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Legal Regulation of Crowdfunding and Investment Platforms: The Experience of the United States, Russia and Europe

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Abstract--The article provides a comparative analysis of the legal regulation of crowdfunding and investment platforms in Germany, Russia, the USA, and France. Crowdfunding has been researched as a category that is an integral part of investment platforms; in a concise form, the formation of crowdfunding in the declared group of countries is disclosed; identified possible risks and problems when using investment platforms and crowdfunding. The legislation of the United States, France, Germany, and Russia in the field of crowdfunding reveals the main provisions that are directly related to investment platforms and investments, thereby helping interested parties navigate in this environment. Although the legislation of Russia, unlike foreign countries, does not directly mention crowdfunding, which in turn gives rise to legal conflicts of using this activity through the national law on attracting investments, limiting the rights of individual citizens to attract investments.

Keywords--crowdfunding, digital currency, digital rights, investment agreement, investment platform, startup.

Introduction

In the first decade of the 21st century, fundamental changes took place in the field of civil and economic relations, not only in terms of mechanisms for regulating the securities market but also in the way of financing a certain kind of socially useful activity, which was primarily influenced by the global economic crisis of 2008. One of the significant changes was the use by subjects of civil rights of a new type of money - digital currency, as a kind of the electronic equivalent of traditional money. Following the development of the electronic digital technologies market, new subjects of legal relations began to appear in the legal field - electronic digital or digital platforms (Kickstarter, Ioby, etc.). Therefore, it is not surprising that in just the beginning of 2021, many companies have emerged seeking to make a profit by increasing the number of crowdfunding entities, where many of them position themselves as intermediaries (Kickstarter), attracting investors, taking an active part in the investment process, including using digital currency (Paschen, 2017; Dung et al., 2021; Dahiya & Chaudhary, 2016).

A number of researchers are thinking about the future of crowdfunding and this issue is becoming the subject of interdisciplinary research (McKenny et al., 2017). Basically, academics agree that crowdfunding helps small and medium-sized businesses — those who provide consumer services, as well as other non-tech businesses — develop (Stevenson et al., 2019). Most of the published works on crowdfunding describe approaches to it in a specific area – tourism, education, medicine, production of goods through investment platforms, analyzes the economics of crowdfunding, including the economic and regulatory aspects of crowdfunding in Germany, Russia, the USA and France (Cumming & Hornuf, 2018). Some studies of issues in the field of law enforcement practice of crowdfunding and investment platforms have substantiated that these institutions need to further improve legal regulation in terms of protecting the rights of its subjects, investment platforms and crowdfunding are closely related (Ashta, 2018; de la Viña & Black, 2018; Goncharova et al., 2020; Belyaeva et al., 2017), as well as the necessary provision of rights and the freedoms of organizations, depending on their organizational and legal form (Bessonova et al., 2017).

According to the official data of the portal The Crowdfunding Center, for the period from January 1, 2014, to March 2021, about 777 thousand projects were launched for a total of about \$ 12 billion (<https://www.thecrowdfundingcenter.com>). However, activities in the field of crowdfunding using investment platforms due to the complication of the mechanism for obtaining and processing digital currency and securities, violations of the rights of the subjects of this activity requires further study and constant improvement of legal regulation. Taking into account the above facts, this work is devoted to defining the foundations of the current legal regulation of crowdfunding and investment platforms in Germany, Russia, the United States and France through the analysis of national legislation of countries, its comparison according to the criteria of subjects of legal regulation and control, restrictions in the framework of financing and problems of using crowdfunding in practice (Kyriazis, 2020; Kumar & Mishra, 2016).

Material and Methods

The study is based on a dialectical approach to disclosing legal phenomena and related processes using general scientific (systemic, logical, analysis and synthesis) and specific scientific methods. The focus group was selected states belonging to different legal families – Anglo-American (USA) and Romano-Germanic (Germany, France, Russia).

Results and Discussion

The term "crowdfunding" consists of two foreign English words, where the word crowd is translated as "crowd", and funding is translated as "funding", and is primarily a remote way of obtaining funding from an unlimited number of people using Internet sites. Crowdfunding is a special initiative project that is aimed at useful public goals with the possibility of financing "the money of citizens" and legal entities, in circumstances when only public funds are not enough. Lynda De La Vina uses a similar definition of crowdfunding: "Crowdfunding is defined as a process of an individual or group of individuals raising capital for a cause; be it cultural, social or business by attracting small contributions from a large crowd using social media and internet as the medium for communication" (de la Viña & Black, 2018). However, the above definitions do not disclose the nature of the legal mechanism for regulating crowdfunding, it is also impossible to determine how this process functions, in particular, what is the basis of legal administration inherent in its functioning. To understand the above issues of crowdfunding, let's explore the multifaceted concept of "investment platform".

The term "investment platform" is closely related to the concept of crowdfunding, since the second, as a rule, should be performed with the participation of the first. Consider the multifaceted concept of an investment platform without reference to the legislative norms of a particular state. As pointed out by Thies, F. Wessel, M. & Benlian, A., this definition includes transactions in which persons attracting investments (startups) publish detailed descriptions of their projects on websites (CF platforms) and sponsors choose, what projects to support based on the descriptions provided. All types of CF have one thing in common: platforms use technology-intensive platforms to keep in touch with startups and sponsors (Thies et al., 2016). Thus, an investment platform is understood as an online platform designed to conclude legal contracts between startups and investors using modern information technologies and tools. Therefore, these transactions are subject to rules that do not contradict the current legislation in the country where these procedures are officially legalized.

Many interested citizens, in particular lawyers and economists, may get the impression that the functioning of investment platforms is a purely technical programming algorithm that requires only a technical aspect of regulation, but in practice this is far from the case, which is confirmed by the statement cited in his study Divya Ashta: "This study shows that although information technology allows online crowdfunding platforms to be virtually global, the social capital and network required to enroll the right crowds in the given project locations are often local or regional, so they require a more targeted approach... the success of online crowdfunding platforms in general terms should depend on their ability to build

and maintain a global network of funders, enroll local fundraisers, and impose itself as an obligatory point of passage between the two networks through the strategic use of norms and rules embedded in the information technology system" (Ashta, 2018). Based on the presented reasoning, we can conclude that the implementation of any legal activity requires not only a well-developed mechanism for the technical functioning of crowdfunding, but also a formed legal framework based on centralized national law, therefore, let us turn to the legislative experience of countries that were the first to legalize crowdfunding and investment platforms.

The Jumpstart Our Business Startups Act (hereinafter referred to as the JOBS Act) is a specialized law designed to promote civil finance for small businesses in the United States of America by relaxing many of the country's regulatory restrictions on the securities market, passed on April 5, 2012 throughout the United States. Section 3 of this regulation, known as the Crowdfunding Act, empowered companies and organizations to use crowdfunding to issue securities that were previously officially prohibited by US federal law. The JOBS Act requires so-called "funding portals" or "investment platforms" to register with the US Securities and Exchange Commission in a specific manner and is a comprehensive commitment to them. These include procedures to reduce corruption and fraud, which in turn include checking the economic and biographical data of directors and founders of companies, as well as ensuring that investors do not invest more than they are allowed by law (Forbes & Schaefer, 2017). In addition, the JOBS Act directs the SEC to establish more detailed rules for funding portals. Small businesses are allowed to raise up to \$ 1 million a year through small investments through web platforms that are overseen by the Securities and Exchange Commission.

Analysis of the third section of the JOBS Act revealed possible problems in its implementation. First, this law has a regulatory limitation in practice - a requirement for companies that collect funds. Therefore, the total amount of investments cannot exceed \$ 1 million per year, and before the start of the crowdfunding campaign, the firm is obliged to publish data on the founders, their financial condition, the financial condition of the project and a detailed business plan. This point is not critical for small startups that raise rates in the early stages, but it is not so attractive for those who want to raise rates at larger stages, expanding and increasing investments. At the end of the crowdfunding campaign, the project team is obliged to regularly report on the spending of funds to its investors and the US Securities and Exchange Commission. In case of violation of these requirements, the company will be subject to administrative and criminal liability in accordance with applicable US law. Thus, for the opportunity to raise only \$ 1 million per year, many companies should not turn to non-accredited investors. However, the aforementioned \$ 1 million a year cap may soon be broadly removed by new rules to simplify the process for startups and investors, balancing consumer protection with the need to raise funds for startups, however, official US legislation has not yet been updated (Li et al., 2019; Sun et al., 2020; Prykhod'ko et al., 2021).

Based on the stated requirements of Section 3 of the JOBS Act, the term crowdfunding has evolved from an Internet term into an economic and legal one.

However, an urgent problem remains that some accredited investment firms are still reluctant to invest in companies that have non-accredited investors. Thus, most startups in the United States, like crowdfunding itself, are recognized as small deals, with which large investment intermediaries still do not want to get involved due to unjustified investment and legal risks. The requirements for information about issuers are quite complex, the volume of which depends entirely on the amount of investment since for their implementation one should often contact qualified lawyers, which in turn increases the cost of the issue. If the law is not followed correctly and there is no proper control, unscrupulous persons can get personal data, and the investors themselves can refuse the transaction (Palmiter, 2012).

France was one of the first states in Europe to enact special legislation to regulate crowdfunding. In October 2014, a bill came into force to facilitate the work of crowdfunding platforms – "Monetary and Financial Code as modified by Ordinance № 2014-559". This law divided investment platforms and intermediary resources into 3 categories: platforms for loans with or without interest (IFP), resources for the sale of shares (CIP) and resources for the provision of investment services (PSI). All three types of platforms must register with the Association for Certification of Intermediaries in Insurance, Banking and Finance (ORIAS). PSI is the most professional crowd investing platform that requires clients to have a certain minimum capital. The law establishes the maximum amount of funding at 1 million euros and limits the maximum amount of investments, it is 1 thousand euros. The restriction is made to protect investors from too large losses. The Wised.fr platform was the first on the French market and is currently the leader in terms of volume of transactions. Among the rapidly developing crowdfunding platforms, it is advisable to single out the investment platform Lymo.fr, which specializes in real estate and has a number of advantages over technology startups, in particular, it is more understandable for most investors (Chandna, 2021; Belleflamme & Peitz, 2010).

Germany became the second European state in terms of the volume of crowdfunding operations, the potential market of which is the largest in the European Union with the number of consumers exceeding 82 million people. Crowdfunding activities in Germany are developing dynamically. The only obstacle to the development of crowdfunding in Germany was the presence of regulations restricting the scope of this funding model. In 2011, crowdfunding platforms cooperated only with registered investors and the allowed volume of transactions could not exceed 100 thousand euros. Since 2015, new laws have been enacted in Germany that set limits on the maximum amount of funds raised through crowdinvesting platforms. The result of a set of measures was the first project (Referentenentwurf) the so-called Private Investor Protection Act (Kleinanlegerschutzgesetz), published on July 28, 2014. Government project (Regierungsentwurf) was published on October 10, 2014. The German Bundestag subsequently passed the Law (Kleinanlegerschutzgesetz) of April 23, 2015 in defense of retail investors. Due to the novelty of the concept, the country's legislative bodies do not have at their disposal a number of regulations designed to protect the interests of investors. Several cases have already been registered on the German crowdinvesting market when investors lost all funds invested in crowdinvesting projects (Kamyshansky et al., 2020; Kamyshansky et al., 2017).

Such incidents forced the country's legislature to pay attention to the development of regulations governing the shadow financing market. The main purpose of the regulations is to protect small investors and increase the level of confidence in this activity. There are about 80 crowdfundering platforms in Germany, where tech startups can sell their shares, and ordinary citizens can buy them. Moreover, such investments are usually associated with high risks. There is a limit on the maximum amount of the contribution: small investors can invest no more than 1,000 euros in crowdfundering projects, large investors, if they can confirm the presence of assets worth more than 1 million euros, will be able to increase the maximum investment amount, which in turn provides an opportunity to exit to the limits of joint stock crowdfundering in the amount of 100 thousand euros per year (Irwin, 2004; Davoodalhosseini, 2021).

Next, let's turn to the experience of using investment platforms and crowdfundering in the Russian Federation. Researchers associate the theoretical basis of the formation of the study of crowdfundering in Russia with the aggravated economic crisis of 2008, which became a kind of catalyst for a separate transition from traditional bank financing to crowdfundering. However, until 2019 in Russia there was no specialized legislation governing these legal relationships. With the adoption of Federal Law No. 259-FL dated 02.08.2019 "On attracting investments using investment platforms and amending certain legislative acts of the Russian Federation" (hereinafter - Federal Law No. 259-FL), a regulatory framework appears in Russia that legalizes crowdfundering, however, the term "crowdfundering" is not used in the legal act itself. According to some scholars, this term is not legal, although it was present earlier at the stage of the draft law and was replaced by investment (Tan & Reddy, 2021; Plyth & Craham, 2020).

Within the meaning of this law, crowdfundering is one of the ways to attract investments using investment platforms, which include: providing loans, purchasing equity securities, acquiring utilitarian digital rights and acquiring digital financial assets. (Articles 1, 5 of the Federal Law № 259-FL). As you can see, from the presented methods, it is not clear how exactly crowdfundering is regulated. There is no definition of utilitarian digital rights in this law, although the term "token" appears without definition. As rightly noted by A.V. Gabov "... the wording of the Law leaves the question of gratuitous crowdfundering completely open", "... classic crowdfundering and emerged as a gratuitous form of support", "... this form of raising funds is actively used, it is cross-border in nature, moreover, it is actively used and to achieve illegal goals", "... relations that are called gratuitous crowdfundering exist, have their own specifics, but they do not exist for the Law" (Gabov & Khavanova, 2020).

In accordance with Russian law, as well as sharing the position of A.V. Gabov, we will consider crowdfundering from the point of view of investments through investment platforms: "crowdfundering is not included in the regulation of this law (this word is not used in the law, neither formally, nor as a complex legal phenomenon)" (Gabov & Khavanova, 2020). As for the restrictions on investment activities within the framework of Federal Law № 259-FL, then according to Art. 7 The operator of the investment platform can provide an opportunity to invest for an individual within one calendar year no more than 600 thousand rubles - these restrictions do not apply to individual entrepreneurs. There are also general

restrictions for a person attracting investments - it is impossible to attract amounts of more than 6 billion rubles using investment platforms within one calendar year (Article 6). The investment platform operator verifies these restrictions, although a specific verification mechanism is not spelled out in the law. With regard to state regulation of the specified activities to attract investment through investment platforms, Art. 16 of Federal Law № 259-FL establishes the powers of the Bank of Russia to adopt regulations, the procedure for conducting inspections, maintaining a register of investment platform operators, and including information about operators in the relevant register (Rinartha et al., 2018; Nucciarelli et al., 2017).

Conclusion

The legislation of the United States, France, Germany and Russia in the field of crowdfunding reveals the main provisions that are directly related to investment platforms and investments, thereby helping interested parties navigate in this environment. Although the legislation of Russia, unlike foreign countries, does not directly mention crowdfunding, which in turn gives rise to legal conflicts of using this activity through the national law on attracting investments, limiting the rights of individual citizens to attract investments. The main problems in the application of the considered laws are expressed in the fact that operators of investment platforms are still not a guarantor of full confidence of investors in the rational use of their investments. Therefore, large investments are not received by small or medium-sized enterprises, due to the lack of confidence from investors in the use of investments for their intended purpose. In this regard, it is currently necessary to further improve the law on investment platforms and crowdfunding for all the countries considered, since the number of companies wishing to exercise the right to crowdfunding is constantly growing, but at the same time, the number of people who want to make money on this in a criminal way is growing.

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