

## Conference Paper

# The Problems of Crowdsourcing Legal Regulation in Russian Federation

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## Abstract

In this article the problems of legal regulation of fintech in Russia are considered, special attention is paid to the crowdsourcing, its classification, examples of business models, and the importance of developing alternative financial instruments due to the growing role of information technology in the terms of environment. The actual legal system of Russian Federation is analyzed due to the questions of fintech and traditional financial instruments. The article examines contradictions of laws and legal hurdles. The author suggests generalized measures to eliminate the deficiencies of legislation aimed at the development of fintech in Russia.

**Keywords:** crowdsourcing, crowdfunding, crowdlending, crowdinvesting, legal regulation, problems of legislation

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## 1. Introduction

The level of the financial system of the state is one of the most demonstrative indicators of the country economic security. Currently, banks, financial and industrial groups, insurance companies, non-state pension funds, credit and financial organizations form the foundation of the credit and financial system. These entities concentrate large amounts of money capital.

Due to the increasing role of information technologies, not only at the level of the individual and the private company, but also at the state, the fintech area (from short - financial technologies) [14] is actively developing. Fintech is a set of methods, technologies, mechanisms, mostly of an innovative nature, used as an alternative to traditional technologies exploited by banks, credit institutions, insurance organizations and other financial entities [16]. The development of the fintech and its distribution is becoming especially important for increasing the effectiveness and security of the financial sector, ensuring its capability of countering the potential and real threats,

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both internal and external. Fintech includes unique innovative methods to ensure fast, troubleproof and more efficient processing, in particular:

the improvement of technologies of banking transactions, the expansion of range of methods for remote authentication of client's identity, methods for ensuring the security of payments and transfers, as well as cash transactions;

Development of crowdsourcing namely alternative methods of lending, financing and investing;

Creation and development of ways to manage capital, financial investments, planning in pension system and real estate.

Crowdsourcing development can become both a factor that increases the prestige of the country in general, and a factor of growth of the economy and the well-being of the citizens.

## 2. Materials and methods

The subject of research in the article is the national legislation of the Russian Federation in the sphere of financial technologies, traditional financial instruments and institutions, as well as legislation of money laundering combating and terrorism financing. The article used general theoretical, scientific methods of research with application of general legal approaches to understanding of the law.

## 3. Results of research

Regular capital infusions represent permanent process of investment and that is the main factor for the growth of economy. The subjects of investment may be individuals, enterprises, states, foreign investors. One of the ways of investing, which is still not widely spread in Russia, but crowdsourcing is demonstrating high potential. Crowdsourcing is a resource mobilization of a large number of individuals (crowd).

A special area of crowdsourcing is crowd lending [14], which is a way of money lending by unrelated individuals without involving a traditional financial mediator: bank, microfinance organization, or any other financial institute. A platform, a mechanism for ensuring mutual financing by individuals, is called a crowdlending-platform or P2P-platform (from peer-to-peer) [15]. The main product in the crowdlending area is a consumer credit (P2P-credit). P2P-platform is a place for meeting of potential creditors and loan recipients. In addition, platform checks the identity of all participants, provides

the authentication of data submitted by them, organizes a mechanism for registering a request for lending (the initiative may come from both the recipient and the lender).

Based on the mechanism of scoring, the platform offers a rate of loan interest, and loan period. A characteristic feature of the crowdlending sites are: availability of a credit rating, limitation of the maximum credit amount and loan period, absence of traditional commissions for preschedule repayment of credit, and so on. The profit of P2P-platform is formed by commissions, which can be paid by both creditors and recipients. Also, to ensure equality of creditors and minimize the risks due to the fraud, the personalities of the investor and the recipient are confidential, otherwise the platform collects evidence of the transaction parties independence. An example of crowdlending site is the Lending Club, the largest company in the USA.

Crowdfunding is an attraction of financial resources from a large number of subjects (individual and legal entities) who consolidate their own resources for the implementation of a charitable, commercial, investment project, the provision of services to support indigent population and other projects [14, 17]. The practice of crowdfunding is based on availability as subjects: the initiator of the project, individuals or their associations ready to provide financing, and site that unites initiators and investors, and can be found on the Internet, supports interaction of the participants by the API. The implementation of the project usually entails the registration of a legal entity, that is why the crowdfunding sites are called P2B-platforms (short form from Peer-to-business - equal creditors (individuals) for business).

Difference between crowdfunding and crowdlending is transparency (identities of participants are not confidential). The anonymity of the initiator's personality, hiding of composition costs, and hiding of progress of the project are not allowed, investors should be regularly provided with reports on the funds expended, planned information on the completion dates of individual stages and the whole project. Information on the significant internal and external factors that influence on the implementation of the project should be available also.

One of the types of crowdfunding is crowdinvesting [14], the main feature of which is the financing of projects for acquiring a part of shares, business interests, capabilities business management, part of the company's profits. Investors in this case bear the risks associated with the successful implementation of the project and the form of the legal entity.

The most common type of crowdfunding in Russia is a non-profit crowdfunding [14]. This is a form of public funding for implementation of charitable, social, environmental, political and other non-commercial projects. In this case, investors realize

non-refundable investment, so they will not take effect. Nonprofits organizations are obliged to report to the donors for the received and spent funds, make estimates of costs, and inform all interested participants about the progress of projects. Purposes of the non-profit organizations are indicated in their statutory documents. Examples of organized platforms of funds collection for charitable purposes in Russia are Rusfond, Podari Zhizn, Center Socialnykh Program, Vera, Liniya Zhizni. The practice of charitable organizations are regulated by the Federal Law, dated 12.01.1996 N 7-FZ (edited 19.12.2016) "On non-profit organizations" [11], their status is fixed in the Civil Code of the Russian Federation (sections 5,6,7 chapter 4) [3, 4].

At the moment crowdsourcing has a low legal regulation. Actually, it is reduced to the interpretation of already existing laws in the context of crowdsourcing activities. In accordance with the supreme normative act of the Russian Federation - the Constitution [1], everyone has the right of the free usage of his or her abilities and property and other economic activities not prohibited by the law in particular to obtain economic benefits, including the provision of funds as a loan with interest, commission and other form of profit.

In case of submitting a P2P-credit once a citizen is obliged to pay income tax, to report tax return to authorized bodies, and in this case his duty to pay taxes and fees are executed [14]. However, regular lending of individuals (at least four times within one year) in the context of law is interpreted as a professional activity in consumer lending. Federal Law, dated December 21, 2013 No. 353-FZ "On Consumer Credit (Loan)" [6] establishes a definition of consumer lending:

"Professional activity in consumer lending - the activities of a legal entity or self-employed individual to provide consumer loans in cash, carried out at the expense of systematically attracted on a returnable and paid basis of money and (or) carried out at least four times within one year (except loans provided by the employer to the employee, and other cases provided for by the Federal Law)."

The clause of the Federal Law prohibits a consumer lending for individuals who do not have special registration. Therefore, for the consumer lending, an individual must obtain the official status of the official individual entrepreneur. But the next Article of the Federal Law establishes the circle of persons entitled to carry out consumer lending, contradicting the previous clause, and excluding individual entrepreneur from this circle:

"Professional activities in the consumer lending are carried out by credit institutions, as well as non-credit financial organizations in cases defined by federal laws on their activities"

The article established that only credit and non-credit financial organizations (below - NFOs) may conduct consumer lending, the list of which is defined by the Article 76.1 of the Federal Law No. 86-FZ, dated July 10, 2002 "On the Central Bank of the Russian Federation (Bank of Russia)" [2]. The list is closed and does not contain a reference to activities of individual entrepreneurs, individuals, and uses only the terms "company", "organization".

Federal Law No. 151-FZ, dated July 2, 2010 "On Microfinance Activities and Microfinance Organizations" [5] also does not contain a rule that includes individual entrepreneurs as subjects of microfinance activities. Judicial practice, which has taken shape now, confirms that individual entrepreneurs are not authorized to carry out consumer lending on the professional basis.

So the Russian legal system currently leaves the participants of crowdlending platforms outside the legal framework if they provide consumer loan more than four times a year.

Investing in the project, not related to further participation in the management of the company, but associated with the profit obtaining, implies the obligation of an individual to pay income tax. It can be argued that in the case of irregular investment by this way (once or twice a year), there will be no problems with the fiscal for an individual. Extraction of profit on a regular basis will require the investor to register as an official individual entrepreneur or a legal entity or to acquire a stake in the authorized capital.

Problems of legal regulation of crowdfunding is associated with the features of legal entity forms in Russia. Investments in the development of the project imply further participation in the management of the company, the receipt of a part of the profit in the form of dividends. To achieve these goals, it is necessary that the individuals have the status of a shareholder or a participant in a legal entity formed in the connection with the implementation of the project.

It should be noted that most of the legal entity forms in Russia are inconvenient for investment by large number of individuals. They contain many restrictions, oblige to register any changes in the authorized capital, membership, constituent documents in state bodies, and entail large volumes of administrative work, as well as property responsibility not only for the recoverable income, but also for the company's obligations. The number of investors may be more than it is legislatively established, their composition is very mobile, as well as the size of the authorized capital. So crowdfunding in the sense that a large number of individuals consolidate their funds in small amounts, and as a result becomes sufficient for covering the costs of the

investment project, may be impossible or very difficult with usage of reviewed legal entity forms.

The most appropriate form for crowd investment is a public joint stock company, but the costs of its creation, maintenance, issue of shares are often unacceptable for projects in the initial stage. Table 1 summarizes the characteristics of the four legal entity forms.

TABLE 1: Compare of legal entity forms.

Name of the legal entity form	Minimum amount of the authorized capital	Terms of payment of participation shares	Maximum number of participants/ shareholders	Shares, share accounting	Additional characteristics
Limited liability companies [8]	10 000,00 rubles	Within 4 months after the day of official registration	50	No	Participants are responsible for the obligations of the company within the limits of their share in the authorized capital (in proportion)
Non-public joint-stock companies [9]	10 000,00 rubles	At least 50% of amount within 3 months after the day of official registration, remaining amount within one year after the day of official registration	50	Yes, maintaining the register of shareholders by the authorized registrar	The list of participants is closed, the activity is a subject of the audit
Investment partnership [7]	Established by the investment agreement	Established by the investment agreement	50	No	Participants of an investment partnership can be only legal entities
Public joint-stock company [9]	100 000,00 rubles	At least 50% of amount within 3 months after the day of official registration, remaining amount within one year after the day of official registration	Not established	Yes, maintaining the register of shareholders by the authorized registrar	Obligatory creation of managing bodies, a large amount of administrative work, the absence of some tax benefits, mandatory application of legislative norms

Adequate legal regulation of crowdsourcing activities also implies establishment of companies and individuals as subjects of the regime of combating money laundering and financing of terrorism (Article 6 of the Federal Law, dated 07.08.2011 № 115-FZ "On Countering the Legalization (Laundering) of Incomes, obtained through criminal means, and financing of terrorism") [10]. The articles of law should oblige them to make a thorough customer verification, to identify the beneficiaries (including individuals), to send suspicious transaction report to the competent authorities, to ban anonymous customer service.

To realize their duties, they should also be given the authority to request information and documents, to interact with other subjects of the Federal Law 115-FZ and state bodies. These measures will protect the crowdsourcing platforms and economy in general against fraud, money laundering and terrorism financing. To ensure financial market regulation, crowdsourcing sites should be included in the list of non-financial organizations, report to the Central Bank of Russia and be under control by CBR.

To develop crowdlending, the legislation should be reformed and should allow individuals and individual entrepreneurs to carry out consumer lending activities. An adequate measure is to isolate such subjects into individual clusters along with lawyers and notaries, owners of farms, etc., which will allow them to maintain control of their activities, monitor tax payment and comply with the AML / CFT regime.

To increase the attraction of "people's financing" it is possible to provide tax benefits, full or partial privilege of taxes and fees, for example, for the first few years since the date of registration.

## 4. Conclusion

As a result, the article proves the necessity of reforming the legislation of consumer lending, creating a legal basis for the development of crowdsourcing, the introduction of transparent, accessible and understandable generally accepted investment procedures. An important aspect is also the need to modernize legislation of combating money laundering and the financing of terrorism. Advantage of the proposed measures will be an increase of the volume of the capital market, an improvement of the investment climate in Russia, growth of macroeconomic indicators and the standard of living in particular.

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