

Existing Legal Issues for Crowdfunding Regulation in European Union Member States

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Abstract

The start of the global financial crisis of 2008-2009 and the post-crisis period jumpstarted the search for new, alternative ways to fund various innovations and projects. America's top banks have already recognized crowdfunding as a legitimate financing alternative. Although investment-based crowdfunding internet platforms in the EU have been around for over a decade, the key legal acts regulating the whole process came into effect only recently. Up until the middle of 2017, national crowdfunding-specific laws were passed in only 11 European Union Member States. In this article crowdfunding legal regulation is analyzed and evaluated in some European Union Member States. The aim of the study was to analyze the problems associated with crowdfunding regulation seeking to optimally satisfy the interest of all three parties: investors, project owners, and crowdfunding platform operators. The paper examines the concept of crowdfunding, its origin, and different types as well as advantages and disadvantages of this alternative financing method compared to other methods of funding projects.

Keywords: crowdfunding regulation, peer-to-peer lending regulation, donation-based crowdfunding regulation, legal issues, financial market, banks.

1. Introduction

Two main reasons can be concluded as to why crowdfunding came to be: the beginning of the global financial crisis of 2008-2009 and the post-crisis period provoked a desperate need for new, alternative financing since banks became more conservative in giving out loans to start-ups and small businesses because of higher risk. The crisis was the cause of a rapid increase in the creation of crowdfunding platforms, although Zopa, the first platform, was launched before the crisis in 2005 in the United Kingdom (Atz, 2016); the emergence and popularity of peer-to-peer lending (P2P lending) and crowdfunding platforms was also influenced by the fact that the people of the twenty-first century have become inseparable from the internet and social media, which is the result of the continuous development of information technology (IT). By using this special method, potential investors can be more involved with different projects and at the same time take part in economic growth and jobs creation. The aim of the study is to analyze crowdfunding's legal issues in regulating the rights and duties of investors, project initiators, and platform operators while finding a fair balance of interest between them. The objectives of the article: to study the concept of crowdfunding as one of the financial alternatives for funding business projects; to analyze the advantages and disadvantages of crowdfunding in the light of other more traditional ways of financing; and to cover the main issues that occur in regulating the rights and duties of project owners, investors, and platform operators. In the course of this research, the following methods were used: legal act analysis, scientific literature analysis, periodic article analysis and synthesis, systemic analysis, historic analysis, and summarization.

2.The concept of crowd funding and its origins

According to Cambridge dictionary, crowdfunding is described as the practice of getting a large number of people to each give small amounts of money in order to provide financing for a business project, typically using the internet (Cambridge Dictionary, 2017).Crowdfunding includes at least three parties: the project owner seeking financing to fulfill their project goals; a crowdfunding platform acting as an intermediary between the project owner and the investor, or lender; and the investor, who along with others lends money for the project.

IT, which is constantly under development, helps create a market consisting of different types of alternative financing instruments that emerge outside of the traditional financial system (i.e. regulated banks and capital markets). Examples of alternative channels are online “marketplaces” such as equity- and reward-based crowdfunding, P2P, and invoice trading third-party payment platforms. Alternative instruments include small and medium-sized enterprise (SME) mini-bonds, private placements, and other “shadow banking” mechanisms, social impact bonds, and community shares used by non-profit enterprises and alternative currencies such as Bitcoin and Monero (Wardrop, 2015). Traditional and alternative lending models differ significantly in their flexibility and allocation of risk. Alternative financing channels differ from traditional lending intermediaries by the fact that alternative lending platforms directly match the lending needs of borrowers with willing lenders (individuals or institutions), reducing the financing process fees and resulting in the increasing effectiveness of the financial market. In retrospect, we can identify examples of crowdfunding that were in use hundreds of years ago. For example, in the seventeenth century book publishers would only publish their book if enough people beforehand showed interest in buying it once it came out.

Another example is when in 1885 Grover Cleveland, the governor of New York, rejected the use of city funds to pay for a granite plinth for the Statue of Liberty given by the French (around \$6.3 m [£4.1 m] at today's prices), and Congress could not agree on a funding package. Nevertheless, the well-known publisher Joseph Pulitzer launched a campaign in his newspaper, *The New York World*, to raise the money. 160,000 people chipped, three quarters of contributors giving less than a dollar (“The Statue of Liberty”, 2013). This project fits the modern crowdfunding model in a few ways: first, a myriad number of people raised money in small increments, and second, the process was controlled by one intermediary – the newspaper. Modern crowdfunding is a new phenomenon mostly by its use of social media. It first gained popularity and mainstream use in arts and music communities. The first instance of modern crowdfunding was in 1997, when fans underwrote an entire American tour for the British rock group [Marillion](#), raising \$60,000 in donations by means of a fan-based Internet campaign (Golemis, 1997).

The earliest recorded use of the term “crowdfunding” was in 2006 by Michael Sullivan with the launch of fundavlog, a sort of an incubator for videoblog-related projects with a funding mechanism (Castrataro, 2011). Hence, the phenomenon of crowdfunding existed long before the term “crowdfunding” came into play.

The first ever crowdfunding platform was launched in 2005 in London. Zopa P2P lending works by bringing together individuals who have money to lend and individuals who wish to borrow money. Instead of going through traditional banks, borrowers looking for low-rate loans are matched with lenders looking for better returns on their money. Although foreign services have now closed, Zopa used to have operations in the U.S. and Italy. As of 2015, the number of alternative finance platforms in the U.S. was more than 140 and 94 in the EU and U.K. with 49 in France, 35 in Germany, and 30 in Italy (“Number of alternative finance”, 2015). In the last quarter of 2015, the global number of crowdfunding platforms was presumed to hit the 2,000 milestone. The global crowdfunding volume just 5 years ago, at the end of 2010, was \$800m, in 2014 it rose to \$16b (Barnett, 2015), and in 2015 it reached \$35b (Massolution Crowdfunding Industry, 2015). As we can see, the crowdfunding market is increasing rapidly every year and has spread across various types of financing models such as rewards, equity, donation, and debt/lending.

We can see there are two primary types of crowdfunding:

Reward-based crowdfunding, also called non-equity crowdfunding or the “Kickstarter model”. When entrepreneurs pre-sell a product (or service) to enough people, then a business can start (or a product can launch) without debt or sacrificing equity (or shares). Reward-based crowdfunding campaigns are commonly offered in one of two models. The “keep-it-all” (KIA) model involves the entrepreneurial firm setting a fundraising goal and keeping the entire amount raised, regardless of whether or not they meet their goal, thereby allocating the risk to the crowd when an underfunded project goes ahead. The “all-or-nothing” (AON)

model involves the entrepreneurial firm setting a fundraising goal and keeping nothing unless the goal is achieved, thereby shifting the risk to the entrepreneur. Small, scalable projects are more likely to be funded through the KIA scheme, while large non-scalable projects are more likely to be funded through the AON scheme.

1. Overall, KIA campaigns are less successful in meeting their fundraising goals, consistent with a risk-return tradeoff for entrepreneurs, where opting for the KIA scheme represents less risk and less return for the entrepreneur (Dauglas, 2014).
2. Equity crowdfunding, also called “crowdinvesting”, “investment crowdfunding”, or “crowd equity”. Equity is the financial fuel of the innovation economy. There are two main types of purchasers who fuel startup development through their investment in equity securities: angel investors and venture capitalists (Oranburg, 2015). Equity crowdfunding is a mechanism when investors, in exchange for financing a certain project, get stocks. Investment crowdfunding can be debt based (also called “P2P”, “marketplace lending” or “crowdlending”) or equity-based, or it can follow other models, including profit-sharing and hybrid models. The term equity crowdfunding is often used to describe crowdinvesting into both debt- and equity-based instruments. Debt-based crowdfunding emerged as an investment vehicle in 2005 in the U.K. (Zopa) and a year later in the U.S. (Lending Club). The debt version of crowdfunding lets individual borrowers apply for unsecured loans (not backed by collateral) and, if accepted by the platform, borrow money from “the crowd”, then pay it back with interest (Freedman, 2015).

In academic literature and other sources we can find one more crowdfunding type – “donation-based” crowdfunding. This type is used when trying to achieve a certain charity goal in fields such as scientific research or education as well as for distributing basic technologies in developing countries and other (Johnson, 2016). In general, donation- and reward-based crowdfunding are non-financial return models and typically fall outside the purview of financial regulators. Loan- and equity-based models are typically regulated financial activities in most countries (Garvey et al. 2017).

3. *Advantages and disadvantages of crowd funding*

By analyzing the practices of other countries, we see that small and medium-sized businesses that have some capital or property often refrain from crowdfunding. In those cases it is easier to ask for loans from banks by pledging the company’s property. We can identify several advantages and disadvantages of financing different projects through crowdfunding as opposed to other sources of crowdfunding such as venture capitalists or angel investors.

The following advantages can be seen:

- *Access to capital.* Crowdfunding gives people the opportunity to fund their projects when other sources are unavailable, for example, if a bank loan cannot be secured or angel investors or venture capitalists are not convinced to support their business. It’s much easier when a group of people each contribute a small fraction of the funds for a project rather than when a bank gives out a loan and risks larger amounts.
- *Time efficiency.* It’s a quick way to raise money for a project/idea as opposed to bank loans and venture capitalists; a longer amount of time is required for banks and venture capitalists to scrutinize the business before parting with their money.
- *Marketing.* A public announcement of a project on the internet can be a valuable form of marketing. It can attract media attention as well as feedback and professional guidance on how to improve it.
- *A good way to check the project.* It’s a good opportunity to determine the level of demand and support for an idea or a project. If it gets a lot of positive attention, that’s a sure sign that a certain project is promising.
- *Investors can track the progress.* This may help to promote an idea through their networks and attract more investors. They become automatic ambassadors to the project.
- *Loyalty of Investors.* People who finance a certain project usually become loyal customers and finance future projects, often on more favorable terms.
- *Lower overhead – better interest rates.* In the last couple of years, rapidly expanding P2P lending companies have been able to run with lower overhead and provide cheaper services than traditional financing institutions because they save money by not needing to spend a lot on employees, subsidiaries, etc.

As a result, lenders often earn higher returns compared to savings or investment products offered by banks, while borrowers can borrow money at lower interest rates, even after the P2P lending company has taken a fee for providing the match-making platform and credit checking the borrower.

- *Increase of competition in the financial sector.* Overall, all non-bank financial institutions, including those that deal with crowdfunding, enhance competition within the financial services industry, which results in a decrease in the cost of services for consumers (Carmichael, 2002). Moreover, there is a high known correlation between financial development and economic growth. Better access to financing for small businesses promotes entrepreneurship and ultimately contributes to growth and job creation. One study estimates that in Spain alone, 7,500 direct “crowd-jobs” were created through some 2,800 successful crowdfunding projects (Ramos, 2013).

The following disadvantages can be the following:

- *The AON method.* Most crowdfunding platforms use the “all-or-nothing” model. That means if the target amount is not reached, potential investors get a refund, the business gets nothing, and all the time and money invested in the campaign is wasted.
- *Not necessarily an easy journey.* Crowdfunding may not be a successful way to get funded since disputes can happen between internet platforms and the state’s supervisory institution requirements.
- *Initial fees.* When starting a new project, actions taken on an internet platform can sometimes require significant money and time (e.g., creating an attractive project page, making a compelling video, brainstorming rewards, reaching out to reporters and designating expenditure for management consultants, financial advisors and so on).
- *Reputation.* If the project is unsuccessful it will damage the reputation of the business and disenfranchise the people who trusted that business with their money. Moreover, the information about the fruitless endeavor will stay on the platform for everyone to see and that will have negative effects on the company in the future.
- *Intellectual property protection.* It’s critical to have suitable protection for an idea before showing it to the public. If a project is not protected by copyright, trademarks, or patents, anyone can steal the business idea posted on the platform, especially if the idea is easily replicated.
- *Potential lawsuits.* Lawsuits arising from failed business ventures can occur. Project owners can be accused of fraud, breach of contract, or mismanagement. Although each investor contributes a very small amount and it may be cost prohibitive to pursue legal claims, they can file complaints to regulatory agencies that might lead to investigations.
- *Negative effect on financial options.* Companies that issue shares through crowdfunding are beholden to myriad unsophisticated investors who own small stakes in their business. The result of this could deter angel investors or venture capitalists from investing in a company that is owned by hundreds or even thousands of inexperienced shareholders.
- *Uninsured deposits.* When investors invest via crowdfunding as opposed to banks, their contributions are not insured by the state deposit insurance (the Federal Deposits Insurance Act in the U.S., the Financial Services and Markets Act in the U.K., the Law on Insurance of Deposits and Liabilities in Lithuania).
- *Imperative to watch for fraud.* Different countries’ financial market players are monitored by financial regulators or securities regulatory agencies (the Central Bank of the Republic of Lithuanian (LB) in Lithuania, the Financial Conduct Authority (FCA) in the U.K., the Securities and Exchange Commission (SEC) in the U.S., the Autorité des marchés financiers (AMF) in France, etc.). However, the possibility of fraud always exists due to such problems as fake websites, fictional charities, Ponzi schemes (Šadžius, 2005). Naturally, new market players provoke even bigger competition in certain areas such as payment and small credit, and thus, some of those services are being provided less frequently by banks. Considering the recent surface of this financing method referred to as crowdfunding and keeping in mind that the current EU legislation was not designed having regard to these businesses, it can be asserted that there was a clear risk of varying interpretations of the legislation. Furthermore, because of the novelty and a wide range of business models it was unclear which law to apply or what potential EU legislation was applicable and the rules or guidelines on how they should be applied.

4. Crowdfunding regulation

In the EU Member States there are three broad types of crowdfunding depending on the return the investor receives. Given the vast variety of crowdfunding campaigns, depending on the specific features of each, different EU rules may apply to crowdfunding. General legal acts regulating this process in the EU are the following: the *Anti-Money Laundering Directive (AML)*, The *Regulation on Information on the Payer Accompanying Transfers of Funds*, The *Regulations on Unitary Patent Protection*, The *E-commerce Directive*, the *Directive on Misleading and Comparative Advertising*, the *Directive on Unfair Commercial Practices* and others. Other EU regulations can be applied depending on what type of crowdfunding is chosen and what business model is used in a certain country. These include updated rules for markets in financial instruments such as the *MiFID 2*, the *Alternative Investment Fund Managers Directive*, the *Prospectus Directive*, the *Capital Requirements Directive IV*, the *Payment Services Directive*, the *Consumer Credit Directive*, the *Capital Requirements Regulation*, the *European Venture Capital Funds Regulation*, the *Regulation on European Social Entrepreneurship Funds* and others. All of the abovementioned international legal acts and national laws regulate the main problematic aspects of legal regulation of the crowdfunding process, and the approach to solutions vary from jurisdiction to jurisdiction: in the market intermediaries/portals field: market intermediaries registration requirements.

Permissions and prohibitions, business conduct rules (e.g., customer due diligence, suitability, marketing/promotion), procedures for dealing with platform/intermediary failure, risk of fraud, availability of communication channels, handling of customers' funds and assets, liability attached to different parties (e.g., which party has the obligation to conduct due diligence on the issuer, liability for disclosures made to investors), and reporting obligations; in the equity/debt issuers field: equity/debt issuer's qualifications (e.g., size/type of companies), limits on offering size, offering parameters, limits on securities, risk of default; in the investors field: investor protection, eligibility of investors (e.g., sophisticated investors only), restrictions regarding number of investors and maximum amount of investment, experience, education; in the disclosure field: point of sale and ongoing disclosure, prospectus requirements (e.g., type of information to be included, exemption from prospectus requirements), and liability attached to materials; in the mitigation of emerging risks field: cyber risk, interconnectedness, etc. Perfected legal regulations and effective supervision directly influence the stability of the financial market. In different scopes of regulation, these requirements differ. By analyzing the regulation of investment-based crowdfunding and the lending-based crowdfunding of some of the most developed countries, the main legal requirements which are implemented in the national laws of these countries that govern the activities of the three parties can be explained.

4.1. Requirements for platform operators

Internet crowdfunding platforms are legal entities that operate like any other business, where the main purpose is profit. Platforms generate revenue by acting as intermediaries for project owners and collecting fees for such services. The fees can be percentage-based or a one-time fixed annual payment depending on the generated sum of money. Additionally, lending intermediaries receive loan servicing fees from investors. There are examples of platforms that are not only charging 5 percent from the invested amount but also 5 percent from the raised amount. Project creators who decide to look for financing outside of traditional methods like banks or other financial institutions via internet crowdfunding platforms should make a careful assessment to determine which platform suits their needs best depending on the type of project they want to launch. The reason is that among existing internet platforms, there is a vast variety of services being provided and different platforms offer different financial services.

Authorization. Most EU Member States such as Austria (Law on Crowdfunding of Austria, 2015), Belgium (Law on Crowdfunding of Belgium 2016), France (Law on Crowdfunding of France, 2014), Italy (Law on Crowdfunding of Italy, 2016), Portugal (Law on Crowdfunding of Portugal, 2015), and Spain (Law on Crowdfunding of Spain, 2015) have in their laws on crowdfunding the notion that only legal entities can be operators of a crowdfunding platform. These platforms acquire the right to provide financial services in the financial market when certain state institutions, such as government financial regulators, for example, the Italian Securities and Exchange Commission (CONSOB) in Italy or the National Securities Market Commission in Spain, or security regulatory agencies, for example, the AMF in France or the FCA in the U.K., grant them license for this activity and put them on the public crowdfunding platform operators list. The supervisory authority can make exceptions for platforms when they are subject to fulfilling certain conditions such as conduct of business rules or specific requirements for the sake of mitigating risks in the business model of the relevant platform.

There are four broad models of crowdfunding platform authorization in EU Member States. First, authorization under the MiFID; the advantage of this method is that platforms can carry out their business across the EU. Second, authorization under a domestic bespoke regime which is the exemption found in MiFID (Art 3); by this method platforms can only operate on a national level. Third, authorization for services and activities in relation to non-MiFID financial instruments; this is when a platform intermediates instruments that are not financial instruments according to MiFID, such as non-readily realizable securities. Last, authorization outside the scope of MiFID. In practice, some of these models in certain EU member states are combined.

When a crowdfunding platform is under the regulation of MiFID and there are no applicable exemptions, then the platform can be either directly authorized as an investment firm, be operated by such a firm or credit institution that has been authorized under MiFID, or act as a tied agent of either the firm or the institution. Nevertheless, Member States can choose to allow or disallow the use of tied agents.

Minimal capital requirements. In different jurisdictions, national laws have risk management standards. Those are referred to as minimal capital norms or professional liability insurance. One of the purposes of these regulatory capital requirements in MiFID (Art. 15) is to protect the customers of investment firms from the risk that comes with the firm becoming insolvent and to ensure operational continuity. That being said, by systemic analysis of different Member States' laws it is apparent that this minimal standard varies and that, seemingly, for the most part depends on the wide variety of internet platforms and a wide range of activities.

For example, in the U.K. (FCA, PS 14/14), for all the firms that operate effective platforms there is a minimal capital requirement of £50,000, with a £20,000 requirement during the transition period. In Spain (Alois, 2015), the owners of crowdfunding platforms must have a share capital of at least €60,000 or have social responsibility insurance that can cover €300,000 worth of complaints regarding damages and a total of €400,000 annually for any complaints. If the amount of funds raised is above €2m within the last 12 months, then the minimum capital of the company would be €120,000 and increase in proportion to the funds raised, up to €2m. In Portugal and Finland (Crowdfunding Act of Finland, 734/2016), €50,000 minimal capital or liability insurance covering that amount is required. Under other national law, such as that for Italy, there is no minimum capital requirement at all. The general requirements under the regulations of EU can be found in MiFID: the initial capital requirement is €730,000 or, if a firm receives and transmits orders and/or executes orders and/or manages a portfolio and holds the client's money but does not deal on its own account, €125,000. Member states may lower the initial capital requirement of €125,000 mentioned above to €50,000 if the firm is not authorized to hold client money (Directive 2013/36/EU, Art. 28(2), 29(1,3)). All that being said, the usual MiFID capital requirement applied is €50,000 or, in some cases, an equivalent in regards of professional compensation insurance. When Member States develop regimes under the exemption in Article 3 they are subject to lower capital requirements. However, platforms incur costs which they otherwise would not and more importantly they do not have access to a passport.

Disclosure to investors by the issuer. The project owner must present the platform operator a document for confirmation which consists of information about the project owner and their proposal to conclude a contract. Different countries have different rules on the contents of such document. There may be cases when in certain EU Member States there is a requirement to provide an informational document but it is not approved by the supervisor. Furthermore, this document also may not be required to follow a template. All this is determined by national laws. For example, in Italy information should be communicated in a concise, precise and clear way using the Consob standard form. All the information is provided by the offeror under its own responsibility and there is no requirement of prior approval by Consob. Offerors are allowed to use other communication tools such as films, interviews, slides and pitches (Consob Regulation, 11971, art. 16, part 2). In Portugal, the issuer must prepare a document called "Key information for investors in crowdfunding investment" (Legal framework of some countries, 2015). Moreover, if a project owner wants to issue securities when the sum exceeds €5m, it is required to provide a harmonized EU prospectus and it must be confirmed by a respective country's financial market supervision authority under the Prospectus Directive (Art. 3). This is fundamentally regulated by MiFID (Art. 33-3(c)). On the other hand, in separate jurisdictions there can be lower limits set for issuing securities through crowdfunding platforms. Furthermore, offers with an annual consideration of €5m are outside the regulation of the Prospectus Directive (Art. 1-2(h)).

Obligation to publish a prospectus is also excluded when the annual consideration is below €100,000 (Art. 3-2(e)) and if the offers are directed exclusively to professional investors under MiFID (Art. 3-2(a)). That being said, Member States can act at their own discretion in applying national requirements when the offers are in the range of €100,000 and €5m.

Information requirements and risk warnings by platform. In an investment-based crowdfunding platform, operators are obliged to disclose certain information, such as information about investment risks, the fees for investors and project owners, terms and conditions of refunds for investors, or risk management methods, if applicable. The list of what must be shared with the public is different depending on each country's national law. In Spain, for example, there are warnings that platforms are not investment firms nor, for that matter, credit institutions and that there are risks in investing in the projects published by the platforms. Users are also warned that projects are not subject to supervision and authorization, meaning the information provided by promoters has not, in fact, been reviewed by a supervisor and does not, in any way, constitute an approved prospectus, or representations prior to the investment or requirements on investor's information. In Italy, there is information regarding activities performed, taxation benefits, investors' fees, and general risks related to crowdfunding investments. There is information that relates to each offer independently: risks, the offer, the issuer, and the financial instruments and services offered by the platform in relation to the offer. It would seem that typically platforms structure their business models in such a way as to avoid requirements under MiFID. As a result, when platforms are established outside of MiFID, investors are subject to greater risks that are not addressed on an EU level. Furthermore, the lack of a passport makes achieving the potential scalability of platforms a lot harder. While the mentioned greater risks could be addressed on a national level it will not cover the issue of scalability.

Due diligence. The platform must check the completeness, comprehensibility and consistency of the issuer's information and in some cases platforms may be required to provide the pre-determined criteria for selecting the projects. In Italy, for example, in an investment-based crowdfunding, platform operators must provide detailed information relating to strategies for the selection of the offers presented on the platform.

In comparison, in Spain, platform operators shall confirm that the information regarding the project required by law to be disclosed to investors is complete. In France, lending-based crowdfunding platforms are obligated to perform due diligence when selecting the projects and also disclose the predetermined criteria used in the selection process.

Conflict of interest. Different countries' national laws regulate platform operators' rights, duties, and restrictions differently. In France, for example, platforms are subject to rules regarding the management of conflicts of interest described in the General Regulation of the Financial Markets Authority (T 1, Ch 3, Sec 1, Sub-sec 6). In Germany, platforms are required to disclose any fees, payments or other monetary benefits that they receive from third parties other than investors in connection with the services provided. In Italy, platforms must work with diligence, fairness and transparency avoiding any conflicts of interest which could arise in the management of the platform that may affect the interests of investors and issuers and ensuring equal treatment of the beneficiaries of the offerors who are in identical conditions. It is clear that platforms authorized under MiFID incorporate administrative agreements with the legal approach to take carefully designed steps in order to avoid conflicts of interest without dramatically having an impact on the interests of clients. Contrary to platforms that decide not to go through authorization under MiFID, there are national regimes that specifically address this issue, including requirements to recognize and manage potential cases of conflict of interests and disclose to users the conflict of interest management and limitations policy or even prohibitions to the extent to which it is allowed for platforms to act either as investors or issuers.

The Regulation (Regulation (EU) 1095/2010, Art. 29) obliges the European and Securities Market Authority (ESMA) to contribute to creating a harmonized and consistent supervisory culture as well as supervisory practices, making sure that consistent approaches and common procedures exist throughout the EU. In addition, Article 29(1)(a) encourages the ESMA to provide opinions to various different authorities. The ESMA concluded that one of the cornerstones of an appropriate crowdfunding regulatory regime is a proportionate balance between the platform's organizational arrangements and conduct of business, particularly regarding conflicts of interest and continuity of services where relevant (ESMA, 2014/1378, 12).

Professional requirements. Special attention is given to the competence of members and managers of crowdfunding platforms. In France, platform managers and administrators must provide evidence of the required level of professional skills (requirements examined by the AMF) before the platform is registered as well as evidence of fulfilling the appropriate professional skills and good reputation requirements of crowdfunding investment advisers. Similarly, in Germany, reliability and expertise are shown by passing an exam conducted by the Chamber of Industry and Commerce. Slightly differently in Portugal, platforms should have the necessary human, technical, material, and financial resources and an assessment of platform's officers must be conducted by the National Securities Market Commission. It can be seen that at least some platforms actually prefer to be under a certain regulatory or supervisory regime for the purpose of inspiring confidence in potential parties. On the other hand, other platforms choose to structure their businesses in such a way as to avoid the current grasp of regulation as much as possible. As a result, investors may see this as a higher risk.

4.2. Requirements for project owners

By researching different national laws in EU Member States, it can be concluded that the standards that project owners have to meet also vary considerably.

Size of offer (prospectus requirements or limitations). In France only €1m is allowed per year per project. In Portugal it is also €1m per year per project but €5m if the offer is limited to professionals, that is, individuals with an annual income above €100,000 and legal persons only. In Italy, it is lower than €5m. In Spain, it is €2m per project in a given year, although it can be €5 m if the offer is limited to accredited investors. In Germany, there is an exemption from the full prospectus requirement for offers of profit-participating loans, subordinated loans or other investment products below €2.5m, yet this exemption may not apply in certain cases (Capital Investment Act, sec. 2, par. 1, no. 3). If a project owner in Lithuania is seeking to raise from €100,000 to €500,000 in the period of 12 months, they must provide the platform operator with an information document for approval. If the sum reaches €5m, the project owner can raise the money by issuing securities according to the Securities Act of the Republic of Lithuania (Art. 2, par 2, part 6). Furthermore, when the sum reaches €100,000 or above, the project owner will have to allocate no less than 10 percent of their own money to finance the project.

4.3. Requirements for investors

The national law in developed countries provides that using internet crowdfunding platforms the right to invest in a specific project belongs to natural persons as well as legal entities and other subjects such as investment funds. Requirements for investors differ from country to country. Virtually in all of the jurisdictions where crowdfunding exists there are a number of similarities in the general approach to protecting investors. This protection ranges from limitations on the amount that may be invested to education requirements, risk warnings, cancellation rights, and other jurisdiction-specific protection provisions. Furthermore, crowdfunding platform operators conduct checks on individual projects to see whether they are suitable and appropriate for the investor. By studying the main legal acts of some EU countries that regulate the crowdfunding process a few requirements for individuals who want to invest in certain projects via internet crowdfunding platforms can be highlighted:

Know-your-customer rules (suitability or appropriateness). In Austria, platforms must establish the identities of both project owners and investors. Moreover, there is an obligation of compliance with anti-money-laundering and terrorism financing legislation. In France, in addition to the latter, the access to platforms is restricted only to registered investors who have been warned of and have expressly accepted the risks. A suitability test is also mandatory, that is, platforms must ensure that the investment is in accordance with investor's financial situation, experience, and risk appetite or refuse the investor's participation. In Germany, this suitability check is in accordance with Article 16 of the Financial Investment Brokerage Ordinance and with Section 31, Part V of the Securities Trading Act. AML/CFT rules will apply if platforms qualify as obliged entities under the AML/CFT Act. Moreover, if the platform falls under MiFID, especially the business rules regarding suitability, the entirety of the MiFID rules apply. In Spain, platforms must assess the knowledge and experience of their clients and verify that they are capable of making their own investment decisions and understand and prioritize risks. A special kind of attention is given in various jurisdictions to the prevention of money laundering under Directive 2005/60/EC, which prevents money laundering and terrorist financing. Articles 6-13 requires platforms to carry out due diligence on clients, which are strengthened or simplified in certain cases and Articles 30-33 call for an appropriate record-keeping as well as other internal procedures. Firms have a duty to cooperate with other authorities, which includes reporting suspicious activities as well as nondisclosure of any information regarding report or investigation under Articles 20-24, 26 and 28.

Additionally, Member States can impose stricter rules according to Article 5. Since many current platforms are not regulated by MiFID, they do not automatically fall under the scope of the AMLD. That being said, however, the definition of “financial institution” includes those realizing money transmissions, participation in and the provision of services related to security issues, and the safekeeping and administration of securities. This, depending on the business model, can “capture” some platforms.

Maximum investable amounts. In Austria, for example, €5,000 per individual investor per year is the maximum investable amount. This limit, however, does not apply to professional investors¹ and legal persons. Exceptionally, individual investors can invest over €5,000, but not more than double their monthly net income nor above 10 percent of their financial assets. Some jurisdictions, such as the U.K., decided to enforce a limitation for people who do not qualify as professional investors to participate in lending-based crowdfunding, whilst other countries.

Such as France and Belgium, have limited the maximum amount of money lenders can invest in such platforms to €1,000 (Rusu, 2016, 28). However, in investment-based crowdfunding, French national law has no restrictions whatsoever regarding the number of investors, the type of investors, or maximum investment limits. In Germany, there are no limits for legal entities. For natural persons, the limit is €10,000 if the investor has liquid assets of at least €100,000; if not, the limit is twice the investor’s monthly income of up to €10,000, and if the individual does not provide any statements about their assets or income, then the limit is €1000. In Spain, accredited investors can invest without limit. Others have a limit of €3,000 per project and €10,000 for all platforms. Accredited investors are a) institutional investors; b) companies with €1m in assets, €2m of annual turnover, or €300,000 in equity; or c) individuals with €50,000 in annual income or €100,000 worth of financial assets. As opposed to other types of crowdfunding, P2P regulations are very different amongst countries. In some, P2P consumer lending is completely unregulated but legislation is prepared to protect the interests of consumers and prevent irresponsible borrowing. Although the regulations for platform operators, investors, and project owners vary from one jurisdiction to another, commonly understood virtues are addressed concerning the regulation of the crowdfunding process. Up until the beginning of 2017 national crowdfunding-specific laws have been passed only in 11 EU Member States (see Table 1).

Table 1. Dates when the national investment-based crowdfunding laws of the European Union Member States came into force

EU Member States	Entry into force
Austria	September 1, 2015
Belgium	February 1, 2017
Bulgaria	-
Croatia	-
Cyprus	-
Czech Republic	-
Denmark	-
Estonia	-
Finland	September 1, 2016
France	October 1, 2014
Germany	July 10, 2015
Ireland	-
Italy	June 26, 2013
Lithuania	December 1, 2016
UK	April 1, 2014
Greece	-
Hungary	-
Latvia	-
Luxembourg	-
Malta	-
Netherlands	April 1, 2016
Poland	-
Portugal	August 24, 2015
Romania	-
Slovakia	-
Slovenia	-
Spain	April 29, 2015
Sweden	-

¹Professional investors, i.e. professional clients. According to MiFID, Annex II, a professional client is a client who possesses the experience, knowledge, and expertise to make its own investment decisions and properly assess the risks that it incurs.

Conclusions and Recommendation

The phenomenon of crowdfunding existed long before the term “crowdfunding” itself. The start of the global financial crisis of 2008-2009 and the rapid progression of information technology led to this alternative financial method being used to fund different projects. Crowdfunding brings together three parties: the project owner who is seeking to get financed; the investor as a part of a huge group of subjects financing the project; and a crowdfunding platform, which acts as an intermediary between the project owner and the investor. Although the researched financing method has a lot of advantages in funding a variety of ideas, on the flip side, it also has quite a few disadvantages. That is why every person seeking money through crowdfunding should take all those factors into serious consideration. The European crowdfunding market is still at an early stage of development and continues to evolve rapidly. By analyzing international laws and the national laws of different jurisdictions that govern the activity of the three parties involved in crowdfunding it is apparent that legal regulations vary from one jurisdiction to another, though the main requirements for project owners, investors, and crowdfunding internet platforms are mutual. One of the top priorities in this process is the development of financial market regulatory institutions, since well thought-out legal regulations and supervision are the cornerstones of a stable financial sector. Although investment-based crowdfunding internet platforms in the EU have been around for over a decade, the key legal acts regulating the whole process came into effect rather recently.

For example: 1 September 2015, Austria; 17 May 2014, Belgium; 1 October 2014, France; 10 July 2015, Germany; 29 April 2015, Spain; and 24 August 2015, Portugal. Crowdfunding regulations took a while to emerge in various jurisdictions and in some it is still in the making because the process has many concerning issues that require long hours of discussion. For example, in the area of platform operators: activity continuity, issues arising on how licensing should be settled and questions on conflict of interest; from the investors’ point of view: whether the requirements are necessary for investors when deciding whether everyone can invest or only qualified/accredited investors, also whether limitations on the amount invested is fair as well as the questions of suitability tests and disclosure of information. It is essential to strengthen coordination and collaboration between regulators. In different countries there are many discussions about the strong and weak points of crowdfunding regulatory regime. Increasing collaboration among policy-makers must be a priority.

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