
CROWD FUNDING REGULATION IN THE REPUBLIC OF LITHUANIA

Assoc. Prof. Linas Sadzius
(Corresponding Author)
Mykolas Romeris University
Faculty of Economics and Finance Management
Institute of Economics Study
Ateities str. 20, LT-08303 Vilnius, Lithuania.

Tomas Sadzius
Master of European and International Business Law
University Of Savoie Mont Blanc
Faculty of Law
27 Rue Marcoz, 73000 Chambery, France.

ABSTRACT

The start of the global financial crisis in 2008-2009 and the post-crisis period really jumpstarted the search for new, alternative ways to fund various innovations and projects. In the last quarter of 2016 the popular method of crowdfunding existing in the leading technology-developing countries in the world such as United States of America, the United Kingdom and other European Union Member States has also been legally regulated in Lithuania. In these countries, because of objective and subjective reasons, crowdfunding legal regulation faced quite a few hardships. In this article, crowdfunding legal regulation is analyzed in the Republic of Lithuania.

Keywords: *crowdfunding, peer-to-peer lending, donation-based crowdfunding, financial market, Central Bank.*

INTRODUCTION

Crowdfunding came to be as a result of two factors: the beginning of the global financial crisis of 2008-2009 and when 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; the emergence and popularity of peer-to-peer lending (P2P lending) and crowdfunding platforms were 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.

Although investment-based crowdfunding internet platforms in the European Union (EU) have been around for over a decade, the key legal acts regulating the whole process came into effect only recently. In this article, crowdfunding legal regulation is analyzed and evaluated in the Republic of Lithuania.

The aim of the study is to analyze the creation of crowdfunding and legal regulation in the Republic of Lithuania.

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.

Creation of Crowdfunding in the Republic of Lithuania

Rapidly increasing in popularity, crowdfunding, which has previously been available to Lithuanians only via foreign platforms, is now regulated in Lithuania. National crowdfunding-specific laws have been passed only in 11 EU Member States as of the beginning of 2017. (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	-

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 crowdfunding 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 crowdfunding 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 crowdfunding in force in the aforementioned states, although it must be mentioned that the legal acts governing crowdfunding in Italy regulate only investment-based crowdfunding (Saukalas, 2016). On November 3, 2016, the Parliament of the Republic of Lithuania passed The Law on Crowdfunding (SFI) (The Law on Crowdfunding, 2016), allowing business financing through debt and equity crowdfunding platforms. On November 29 the CB as a supervisory institution also passed statutory acts such as the CB decision on the procedure for the disclosure of information of crowdfunding platform operator-directors and members to the CB (The Bank of the Republic of Lithuania, 2016, No. 27859), the CB decision on crowdfunding 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 crowdfunding 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 crowdfunding 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 crowdfunding 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).

Crowdfunding 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 Bendras finansavimas and whose trademark belongs to New Chartered Limited (UK), was established in 2014. Later, in 2015, platforms such as FinBee, Paskolų klubas, and Optimalus Kreditas 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 in a period of 12 months, and 2) The total sum given out to all individuals combined cannot exceed €5,000 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 crowdfunding platforms in Lithuania that were all P2P consumer-lending based. In February of the same year, FinBee Business was launched, becoming the first crowdfunding platform in Lithuania to include legal persons as parties and be included on the public crowdfunding platform operators list on the CB website. To this day there has been no example of an equity-based or donation-based crowdfunding platform in Lithuania.

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 crowdfunding 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 crowdfunding platforms, startups have a wide radius of marketing for their product for free.

The Law on Crowdfunding 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 crowdfunding 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 crowdfunding 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 crowdfunding 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 in the period of 12 months, no additional requirements apply regarding raised funds. Also, if the securities offering does not exceed €5m, the project owner only has to provide an information document which must pass the operator's approval (Explanatory letter of the Law on Crowdfunding, 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 does exceed €5m, the project owners can raise funds only by issuing securities under LR joint-stock company law (Law on Joint-stock Company). 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 €m, the project owner must publish a prospectus (Law on Crowdfunding, 2016, art. 4, 14). Under art. 7 par. 2 of the LR SFI the operator is required to have startup equity of €40,000. 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 crowdfunding 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 per claim of investors to indemnify their losses, and €500,000 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 crowdfunding platforms, but it does not apply to crowdfunding-based on non-financial incentives such as donation and reward crowdfunding. Crowdfunding 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 crowdfunding 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 crowdfunding 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, crowdfunding platform operators, investors, and regulatory representatives as well as inputs from specialists from Lithuania's Central Bank 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 Crowdfunding 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 crowdfunding 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

1. Crowdfunding platforms were in operation in Lithuania for a couple of years before the national Law on Crowdfunding 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 Crowdfunding allows the establishment of debt-based and equity-based crowdfunding platforms, but it does not apply to crowdfunding based on non-financial consideration/incentives such as donation and reward crowdfunding. Crowdfunding 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 Crowdfunding, 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 crowdfunding sector.
2. After the national Law on Crowdfunding 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. Crowdfunding continues to rise in popularity. The effort and result of creating and perfecting special legal regulations for this process do not go unnoticed. Crowdfunding is appealing to businesses and encourages them to innovate and prosper.

REFERENCES

1. Civil Code of the Republic of Lithuania (2000), Lithuania.
2. Council recommendation of 12 July 2016 on the 2016 National Reform Program of Lithuania and delivering a Council opinion on the 2016 Stability Program of Lithuania. 2016/C 299/17. EUR-Lex. [Online] Available: <https://www.bing.com/search?q=1.%09Council+recommendation+of+12+July+2016+on+the+2016+National+Reform+Programme+of+Lithuania+and+delivering+a+Council+opinion+on+the+2016+Stability+Programme+of+Lithuania.+2016%2FC+299%2F17.&src=IE-SearchBox&FORM=IENTSR>.
3. Decision on the agenda of government of the Republic of Lithuania (December, 2012). Parliament of the Republic of Lithuania, No. XII-51.
4. Directive 2014/65/EU of the European Parliament and of the Council on markets in financial instruments, 2014, O.J. L 173/349. EUR-Lex. [Online] Available: <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A32014L0065>.
5. Law on Charity and Sponsorship of the Republic of Lithuania (1993), Lithuania.
6. Law on Consumer Credit of the Republic of Lithuania (2010), Lithuania.
7. Law on Crowdfunding (2016), Lithuania.
8. Law on Crowdfunding of the Republic of Lithuania and other relating legal acts explanatory letter (2016). [Online] Available: https://www.google.lt/url?sa=t&rct=j&q=&esrc=s&source=web&cd=2&cad=rja&uact=8&ved=0ahUKEwiLp_uxyLjSAhUmCpoKHcWmC4QQFggjMAE&url=https%3A%2F%2Fwww.e-tar.lt%2Frs%2Fasupplement%2Fb21f55d04d9611e6b72ff16034f7f796%2F5fc557d24da511e6b72ff16034f7f796%2Fformat%2FISO_PDF%2F&usq=AFQjCNHv72Ijj03a0HsM2dUwuZIk6kpCA&sig2=0m-hlS4LkjZ7E7rMV0fLsA.
9. Law on E-money and E-money Institutions of the Republic of Lithuania (2011), Lithuania.
10. Law on Financial Institutions (2002), Lithuania.
11. Law on joint-stock company of the Republic of Lithuania (2000), Lithuania.
12. Law on Legal Protection of Personal Data of the Republic of Lithuania (1996), Lithuania.
13. Law on Markets in Financial Instruments of the Republic of Lithuania (2007), Lithuania.
14. Law on Securities of the Republic of Lithuania (2007), Lithuania.
15. Law on the Bank of the Republic of Lithuania (1994), Lithuania.
16. Law on the Prevention of Money Laundering and Terrorist Financing of the Republic of Lithuania (1997), Lithuania.
17. Responsible lending provisions of the Bank of the Republic of Lithuania (September 1, 2011), *The Bank of the Republic of Lithuania*, No. 03-144.
18. Saukalas, E., Sobutas, A., (September 6, 2016). Crowdfunding opportunities in Lithuania, *Metida*. [Online] Available: <https://metidalawfirm.wordpress.com/2016/06/09/crowdfunding-opportunities-in-lithuania/>.
19. The Bank of the Republic of Lithuania decision on crowdfunding platform financing agreement suitability and for funders and project owners reliability criteria rules (November 30, 2016), *The Bank of the Republic of Lithuania*, No. 27858.
20. The Bank of the Republic of Lithuania decision on the procedure of disclosure of information on crowdfunding platform operator directors and members to the Bank of Lithuania (December 30, 2016), *The Bank of the Republic of Lithuania*, No. 27859.
21. Transcript. Parliament of the Republic of Lithuania (September 21, 2016), Session IX, No. 380.