry.

Regulatory solutions applied to crowdfunding in Italy are quite specific. It is important to note the absence of a special regulatory framework governing the peer-to-peer lending process, but at the same time, Italy was the first in the European zone to introduce a special legal regime for equity-based crowdfunding, which realization is possible

on the basis of a license. At the same time, there remained many unresolved issues regarding taxation and consumer protection. Survey show that experts recognize the crowdfunding regulation in Italy as excessive and too strict.

The Iberian crowdfunding market, including Portugal and Spain, experienced certain growth in 2017, but it was less significant than in 2016. However, Iberia contributed 169 million euros to the total European market for alternative finance in 2017. In Portugal, the government has regulated peer-to-peer lending and equity-based crowdfunding. In Spain, regulation was also present, but in 2017, the number of respondents who responded positively to the need for regulation decreased [8].

The Central Europe market (Austria, Porter and Liechtenstein) held the 10th place in terms of alternative financing in Europe as of 2017. Austrian and Swiss legislation has undergone major reform. The federal government launched a process of consultation with the business community to amend banking legislation in Switzerland, in 2017 [10]. A novelty was the proposal according to which crowdfunding platforms should receive a banking license if they cooperate with more than 20 creditors. In Austria, a number of existing legal regulations have been amended to facilitate the access of all interested participants to the crowdfunding market. In Liechtenstein, there were no national crowdfunding platforms at the time of 2017.

The Baltic alternative financing market includes Estonia, Latvia and Lithuania. The Baltic States, by 2017, was an interesting example of a region in which an alternative financial market appeared and developed without special regulation. The alternative financial market in Estonia is quite unique and based on the principles of self-regulation, the basis of which is the "industry code of conduct", which the platforms adhere to on a voluntary basis. In Latvia, there were also no common and binding requirements for all participants in the alternative financing market by 2017. However, by the end of 2016, Lithuania had formed a common regulatory framework for peer-to-peer lending and equity - based crowdfunding.

Eastern Europe, including Poland, the Czech Republic, Slovakia and Hungary, was the seventh largest European alternative financial region in 2017. The approaches to the crowdfunding regulation in this region in various countries are different. None of the jurisdictions in this region had a special legal regime for crowdfunding regulation, although Poland and Slovakia have already begun drafting laws. Compared to the regions, which have been already considered, the alternative finance market in Southeast Europe (Slovenia, Bulgaria, Romania and Greece) was still in its infancy in 2017, valued at 37.2 million euros. At the same time, the presence of foreign platforms was a feature of Southeastern Europe, and this could provide a transfer of experience and technology to local platforms.

Research into crowdfunding regulation approaches is ongoing. Cooperative report «Regulating alternative finance: results from a global regulator survey» was published in 2019 [7]. The study was not confined to the

European framework and covered various regions of the world. The report recognizes that despite a boom in regulating alternative financing since 2015, many crowdfunding models are still not technically regulated in most jurisdictions. The most advanced regulatory jurisdiction to date is the United Kingdom, followed by the United States and Singapore. Also in the top - ten include Malaysia, the UAE and Mexico. In many developing countries, including the BRICS, crowdfunding regulation is still at the initial level or lacking [9].

Table 1 Crowdfunding regulation approaches

Name	Characteristic
Prohibited	National legislation prohibits all or certain crowdfunding types
Self-Regulated	The country lacks common regulatory requirements for crowdfunding, but the platforms independently determine the rules for their work. As part of this approach, internal rules of the platforms for selecting and evaluating projects to ensure investor confidence are of great importance.
Regulated	National legislation regulates all or certain crowdfunding types

4. CONCLUSION

The study allows identify three fundamental approaches to the crowdfunding regulation.

In conclusion, it is feasible to apply the developed approach for Russian Federation. The alternative financing market was outside beyond the legal regulation, and, accordingly, the technical and legal constructions of economic concepts that the crowdfunding market operates in developed economies were absent in Russian Federation until 2020 [6]. Despite the absence of a federal law, crowdfunding activities have been developing and each platform has determined the rules for attracting and spending funds. The Federal Law "On the investment promotion using investment platforms and on changes to the individual relevant pieces of legislation of Russian Federation" dated 2 August 2019 N 259 - FL entered into force on January 1, 2020. Russian Federation has changed its approach from "self-regulated" to "regulated" since that time.

In many countries, the awareness of the need to regulate of crowdfunding has been recognized. The interest of investors and businesses will largely depend on the level of regulatory requirements. The complexity of developing regulatory approaches is that crowdfunding is a heterogeneous model. This financing method can be used both for financial and social purposes. The Federal Law

"On the investment promotion using investment platforms" has come into force since 2020 that allow predict ordering market. In the view of the positive changes in domestic legislation, the use of crowdfunding digital platforms as a tool allowing implement alternative financing models is possible, but on the condition to the application and adaptation of the developed countries experience in this direction. Further development of the legislative regulation of crowdfunding requires continued research in Russian and international experience.

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