

Crowdfunding risks and rules (2/13/17)

The last decade has seen an increase in the popularity of various crowdfunding platforms. This article explores the idea of crowdfunding as well as associated risks and rules.

The idea of crowdfunding

The name of this type of funding reflects its unique idea of attracting multiple unprofessional investors to individual projects or products through the mass media. This allows an entrepreneur to raise the necessary funds without involving traditional lenders.

Global leaders in this type of business are companies such as Kickstarter and Patreon, who offer similar services to a variety of customers. In Latvia, crowdfunding platforms are referred to as alternative financial services, most notably Mintos and Bulkestate.

Risks and rules

The concept of crowdfunding covers a wide spectrum with opposite poles. On the one hand, funds can be invested in a project that involves developing a certain product. In that case, if the necessary amount is not collected, the money is usually repaid to the investor in full. On the other hand, money can be invested as a loan, hoping for a higher return. Such investment is usually lost, for example, when the borrower is unable to repay.

The services offered at either end of the spectrum differ not only in terms of idea and purpose but also risks. As a result, various countries have adopted rules that aim to strike a balance between the huge potential of this new type of fundraising and the apportionment of risks among multiple unprofessional consumers. In the UK, for example, crowdfunding platforms are required by law to guarantee that some of the loan invested through crowdfunding will be repaid to the investors who did not receive the expected return.

Crowdfunding rules in Latvia

Latvia has yet to adopt special rules to govern crowdfunding activities. A bill drafted by the Ministry of Finance has been shelved for several years. For this reason, an attempt should be made to apply the existing statutory rules to crowdfunding.

The main difference of opinion between crowdfunding companies and government agencies is on the application of legislation to protect consumers in the event of third-party lending.

In 2015, the Consumer Protection Centre reprimanded Latvia's largest mutual lending platform, Mintos, for offering investors the option to buy out up to 95% of the total amount receivable from the borrower under a contract of assignment, thereby getting rid of nearly all responsibility for guaranteeing the amounts invested by the investors. This dispute has now been taken to court.

At the other end of the spectrum, where consumers invest in projects with clear end results rather than lending money, there are no regulatory risks. Bulkestate's services, which involve attracting collective

investments to property development projects, have been recognised as a legitimate type of crowdfunding.