

Crowd funding Regulation in the Baltic Region

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Abstract

The start of the global financial crisis in 2008-2009 and the post-crisis period jumpstarted the search for new, alternative ways to fund various innovations and projects. In the age of financial technology, crowd funding platforms, which first began their business in the leading technology-developing countries in the world such as the United States of America and the United Kingdom, began to operate in Estonia, Latvia, and Lithuania, otherwise known as the Baltic region. Crowd funding has attracted not only creators of new and innovative projects but also investors, businesspeople, and consumers. Due to both objective and subjective reasons, this financial instrument that has recently emerged on the global financial markets has been fully regulated only in Lithuania out of all three Baltic States –the National Law on Crowd funding was adopted at the end of 2016. This article analyzes the legal regulation of the activities of crowd funding platforms in the three Baltic States and the similarities and differences of this process.

Keywords: fintech, crowd funding, peer-to-peer lending, donation-based crowd funding, banks, financial market, Central Bank.

Introduction

Crowd funding is a financial instrument used to receive funds via online platforms to finance various projects when natural or legal persons cannot receive funding from other alternative sources in financial markets and for small and medium-sized enterprises (SMEs), which represent over 99% of businesses in the European Union (EU) (Access to finance for SMEs, 2018). Studies have also shown that around the globe, SMEs often have one major pain point – dealing with their finances and ensuring appropriate funding. As reported by the International Financial Corporation, a “funding gap” of more than \$2 trillion exists for small businesses in emerging markets alone (World Economic Forum, 2015, 7). The alternative ways to collect capital for business activity are mainly based on financing from business angels, venture capital funds, or private equity funds. Furthermore, the European Union supports the development of small and medium enterprises. The initiatives, which transfer institutional support to this sector, are provided on the national and international level (Bednarz, 2015). The European online alternative finance market has attained diversified growth across a wide array of funding models. The largest amount of funding is raised in North America with the United States of America (US) as the key center, followed by Asia and Europe. However, the highest annual growth rate is to be observed in Asia with 210%, Africa with 101%, and Europe with 98.6% (Mazurek, 2017).

In the last five years, fintech sectors have also been actively developing in the whole region of the northern European Baltic States, which has led to an increase in the efficiency of national financial markets. In Latvia alone, in the first quarter of 2017, the fintech industry was valued at \$878M (Latvian Fintech Startup, 2017). One segment in particular is crowd funding.

Major platforms that develop their business in such areas as focusing on consumer lending, business loans, and invoice factoring¹ are: Viainvest, Latvia, a peer-to-peer lending (P2P lending) platform; Twino, Latvia, the third largest P2P consumer lending platform in Continental Europe; Savy, Lithuania, a P2P consumer lending platform; Mintos, Latvia, P2P lending; Hooandja, Estonia, a donation-based crowd funding platform; Fundwise, Estonia, an equity-based crowd funding platform; Investly, Estonia, the first business P2P lending and invoice factoring platform in Estonia; and Bondora, Estonia, a leading P2P lending platform for investing in European non-bank personal loans. Undoubtedly, the implementation and development of new financial instruments in financial markets will continue to be one of the priority directions in the individual Baltic States. When international laws and the national laws of different jurisdictions of the Baltic States that govern the activity of the three parties involved in crowd funding –investors, project owners, and crowd funding platform operators– are analyzed, it is apparent that legal regulations vary from one jurisdiction to another, though the main requirements for project owners, investors, and crowd funding internet platforms are mutual.

The aim of the study is to analyze the regulation issues of the crowd funding subsector in the financial markets sector of the Baltic region.

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.

1. The crowd funding market in Estonia

One can safely say that Estonia is a European frontrunner. Crowd funding platforms began to operate in financial markets in Estonia very early on. Although the Estonian market is only 1M+ people, it has the potential to grow through virtual Estonians, who are attracted by the e-residency program that was recently launched by the Estonian government. In 2009, a local P2P consumer lending platform called isePankur (now Bondora) was established, which has been ranked one of the largest European P2P lending platforms for unsecured consumer loans. The first equity-based platform in Estonia and in the Baltic States, Fundwise.me, was officially launched in August 2015 and concentrates its activities and helps find investors for SMEs in the Baltic region. The platform gives two options for investors: the direct equity option and convertible notes. The first requires the investor to purchase shares in the business straight away, while the second allows for a delayed transaction where an investor provides a loan to the company that can later on be converted into an equity stake in the business. Equity crowd funding platforms recently established in Estonia include Funderbeam (2016), the first worldwide secondary market for venture capital (OECD Economic Surveys, 2017, 112). As of today the Estonian equity model crowd funding market to date is very limited in size compared to the overall crowd funding market in Estonia. In 2012, Hooandja, the first donation-based crowd funding platform, was established in Estonia. For this platform, project owners are supposed to develop a project based on innovative ideas (including design, music, books, cinema, theatre, etc.), for financing and present it with a video and/or descriptive summary. For these projects, no financial return is involved. On Hooandja €1,990,210 has been raised for 629 projects by 64,215 backers (numbers retrieved on April 19, 2017). Most projects are for CDs, movies and documentaries, books, festivals, and theatre productions (Heinsius, 2017). At the end of 2017, the donations or rewards model was used by three platforms in Estonia to finance creative projects (Review of Crowd funding Regulation, 2017).

When investments in the real estate sector are analyzed, we see that in the US and some EU countries, real estate crowd funding has become an alternative source of investment capital (Cohen, 2016), but in the Baltic region it has begun to develop only recently. Estonian platforms have been more active and popular in the field of real estate in the region. In 2017, Bulkestate.com, the first Latvian real estate crowd funding platform (established in 2016), was established in Estonia, increasing competition in the crowd funding sector. Currently there are two main crowd funding platforms presenting real estate projects. When we analyze the crowd funding sector in the Baltic region, we see that most crowd funding platforms in Estonia are lending based. Indiegogo (US) and Kickstarter (US) are the most important crowd funding platforms from abroad. However, recently there has been much discussion about using crowd funding for funding projects dealing with renewable energy sources (RES projects), but no crowd funding platforms specializing in funding RES projects currently exist in Estonia. Nevertheless, a few RES projects have sought financing through other existing (lending-based) crowd funding platforms.

¹Firms sell invoices or receivables (debts, unsettled transactions or other monetary obligations) to individual or institutional investors at a discount to raise working capital.

In 2015, there were 16,634 investors who used Estonian crowd funding platforms, raising more than 12 million euros. Estonia is ranked in the top 10 European countries by alternative finance market volume, with an overall volume equal to 31.5 million EUR. Lending crowd funding is the most common model in the country. In 2015, Estonia ranked second in Europe on total volume per capita. When looking at the entire crowd funding market in Estonia, it can be calculated that on average, every Estonian provided 24.02 EUR via alternative financing platforms. The United Kingdom (UK) was in first place in Europe with 65.88 EUR per person (the US has the highest total online alternative finance market volume per capita in the world at \$113.43 in 2015) (Wardrop, 2016), and Estonia was followed by Finland with 11.65 EUR invested per person (Sustaining momentum, 2016, 29).

1.1 The main aspects of legal regulation

Estonia does not have specific national regulations in place for crowd funding, such as the National Law on Crowd funding, adopted in Lithuania at the end of 2016. In general, Estonian financial market legislation is based on the regulation of the European Union, the Directive on Investment Services in the Securities Field (93/22/EC) and the Directive on Markets in Financial Instruments (2004/39 EC) (MiFID / MiFID II). National legal acts regulating activities of the Estonian financial market were also adopted: the Credit Institutions Act (1999), the Investments Fund Act (2004), the Financial Supervisory Authority Act (2001), the Estonian Central Register of Securities Act (2000), and others (Marimaa, 2011, 96). The main policy institution responsible for alternative finance in the country is the Ministry of Finance (Rahandusministeerium). In 2015, the Creditors and Credit Intermediaries Act (CCIA) was adopted, and it imposes a license obligation on creditors and credit intermediaries. If the crowd funding platform facilitates the offering of transferrable securities or its operator acts as a securities broker, the platform may be deemed to provide investment services in the meaning of the Estonian Securities Market Act (SMA) and will be subject to the investment firm license requirement. Under the CCIA, lending based platforms, depending on their structure and activity, are obliged to obtain a license from the Estonian Financial Supervision from 21 March 2016.

The crowd funding scene in Estonia is generally regulated by a good practices guide, prepared by Finance Estonia and the Deloitte Legal law firm in Estonia, which aims to make the increasingly popular crowd funding platform providers' activities more transparent for clients and investors. This was necessary because a number of the platform providers' activities in Estonia are not affected by financial regulation. The best practices provide behavioral guidelines for the platforms to ensure increased transparency and clarity for their clients. The best practices do not substitute for the obligation to comply with the legal acts that are applicable depending on the actual business model of each platform. It is mainly the clients that will benefit from best practices. If a crowd funding provider has joined the best practices framework and fails to comply with its rules or explain non-compliance, the investors will have more information to decide on the credibility of the particular platform provider. The fee models of various platform providers often remain unclear for clients. Best practices are what must be clearly communicated to the crowd investors and, as we are talking about investing, it is necessary to be frank with investors about related risks. In the best practices, the following issues of crowd funding activities have been discussed: data protection, measures of money laundering prevention and the implementation of international sanctions, the quality of information and communication of the crowd funding platform provider, avoiding conflicts of interest and the remuneration system, consumer protection and advertising, etc. (Best Practices for Crowd funding, 2016). Having analyzed the main legal acts governing crowd funding in one of the Baltic States, we will give a brief overview of the main aspects of the crowd funding market regulation in Estonia. *General regulation.* If a crowd funding platform offers securities or acts as a securities broker, it provides an investment service, and in this case Financial Supervision Authority (FSA) authorization is required; crowd funding platforms granting or intermediating credit to consumers need a license from the FSA as a creditor or credit intermediary; crowd funding platforms operating the donations/rewards model are not subject to financial services regulation. Currently four platforms have obtained a license as credit intermediaries and two platforms have obtained a license as a creditor.

Prospectus requirement. The prospectus requirement for public offering of securities (securities do not include shares in Estonian private limited companies). Exceptions apply, for example, if the number of investors is less than 150 per European Economic Area (EEA) country or the total amount of investments is less than 100,000 EUR. The platforms operating lending, donations, and rewards models are generally not subject to the prospectus requirement.

AIFMD (Alternative Investment Fund Managers Directive) – regulation: The AIFMD regulation was implemented in the Investment Funds Act in 2013 and 2014; the implementation of the act does not introduce any provisions that explicitly deal with crowd funding.

Payment service regulation: Transfer of funds through an operator may constitute a payment service or money remittance service. In that case, an FSA activity license or application for exemption is required. The commercial agents exemption may be applicable to operators of crowd funding platforms. Cooperation with the payment institute / bank is necessary.

Further possible requirements: Estonian Law of Obligations Act; Estonian Money Laundering and Terrorist Financing Prevention Act; Estonian General Part of the Civil Code Act; Estonian Advertising Act; Estonian Personal Data Protection Act; Estonian Consumer Protection Act; Estonian Information Society Services Act.

Regulatory barriers. Inbound: Fragmented laws; Requirements for permitting the activities for crowd funding platforms fall under the concept of creditor or credit intermediary inbound from other EEA contracting states; Subject to prospectus regulation if the securities are offered to investors in Estonia; If a crowd funding platform or the company/project falls under the definition of an obligated person pursuant to the Estonian Money Laundering and Terrorist Financing Prevention Act and is offering its services in Estonia cross-border or through a branch, then the crowd funding platform or the company/project is required to comply with anti-money laundering regulations in Estonia. *Outbound:* Fragmented laws; Requirements for permitting the activities for crowd funding platforms fall under the concept of a creditor or credit intermediary outbound to other EEA contracting states; Subject to prospectus regulation if the securities are offered to investors in Estonia; If a crowd funding platform or the company/project falls under the definition of an obligated person pursuant to the Estonian Money Laundering and Terrorist Financing Prevention Act and is offering its services in Estonia cross-border or through a branch, then the crowd funding platform or the company/project is required to comply with anti-money laundering regulations in Estonia.

Impact of EU regulation. Prospectus regulation: Relatively high impact as the changes to the prospectus regulation would influence regulations regarding the public offering of securities in Estonia. *AIFM Directive:* The AIFMD has been implemented in Estonian law and is therefore applicable to the crowd funding platforms that wish to operate in Estonia as AIFMs. As the AIFMD simplifies the process of operating crowd funding platforms cross-border, the change in the AIFMD would have a high impact on the Estonian crowd funding market. *MiFID / MiFID II:* As there are currently no crowd funding platforms in Estonia which operate based on a license under MiFID, the impact on the crowd funding market in Estonia from the change in regulation would be limited. *PSD / PSD II (Payment Services Directive):* As there are currently no crowd funding platforms that would operate in Estonia under the license of payment or e-money institution, the changes to the regulation could be deemed to have a moderate impact on the crowd funding market in Estonia (Review of Crowdfunding Regulation, 2017).

Depending on the detailed structure of the platform, investments under the donations and rewards model platforms generally do not qualify as investment services, as they do not relate to (tradable) securities. Furthermore, as the money is donated and not lent, such activity should not require a banking license or credit intermediary license. In the case that the platform operator, under certain circumstances, repays the money donated by the donor, there may be a risk that such an activity would be deemed receiving repayable funds from the public and thus would fall under the Estonian Credit Institutions Act.

2. The crowd funding market in Latvia

Compared to Estonia, the Latvian financial market sees online crowd funding platforms used less often for financing various projects but much more so than in Lithuania. In 2015, market volume per capita in Latvia was 7.68 EUR (after Finland – 11.65 EUR and Monaco – 10.24 EUR), but in in Lithuania 1.00 EUR (Sustaining momentum, 2016, 29). In Latvia, ziedot.lv was the only internet-based financing platform for many years. It was established in 2003 as a charity organization to channel individual and business donations to people in need (Ziedot.lv, 2018). Almost ten years later in 2014, the Lielvarde local action group Ziedzeme set up an internet platform called Idejuarmija.lv (Army of Ideas), which was the first crowd funding platform in Latvia. In April 2015, a collective investment platform called Projektubanka (Project Bank) was established after two similar projects, idejuarmija.lv and mecenats.lv, merged. The Project Bank platform operates with the rewards-based crowd funding principle, allowing the financing of creative and innovative projects, business ideas, or start-ups in return for products or services after project implementation (Mazure, 2017).

By the middle of 2017, Project Bank has successfully supported 23 projects in various fields, i.e. collected the necessary funding for cultural events, music recordings, books, business plans, and other creative projects. In Latvia, refunds are organized similar to international crowd funding platforms, i.e. if the project campaign comes to an end and the required amount is not collected, all the investors get their money back via the virtual Project Bank account. This sum may be diverted to another project or returned to the investor on request.

Currently there are no known crowd funding platforms based on the equity model in Latvia. There are four P2P lending platforms: Mintos, Twino, Viventor and Viainvest. All of these are claim right assignment platforms, meaning that investors can acquire claim rights from loan originators deriving from already concluded credit agreements. The loan originators can be the platforms themselves, as well as third-party non-bank lenders, including consumer lenders. Mintos, the first platform of its kind in Latvia, was established in January 2015 (Mintos, 2018). At Mintos both retail and institutional investors can invest in fractions of mortgage loans, secured car loans, small business loans, and unsecured loans originating across Europe. The minimum investment in one loan is 10 EUR. In the same year another platform called Twino launched (Twino, 2018). Twino is one of Europe's fastest growing mutual loan platforms. As a financial technology company, it has been successfully lending its own money since 2009 and has originated over 380 million in issued loans. The Twino team, numbering 600 employees, operates in Latvia, Poland, Kazakhstan, Georgia, Denmark, Russia, Mexico, Spain, and the Czech Republic (FinTech developments in Latvia, 2017). Later, Viainvest was established, which is a P2P marketplace for private investors – individuals and legal entities – to invest in loans originating from non-banking lenders, the VIA SMS Group and its subsidiaries. Unlike with traditional banking, Viainvest offers private investors access to the non-banking lending sector through a simple process: borrowers request funding from the VIA SMS Group, and the active contract automatically is then mirrored on Viainvest, making it available for public investment. Each investor has full control of how much they want to invest, to whom, and how – manually or using the auto-invest option. Loans listed on Viainvest are secured with a buyback guarantee that the ROI of any investment will never exceed 30 days.

In June 2015, Mintos and Twino, Latvia's peer-to-peer lending platforms, founded the Crowd funding Association of Latvia. The association's aim is to introduce higher standards in the industry, counter unfair commercial activities, and represent the industry's interests by collaborating with surveillance institutions and legislators and getting involved in the policy-making process. It is important to note that both platforms provide investment opportunities for investors from across the EU. Recently two new rewards model crowd funding platforms commenced their operation in Latvia, of which one is solely devoted to financing creative or scientific projects, whilst the other has a broader spectrum and expressly provides for a consideration to be offered by the authors of the project to donors, without specifying the type of such consideration. On December 2016 the first real estate crowd funding platform in Latvia, Bulkestate.com, was established (Latvia's Investors Choose Crowd funding, 2017). Bulkestate was created for those willing to invest in real estate either by providing loans to real estate companies (collective investment – lending-based crowd funding) or through the collective purchase of real estate. The minimum contribution is 50 EUR. The small start-up has expanded by attracting, within almost a year, investors from 25 countries across Europe and the world to finance loans. Similar to Project Bank, if the investment target is not reached, potential investors are returned their investment, via bank account, within 48 hours. Most Internet platforms work with consumer credit and are not interested in real estate market development. More than 94 million EUR worth of loans were financed in the first quarter of 2017, which is three times more than in the first quarter of 2016 (Joint Recommendations, 2017).

Currently no known crowd funding platforms invest in renewable energy in Latvia. Some crowd funding platforms from other countries have invested in real estate in Latvia. For instance, Estonian platforms Estate Guru and Crowde state have operated in Latvia since 2016. Investors from Latvia can invest in these platforms as well. When we analyze support policies, we see that matching funds, state aid, or tax benefits for alternative financing are not available in Latvia. It should be noted that the Financial and Capital Market Commission (Finanšu un kapitālatirguskomisija) is Latvia's financial services regulator. The main policy institution responsible of alternative finance is the Ministry of Finance of the Republic of Latvia.

2.1 The main aspects of legal regulation

General regulation. No regulatory regime specifically adapted for crowd funding. In principle, Latvian law allows for the implementation of crowd funding projects. In each situation it is recommended to involve the local council.

If a crowd funding platform facilitates the offering of securities or other financial instruments or holds money belonging to third persons, the operator of the platform most likely provides investment or financial services, and in this case, Financial and Capital Market Commission (FCMC) authorization is required (Law on the Financial, 2009). Where securities do not qualify as financial instruments, this may fall outside the scope of investment services regulation, although guidance from the FCMC is advised. Depending on the structure in detail: there are sound arguments that contributions made under the donations/rewards model do not constitute the provision of investment or financial services. According to the position of the FCMC, assignment-based P2P lending crowd funding falls under the provisions of investment services. Most likely an entity managing a crowd funding platform which is not a credit institution cannot hold sums of money belonging to third parties: sums might be qualified as deposits. The Credit Institutions Law only permits credit institutions to advertise receipt of deposits and other repayable funds, and to receive them (Credit Institutions Law, 1995).

Prospectus requirement. The prospectus requirement for a public offer regarding transferable securities (i.e., the offer is made to more than 150 individuals in one EU Member State). Exemptions of the prospectus requirements: a) offering transferable securities does not exceed 100,000 EUR within a time period of 12 months; b) only qualified investors are addressed, or less than 150 non-qualified investors per member state are addressed; c) the offering is made in respect of transferable securities with the nominal value at least 100,000 EUR; or d) each investor must acquire transferable securities with the nominal value at least 100,000 EUR, and acquiring one transferable security so that it belongs to several persons is prohibited. Depending on the structure in detail: there are no prospectus requirements for loans or contributions under the donations/rewards model.

AIFMD regulation. A typical start-up company generally does not constitute an AIF. A project company might constitute an AIF: extensive AIFMD regulation for the AIF and its manager; the manager (AIFM) requires FCMC authorization. Depending on the structure in detail: funding by means of or contributions under the donations/rewards model should not entail an AIF. Depending on the scope of the services provided by the crowd funding platform, the crowd funding platform might qualify as an AIFM.

Payment service regulation. Transfer of funds through the operator may constitute a money remittance service: FCMC licensing or registration with the FCMC required. The commercial agents exemption probably not applicable to operators of crowd funding platforms. Another exemption might be that the operator of a crowd funding platform uses an external provider or partner for processing payments rather than acting as an intermediary themselves.

Consumer credit regulation. If consumer borrowers are permitted on a platform (lending model) factors of licensing for issuing consumer crediting and the form and content of the lending agreements are considerations.

Further possible requirements. Civil Law (in Latvian – Civillikums); Commercial Law (in Latvian – Komerclikums); Law on the Prevention of Laundering the Proceeds from Criminal Activity (Money Laundering) and of Terrorist Financing (in Latvian – Noziedzīgiegūtulīdzekļulegalizācijas un terorismafinansēšanas novēršanas likums); Natural Persons' Data Protection Law (in Latvian – Fiziskopersonu datu aizsardzības likums); The Cabinet of Ministers regulations and FCMC regulations in relation to investment services and payment institutions; Consumer Rights Protection Law (in Latvian – Patērētāju tiesību aizsardzības likums); Unfair Commercial Practices Prohibition Law (in Latvian – Negodīgā komercprakses aizlieguma likums); Law on Advertising (in Latvian – Reklāmas likums); Law on Corporate Income Tax (in Latvian – Likums “Par uzņēmumu ienākuma nodokli”).

Regulatory barriers. *Inbound.* 1. Foreign crowd funding platform addresses Latvian investors: a) Crowd funding platforms: may be required to obtain a license under Financial Instrument Market Law (FIML) / Payment Services and E-Money Law / AIFM Law / Consumer Rights Protection Law/ Credit Institution Law; may be required to notify the FCMC on an existing license in another EU member state; the obligations to obtain a specific license or to notify on an existing license are highly uncertain and fact-specific; may be subject to other requirements, such as AML/CTF, consumer crediting rules and other regulations applicable to entities holding a particular license; Latvian law does not recognize the concept of “security trustee,” which allows an agent to hold and enforce security on behalf of multiple lenders; the assignment of claims through P2P lending platforms is not clear from the taxation perspective. b) Foreign companies or projects –the prospectus requirement and AIFMD regulation may apply, depending on the circumstances. 2. Foreign crowd funding platform addresses Latvian investors, companies or projects in Latvia: no specific regulatory barriers.

Outbound. 1. Latvian crowd funding platform addresses foreign investors: a) Crowd funding platforms: may be required to obtain a license under FIML / Payment Services and E-Money Law / AIFM Law / Consumer Rights Protection Law/ Credit Institution Law; the obligation to obtain a specific license is highly uncertain and factspecific and may be subject to other requirements, such as AML/CTF and other regulations applicable to entities holding a particular license; the assignment of claims through P2P lending platforms is not clear from the taxation perspective. b) Foreign and domestic companies and projects –the prospectus requirement and AIFMD regulation may apply. 2. Latvian crowd funding platform addresses foreign companies or projects: no specific regulatory barriers.

Impact of EU regulation. *Prospectus regulations:* FIML generally mirrors the prospectus rules provided in Prospectus Regulation ((EC) No 809/2004). Thus, if a crowd funding platform is considered an investment service provider, it is subject to the prospectus rules provided in the regulation. *AIFM Directive:* So far, no known crowd funding platforms have been subject to the Latvian rules implementing the AIFM Directive. *MiFID / MiFID II:* FIML implements the MIFID I; the MIFID II Directive is planned to be implemented in Latvia by the extended deadline. Thus, there has not yet been an impact to crowd funding platforms from the directive (Review of Crowd funding Regulation, 2017).

On the European level the European Commission is currently in the process of assessing the necessity and added value for the common regulatory framework for all member states. The European Banking Authority, which is responsible for monitoring the European financial system and banking industry, has also been assigned to oversee new financial activities like crowd lending in order to ensure the safety and soundness of the industry and convergence in regulations (The European Banking Authority, 2015). So, currently the European authorities are in the process of developing unified regulations for the industry.

Compared to the UK and other EU countries such as Germany, Italy, France and Spain, in Latvia crowd lending regulations are still undeveloped. However, the FCMC, which oversees the finance industry in Latvia, has begun to develop regulations for the crowd lending industry (Likumi.lv, 2018). Considering the rapid development of the industry, it can be expected that quite some time will be needed until the industry reaches a certain level of maturity in terms of regulatory framework.

3. The crowd funding market in Lithuania

Compared to Estonia and Latvia, the Lithuanian financial market sees even less use of online crowd funding platforms to finance various projects. On the other hand, out of the three Baltic States, only Lithuania has adopted a National Law on Crowd funding.

3.1 Creation of crowd funding in the Republic of Lithuania

Rapidly increasing in popularity, crowd funding, which has previously been available to Lithuanians only via foreign platforms, is now regulated in Lithuania. National crowd funding-specific laws have been passed only in 11 EU Member States as of the beginning of 2017 (Sadzius, 2017). Transparency and honesty as well as people's trust in this new service depend on appropriate legal regulation. For the purpose of creating a favorable environment for hybrid alternative financing platforms in Lithuania that seek global recognition, modern, balanced crowd funding legal regulations have been created that comply with international standards and are not limited to satisfying only the national market. The draft for the act was prepared for the purpose of implementing the priority measure under the program of the Government, which requires improvement of the mechanism by which residents invest their savings in the economy, creating a wider range of funding choices (Decision on the agenda, Sec XV (391)), and taking into consideration European Community recommendations (Council recommendation, 2016/C) to promote alternative sources of business financing. The crowd funding act was put together by specialists from the Central Bank (CB) and the Ministry of Finance of the Republic of Lithuania. The draft law has been drawn up on the basis of the experience of France, Italy and Great Britain and the legal regulation of crowd funding in force in the aforementioned states, although it must be mentioned that the legal acts governing crowd funding in Italy regulate only investment-based crowd funding (Saukalas, 2016). On November 3, 2016, the Parliament of the Republic of Lithuania passed The Law on Crowd funding (SFI) (The Law on Crowd funding, 2016), allowing business financing through debt and equity crowd funding platforms. On November 29 the CB as a supervisory institution also passed substatutory acts such as the CB decision on the procedure for the disclosure of information of crowd funding platform operator-directors and members to the CB (The Bank of the Republic of Lithuania, 2016, No. 27859).

The CB decision on crowd funding platform financing agreement suitability and for funders and project owners reliability criteria rules (The Bank of the Republic of Lithuania, 2016, No 27858), and the CB decision on the public crowd funding operator list regulation provisions. In accordance with the passed act, amendments to the Law on Financial Institutions (Law on Financial Institutions, 2002, art. 4, 45, 46), the Law on the Bank of Lithuania (Law on the Bank of the Republic of Lithuania, 1994, art. 42) and Law on Money Laundering and Terrorist Financing Prevention (Law on the Prevention of Money Laundering, 1997, art. 2, 4) were made. The need for regulating crowd funding relations was as much of a result of EU tendencies as it was of global ones. The recently adopted law regulates requirements and conditions on which platform operators should do business so that investors' interests, as well as those investors' and funding benefactors' own rights and obligations, are protected.

Other common regulations to which the operator of a crowd funding platform may be subject to include, but are not limited to, the Law on Legal Protection of Personal Data of the Republic of Lithuania (Law on Legal Protection of Personal Data, 1996) and the Law on E-money and E-money Institutions of the Republic of Lithuania (Law on E-money, 2011).

3.2 Crowd funding platforms in the Republic of Lithuania

The first platforms in Lithuania started working even before SFI was created. The first P2P lending platform, Savy, which is being administered by UAB Bendrasfinansavimas and whose trademark belongs to New Chartered Limited (UK), was established in 2014. Later, in 2015, platforms such as FinBee, Paskolų klubas, and OptimalusKreditas were established and in 2016 the *Manu* platform came about. Through these platforms loans could be given out by natural persons. When the amendments for the Consumer Credit Act (Law on Consumer Credit, 2010, art. 22(1) (LCC) came into effect on February 1, 2016, it stated that every platform must be on the public P2P platform operators list posted on the CB internet website. Seeking to protect the lenders from an overwhelming risk, LCC art. 25 imposes limits on the lender: 1) The sum given out to one individual cannot exceed 500 EUR in a period of 12 months, and 2) The total sum given out to all individuals combined cannot exceed 5,000 EUR in a period of 12 months. Furthermore, every person seeking to get a loan had to be inspected in accordance with CB-approved responsible lending regulations (Responsible Lending Provisions, 2011). The consumer credit concept is based on article 6.870 of LR Civil Code (CK) (Civil Code, 2000). Despite the fact that special regulations did not exist for the new financial service, it was regulated by similar legal norms and general principals as a result of complying with CK art. 1.8.

Until the beginning of 2017 there were five crowd funding platforms in Lithuania that were all P2P consumer-lending based. In February of the same year, FinBee Business was launched, becoming the first crowd funding platform in Lithuania to include legal persons as parties and be included on the public crowd funding platform operators list on the CB website. To this day there has been no example of an equity-based or donation-based crowd funding platform in Lithuania, unlike in Estonia (Hooandja) or Latvia (Projektu Banka). The SFI allows startup companies to raise funds in a different new way. The fact is that alternative financing for startups is immensely important because getting funds through credit institutions is sometimes not possible at the time, and it takes a very long time, even months, to get funds through angel investors. In comparison, financing via crowd funding platforms can be achieved in a few short weeks. Another great upside is the possibility to very rapidly get opinions from the public on an idea or a product by publishing it on the platform. That helps to change and perfect the project according to corresponding needs, estimate the risk, and determine whether the project is promising or even worth pursuing. Essentially by choosing to raise capital via crowd funding platforms, startups have a wide radius of marketing for their product for free.

3.3 The Law on Crowd funding in the Republic of Lithuania

Systematically analyzing LR SFI reveals that the cornerstones of the legal act are the following: Legal entities are able to raise the needed capital by: a) simple loan agreements; b) issuing equity securities (however, this does not apply to private limited liability companies); c) issuing debt securities; and d) assigning claim rights that derive from already concluded credit agreements. Moreover, legal entities that are allowed to be platform operators, must be put on the list, and according to the LR Law on Markets in Financial Instruments (Law on Markets in Financial Instruments, 2007, art. 4) (MiFI), when they are on the public crowd funding platform operator list they are considered to be a financial advisory firm. An exemption from art. 3 of MiFID (Directive 2014/65/EU) is applied to these firms. Under the MiFI, art. 4 (7), a financial advisory firm can receive and transmit orders and provide recommendations on investment.

Additionally, if the operator seeks to provide other investment services, that operator must be licensed under the Law on MiFI art. 4.7 (1) as a financial brokerage firm. Investors are allowed to invest in crowd funding platforms without restriction. However, under art. 3 of the SFI the investor must take part in a suitability test, and if they fail, the operator is obligated to provide a disclaimer about the risks involved. Only then is the investor free to invest. The financial agreement suitability for the investor is evaluated by the supervisory authority – the CB. In addition, natural persons and legal person can be both investors and project owners. The crowd funding secondary market is considered a multi-party trade system and is governed by MiFI, which implements MiFID. The requirement for the secondary market to comply with the MiFI rules is applied to the entire secondary market in financial instruments with the exception of claim rights.

If the raised amount does not exceed 100,000 EUR in the period of 12 months, no additional requirements apply regarding raised funds. Also, if the securities offering does not exceed 5m UER, the project owner only has to provide an information document which must pass the operator's approval (Explanatory letter of the Law on Crowd funding, 2016, 4). The supervisory authority specifies the content of this document. The information document is just a simple form disclosure about the project owner and the risk relating to the securities offering. If the securities offering do exceed €5m, the project owners can raise funds only by issuing securities under LR joint-stock company law (Law on Joint-stock Company, 2000). In this case, there is no need to present a securities prospectus. If under The Law on Securities (Law on Securities, 2007) offerings are made and exceed €5m, the project owner must publish a prospectus (Law on Crowd funding, 2016, art. 4, 14). Under art. 7 par. 2 of the LR SFI the operator is required to have startup equity of 40,000 EUR. However, personal capital may not be less than the greater number of these two: startup equity of €40,000 or the personal capital requirement. The personal capital requirement is the sum of 0.2 percent of the amount financed through the crowd funding platform and the amount not yet repaid to investors. In addition, par. 1 of the same article states that the platform operator must have a suretyship or guarantee document issued by an insurance company or financial institution for not less than 100,000 EUR per claim of investors to indemnify their losses, and 500,000 EUR for all claims of investors to indemnify their losses per year.

In art. 8, 9 and 13 there are additional requirements for operators, such as those regarding risk management procedures, activity continuity strategy, disclaimers, and the CB measure application regime reputation requirements for the board. The supervisory authority, the CB, may impose a fine amounting to 2 percent of the aggregate annual income from taking actions or pursuing activities prohibited by the legal acts, or for other violations. The SFI allows the establishment of debt-based and equity-based crowd funding platforms, but it does not apply to crowd funding-based on non-financial incentives such as donation and reward crowd funding. Crowd funding platforms based on donations or rewards models may operate in Lithuania without any major regulatory burden. Legal grounds for creation and operation of such platforms already exist in the provisions concerning contracts set forth in the CC of the LR and the provisions of the LR Law on Charity and Sponsorship (Law on Charity and Sponsorship, 1993) and other laws. For the time being, reward-based and support-based crowd funding do not exist in Lithuania, so project owners from Lithuania must resort to foreign platforms. Also, neither state aid, tax benefits, nor matching funds for alternative financing are available in Lithuania. Extended analysis of the national law that regulates the activity of crowd funding makes it clear that, only after long, thorough discussions and the expression of opinions by business representatives, lawyers, and economists, with contributions from the City of London, crowd funding platform operators, investors, and regulatory representatives as well as inputs from specialists from Lithuania's CB and the Ministry of Finance, the SFI was passed in the Parliament of the Republic of Lithuania (Parliament of the Republic of Lithuania, 2016, 30). In the first stages of putting the project together, other parties' insights, such as those from the Lithuanian Free Market Institute and the Lithuanian Peer-to-peer Lending and Crowd funding Association were welcome. This modern and balanced legal act complies with international standards and satisfies not only the domestic market but will play a role in attracting outside source financing for businesses via various alternative sources, bringing businesses closer to society and help them be directly involved in financing different projects through crowd funding platforms. Hopefully, the regulation of this process will incentivize capital market expansion as well as middle and small businesses and of course, contribute to growing the economy.

Conclusions

Estonia does not have a specific national regulation in place applying to crowd funding, as, for example, the National Law on Crowd funding adopted in Lithuania at the end of 2016.

There are two platforms operating with the equity model in Estonia, but this type of model might be subject to investment services or securities market regulation and thus be supervised by the Financial Supervision Authority if the platform provides investment services such as securities brokering or organizing an offer or issue of securities. In addition, those securities that are publicly offered are subject to the prospectus requirements. As of today, the Estonian equity model crowd funding market is very limited in size compared to the overall crowd funding market in Estonia. When the crowd funding sector in the Baltic region is analyzed, we see that most of the crowd funding platforms in Estonia are lending based. The activities of lending-based crowd funding platforms in Estonia are regulated mainly by the Creditors and Credit Intermediaries Act, which came into force in March 2015. At the end of 2017, the donations or rewards model was used by three platforms in Estonia to finance creative projects. Crowd funding platforms based on the donations or rewards models fall outside of the financial services scope and may operate in Estonia without any regulatory burden.

Currently there are no known crowd funding platforms based on the equity model in Latvia. There are four peer-to-peer lending platforms: Mintos, Twino, Viventor and Viainvest. Recently, two new rewards model crowd funding platforms were established operation in Latvia. In 2016 the first real estate crowd funding platform in Latvia, Bulkestate, was also established. Latvian assignment-based marketplace (peer-to-peer) lending platforms have established themselves on the peer-to-peer lending market in Europe. Apart from that, crowd funding is in the early stages of development in Latvia. There is currently no regulatory regime that is specifically adapted to crowd funding in Latvia. Latvian law allows for the implementation of crowd funding projects. Yet the application of the existing financial services regulation is uncertain and highly case specific, which hinders the cross-border activities of crowd funding platforms. Up-to-date regulatory authorities have taken a restrictive stance regarding peer-to-peer lending. In summary, a reform of crowd funding regulations is being awaited, which open new horizons for the development of the crowd funding market.

Crowd funding platforms were in operation in Lithuania for a couple of years before the national Law on Crowd funding was passed in 2016. Their activity was in the framework of Law on Consumer Credit, the Central Bank of Lithuania responsible lending provisions, various Civil Code articles and other. For this new financing method, special regulations were not applied, and general legal norms and principals had to be followed in the meantime. The Law on Crowd funding allows the establishment of debt-based and equity-based crowd funding platforms, but it does not apply to crowd funding based on non-financial consideration/incentives such as donation and reward crowd funding. Crowd funding platforms based on the donations or rewards models may operate in Lithuania without any regulatory burden. The regulations for this process, that is, the 2016 national Law on Crowd funding, acts of the board of the Lithuania's Central Bank and the amendments made to different financial institutions' laws, Lithuania's Central Bank Law, and the Money Laundering and Terrorist Financing Prevention Law will have a positive effect on the expansion of the crowd funding sector. After the national Law on Crowd funding was passed just after a few months, the FinBee platform expanded to FinBee Business, which allows legal persons to be investors as well as project owners. Crowd funding continues to rise in popularity. The effort and result of creating and perfecting special legal regulations for this process do not go unnoticed. Crowd funding is appealing to businesses and encourages them to innovate and prosper.

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