

The problems restricting the growth of Russian crowdlending and their possible solutions

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I Introduction

a) Background

Over the last few decades, crowdfunding has become one of the most popular methods of raising money for small and medium-sized enterprises (hereinafter SMEs) worldwide and, particularly, among startups. This tendency can be explained by broader opportunities, such as finding a larger group of individuals interested in a project at an early stage; avoiding banks with high interest rates on loans, as well as negotiating the difficult venture capital process; testing the level of interest; and garnering support directly from the potential audience of the products or services.¹ Crowdlending (also known as peer-to-peer lending, marketplace lending, peer-to-business crowdlending, business-to-business crowdlending, social lending, debt-based crowdfunding, loan-based crowdfunding) is one form of crowdfunding that gives SMEs, as well as individual consumers, the opportunity to borrow financial resources from non-traditional financial sources. The funds can be gathered from a great number of small investors by using crowdlending platforms as intermediaries, allowing investors to connect directly with borrowers.

Crowdlending has gained in popularity and grown significantly since 2008 due to the collapse of the financial system, which encouraged banks to become more selective about issuing loans to small businesses and individuals. The lack of the potential borrower's credit history and financial assurance, as well as the level of creativity of the future project, can become crucial obstacles for a loan approval. Thus, on the one hand, SMEs and individual consumers have been experiencing difficulties in accessing loans from banks, while on the other hand, the situation has stimulated the development of crowdlending as an alternative method of raising capital and a new FinTech solution, disrupting the traditional financial service sector. Consequently, it is not surprising that this financial method shows positive results, particularly when taking into account other forms of crowdfunding such as reward-based and equity-based lending (US\$180,790.0m, US\$6,923.6m, US\$4,794.9m, respectively). Moreover, a sharp increase in the annual world growth rate (US\$290,135.5m over four years) is expected in the crowdlending segment, which underlines the potential of this financial instrument.²

Traditionally, China, the USA, and the UK are the leaders in crowdfunding, including the crowdlending sector, with transaction values of US\$163,917m, US\$8,470.9m and 2,440.7m, respectively. In these countries, crowdlending was born before the world financial crisis of 2008. For example, the first peer-to-peer lending platform in China was established in 2007 and was called Shanghai Paipaidai Financial Information Service Co, or PPDai.com. Nevertheless, sharp growth occurred after 2012. The environment for growth in Chinese crowdlending includes factors such as funding restrictions for SMEs and individuals, which also exists in other countries, the rapid technological boom, broad access to the Internet, the development of online financial services, encouraging government policy, and favourable legal framework.³

The history of Russian crowdlending started in 2010 when the first crowdlending platform, Vdolg.ru,⁴ connecting investors and individual consumers was established. The first peer-to-business platform, TownMoney,⁵ was developed two years later. Since then, new

¹ (Mollick, 2014)

² (Statista, 2019)

³ (You, 2018)

⁴ (Vdolg.ru, 2019)

⁵ (Townmoney.ru, 2019)

crowdlending/crowdinvesting platforms have been created almost every year: Starttrack (2013),⁶ VentureClub.co (2014),⁷ Simex (2015),⁸ Alfa Potok (2016),⁹ ModulMoney (2017).¹⁰ However, in contrast to previously mentioned countries, Russian crowdlending and other forms of crowdfunding reveal comparatively modest rises. For example, a comparison of the transaction value in the crowdlending segment between the leader (China) and Russia in 2019 reveals a significant difference: US\$163,917m to US\$120.0m (1365 times).¹¹ The slow development of crowdlending in Russia is particularly surprising due to the banks' reluctance to issue loans to SMEs, which is confirmed by economic research (the growth in loans from 2012 to 2018 amounts to 102%, which is a significantly low number in the scale of the national economy).¹²

Consequently, there should be objective reasons restraining investors from participating in crowdlending and SMEs from choosing this financial method of raising money. Interestingly, researchers do not give due consideration to this issue. Usually, analysts only dedicate a few sentences to the underlying sluggishness of Russian crowdfunding as a whole, covering the unfavourable economic climate, the lack of regulation, low-income households and other seemingly established facts instead of a complete explanation and comprehensive analysis. Moreover, there are no suggested solutions to improve the existing environment; thus, previous research on crowdlending in Russia can be classified as superficial, only repeating general facts on crowdlending that are attributed to foreign sources. Therefore, it seems that without a comprehensive analysis of the issue, identification of fundamental problems, and proposals to resolve them, vigorous growth in Russian crowdlending is not probable.

There are several factors that could have a significant impact on the development of crowdlending in Russia. First, a high number of frauds in the Russian economic sphere over the last 25–30 years has led to distrust in all types of investment instruments. The collapse of the USSR and the economic crises of 2008 and 2014 have stimulated the growth of Ponzi and other fraud schemes that promise a quick and high return, but in practice, inexperienced investors with a lack of financial literacy became bankrupt. For example, in September 2018, after an in-depth investigation, the Russian Central Bank announced the fraudulent nature of the one of the most successful Russian peer-to-peer crowdlending platforms, Cashbery, which turned out to be a classic Ponzi scheme. This discovery has damaged the reputation of the crowdlending industry since small investors lost around three billion rubles in this financial pyramid. Moreover, a recent survey (September 2018) conducted by the National Agency for Financial Research confirms that financial pyramids make people suspicious of new financial methods.¹³

Secondly, according to analysis by the Center for Sociological Research (RANEPa),¹⁴ historically, Russian society views financial institutions and instruments with a degree of scepticism and suspicion. This seems reasonable in the case of crowdlending since there is no guarantee that money invested will be received back. Consequently, taking into account risky nature of crowdlending, the existence of a balanced legal framework regulating the industry and stimulating its development is

⁶ (Краудинвестинговая площадка StartTrack, 2019)

⁷ (Ventureclub.co.,2019)

⁸ (Simex.global, 2019)

⁹ (Business.potok.digital, 2019)

¹⁰ (МодульДеньги, 2019)

¹¹ (Statista, 2019)

¹² (Быкова, Ольховская and Профатилов, 2015)

¹³ (Nafi.ru, 2019)

¹⁴ (Vedomosti.ru, 2013)

particularly vital, which has been perceived by many countries, including the leaders – the USA, the UK, and China. Currently, Russian legislators are considering the approval of comprehensive regulation of crowdlending (there is a project dedicated to the regulation of crowdfunding investment platforms); however, it is yet to be approved. Thus, only the general provisions of the contract and consumer laws apply, which leads to a high level of freedom in regard to the operation of crowdlending platforms.¹⁵

Thirdly, the ruble's depreciation in the 1990s, the currency crisis that has existed since 2014, high inflation, unsuccessful pension reforms, the collapse of several banks, and the continuing economic crisis all contribute to the decrease in the level of citizens' trust in the government and financial system. Investors are suspicious of participating in any investment activities due to their lack of confidence that they will receive their investments back in the existing environment, while companies suffer from bureaucracy and corruption as well as from a frequent, unpleasant change of legislation that results in difficulties in planning business operations.

Other factors can be linked to a lack of financial literacy and the people's unstable financial status. The first obstacle is related to the long existence of the Soviet Union, when society did not have a wide array of choices regarding financial institutions and relied on the state in the financial decision-making process. After the collapse of the USSR, people did not have any knowledge of the operation of a financial system in the market economy, which led to the high number of frauds and abuses. Moreover, in the modern country, people continue to wait for assistance from the state to ensure their well-being, which is explained by some researchers as a feature of the Russian mentality.¹⁶ The second obstacle is related to the lack of surplus funds available to participate in crowdlending, leading to the low financial activity of society.¹⁷

b) Problem statement

Factors including the high level of financial frauds, people's suspicion, lack of financial sophistication, the country's unstable financial status, legal uncertainty, and a low level of credit in the government system lead to the unsuccessful operation of crowdlending in Russia. Thus, establishing solutions to the problems, such as legal solutions based on analysis of legal frameworks adopted in the UK and China, and their comparison with the suggested project on crowdfunding in Russia, as well as alternative solutions covering collaboration between crowdlending and banks, and decentralization of platforms should promote the development of crowdlending in Russia.

c) Research question and sub-questions

Research question: What are the main obstacles restricting the development of Russian crowdlending and what measures can be implemented to overcome these obstacles?

Sub-question 1: What is the nature of crowdlending and what are the advantages and risks associated with this lending method?

Sub-question 2: In terms of a legal framework, what approaches were chosen by China and the UK as world leaders in the crowdlending sector?

Sub-question 3: What is crowdlending in Russia and how is it regulated?

¹⁵ (ПРАВО.Ру., 2015)

¹⁶ (Ковальчук and Сайбель, 2018)

¹⁷ (Скопинцева, 2019)

Sub-question 4: What are the factors and problems that influence the growth of Russian crowdlending?

Sub-question 5: By comparing the Russian project for the development of a Federal Act ‘On attracting investment using investment platforms’ (hereafter the Federal project on crowdfunding) with the existing patterns of crowdlending regulation in China and the UK, what legal approaches should be chosen for the regulation of Russian crowdlending?

Sub-question 6: What are the alternative solutions to the problems restricting the growth of crowdlending in Russia?

d) Significance

Crowdlending, as vital fundraising instrument for SMEs and individuals, was chosen among other forms of crowdfunding due to its existence and factual operation, but slow development, in Russia. In contrast, the majority of projects on crowdfunding platforms are not business projects; they are intended to collect money (donations) for purposes including a new movie, book, or theatre performance. Equity-based crowdfunding is at the embryo stage due to legislative restrictions and currently does not work.¹⁸ Consequently, the results of this research will have a practical value, since establishing the problems that restrict the development of crowdlending and possible solutions to the problems should provide individuals and SMEs with an alternative finance-raising method that operates as a safer and more stable instrument (in comparison to the old version), creating trust among its participants and contributing to the development of SMEs and the Russian economy as a whole.

e) Methodology

According to the statistics, the Russian crowdlending sector is far from the leaders. Taking into consideration the mushrooming growth of crowdlending around the world, there must be reasons for the restriction of the development of Russian crowdlending. This study aims to discover these obstacles and offer the most favourable solutions to them. To achieve these goals, the following methods will be used:

1. Analysis of economic studies on crowdlending, crowdfunding and FinTech solutions. The study of this area of theoretical research is particularly necessary to gain an understanding of the economic nature of crowdlending, its roots, features, benefits and incentives for choosing this financial method, as well as its risks for investors.
2. Analysis of legislation regarding crowdlending. The study of foreign and Russian legislation is essential to understand the legal nature of this method. As examples of law, the UK and Chinese legal frameworks will be analyzed, since the features of legal regulation of a prosperous crowdlending sector can be particularly useful in the context of future recommendations for improving the Federal project on crowdfunding. Moreover, as mentioned previously, the Russian government will adopt a model with similar features; consequently, the choice of these legal frameworks for detailed study seems the most reasonable.
3. Analysis of legal research regarding crowdlending is necessary for a better understanding of the regulations as well as conditions that encourage the adoption of a particular legal framework.
4. Analysis of economic studies on investments in the Russian market. These sources will be used to establish the current investment situation on the Russian market, and understand factors that affect

¹⁸ (Habr.com.,2019); (Firma.ru, 2017)

the market, as well as analyze possible reasons that restrict people from participation in investment activities.

5. Analysis of the operation of various platforms. This approach is necessary to identify the crowdlending environment and problems related to the operation of the platforms.

5. Comparative analysis will be used to analyze local features and establish possible problems related to the crowdlending sector in Russia compared to the UK and Chinese legal regimes and business environments of crowdlending. Further, positive examples of legal frameworks and business solutions will be studied to establish favourable changes to Russian legislation, designed to promote crowdlending in the interests of all participants.

f) Literature review

Literature analysis reveals that there are considerably fewer studies on crowdlending than on other forms of crowdfunding. From an economic viewpoint, crowdlending is considered as a unique form of crowdfunding and an alternative financial method of raising capital. Many authors underline its features (Boitan, 2016; Omarini, 2018; Pierrakis and Collins, 2014; Morse, 2015; Wei and Lin, 2013), opportunities (Sadzius and Sadzius, 2017; Orca, 2019; Ayal, Bar-Haim and Ofir, 2018; Nemoto, Storey and Huang, 2019) and particularly risks (Gao, 2016; Hjermann, Jørgensen and Bakke, 2016; Käfer, 2016; Lei, 2016; Fu, Huang and Singh, 2018).

One of the most important issues regarding crowdlending is the interaction between crowdlending platforms and banks, as well as the impact of new FinTech technologies on a traditional financial sector (Fenwick, Vermeulen, and McCahery, 2017; Blohm, 2016; Ahern, 2018; de Roure, Pelizzon and Thakor, 2018; Blohm, 2016; Bertsch, Qi, Hull and Zhang, 2018). Another aspect is the decentralization of crowdlending platforms, their collaboration with blockchain technologies, and the use of smart contracts in the lending industry (Henriquez, Cohen, Bittan, and Tulbassiyev, 2019; Gomber, Kauffman, Parker, Weber, 2018; Gonzalez, 2019).

In addition, the regulation of crowdlending, which is expressed in different frameworks around the world, was analysed by different authors (for instance, comparative analysis in the world (Nemoto, Storey and Huang, 2019); China (You, 2018; Gao, 2016; Chorzempa, 2016; Huang, 2017); the UK (Lu, 2018; Atz and Bholat, 2016), the EU (Ahern, 2018; Sadzius, Sadzius, 2017); and the USA (Bradford, 2011; Heminway, 2017).

The topic of trust and crowdlending also deserves particular attention. For example, Rau (2017) claims that the success of crowdfunding in any country depends on rational economic factors and is not linked to trust. In contrast, other studies (Chen, Lai and Lin, 2015; Bertsch et al., 2018; Ayal, Bar-Haim and Ofir, 2018; Fu, Huang and Singh, 2018) insist that trust in the borrower and trust in the intermediaries are highly significant factors, and that the national features of a particular country affect crowdlending.

Despite a significant number of foreign studies on crowdlending, the level of progress of Russian research on this topic can simply be described as a beginning. There are several blogs dedicated to the issues of crowdfunding that cannot be taken as an authority (e.g., Crowdfund.ru, 2019, and Boomstarter, 2019). The majority of academic articles are general, expositive and familiarising; moreover, they were written by students at different levels, while professors only contributed to several economic works, such as Ермакова and Нестеренко (2018), Быкова, Ольховская and Профатилов (2015), Фирсова (2018). All these studies are aimed at explaining the main features

of crowdlending, the disadvantages and advantages of this financial method, its evolution around the world and, more particularly, in Russia.

g) Chapter overview

This thesis comprises five chapters, including the introduction and conclusion. The second chapter, ‘The nature of crowdlending’ analyzes the features, business models, advantages and risks of crowdlending. As a result, this research contained in this chapter becomes the theoretical part for the following chapters. Moreover, this chapter also covers the examples of two different types of legal frameworks established in countries that are considered leaders in the crowdlending sector (China and the UK).

The third chapter concentrates on the problems of the Russian crowdlending environment. First, data from all Russian crowdlending platforms are analyzed. Second, existing legal regulation is investigated by analyzing public contracts published by Russian crowdlending platforms. Third, factors and problems affecting the growth of crowdlending in Russia are evaluated; this research will particularly focus on the existence of mental barriers, which has a crucial effect on Russian crowdlending. Lack of trust is expressed in three ways: distrust in the platforms, the borrowers’ performance, and the government system. In addition, there is the problem of low financial literacy and financial status.

The fourth chapter is dedicated to possible solutions to these problems. The first group of possible solutions is legal aspects, which is discussed in the context of the government’s intent to regulate investment in the form of crowdfunding (the Federal project on crowdfunding was adopted by the State Duma on first reading on 22 May, 2018 and is now waiting for approval in the second reading). This legal novelty can address two issues at the same time. Firstly, official recognition and support of crowdlending will increase financial literacy about this instrument. Secondly, a new project is aimed to fill legislative loopholes and, as a result, suggest solutions related to the development of an alternative source to finance SME projects. The main fear related to this legislative act is that excessive regulation of the sector, primarily created to defend the rights of investors who may be cheated and face excessive demands from crowdlending platforms, can ultimately stifle business. In this case, the Chinese and English regulations can be considered as successful models that stimulate the growth of crowdlending. Not only can a balanced legal solution establish a favourable environment for the extension, but it can also increase the Russians’ level of trust in this financial instrument.

The fourth chapter also includes two alternative solutions to these barriers: banks as a tool for risk mitigation and decentralization, and blockchain and smart contracts as a way to eliminate the issue of trust. The participation of banks in the crowdlending sector in the capacity of providing a guarantee can enhance the credibility of such a financial instrument. In addition, banks can receive broader benefits from this collaboration than from competition due to the rapidly developing character of this industry. Decentralization can be a solution to distrust in the government system since decentralized peer-to-peer lending platforms are not based on any state institution and blockchain technologies using smart contracts provide lenders and borrowers with the opportunity to transact directly in a democratic way.¹⁹ Moreover, the Federal project on crowdfunding includes the term ‘smart contract’ and allows the possibility of execution of contracts between investors and borrowers.

¹⁹ (Medium, 2018)

Chapter II The nature of crowdlending

2.1. The concept of crowdlending and its business models

Crowdlending is an investment form of crowdfunding which can be determined as a FinTech fundraising practice allowing a great number of small investors having commercial purposes to lend capital collectively to enterprises and individuals by using crowdlending platforms independently from the traditional financial industry.²⁰

Over the last decade, crowdlending has become a revolutionary method of alternative financing, which increases its popularity substantially and continues to show fantastic growth and potential around the world. This alternative solution includes «economic exchange» which is directly executed between parties outside the traditional banking sector. As a result, banks usually have a low profile of depository and do not have any influence on the parties of crowdlending.²¹

It is interesting to notice that the idea of such financial exchange is not that new and existed among communities and families throughout centuries. For example, Britain Friendly Societies established in 1630s-1640s were the first peer-to-peer lending communities aiming mutual financial support of members for achieving collective benefits. The reemergence of crowdlending in the 21st century was determined by several factors. Firstly, the mushroom growth of the Internet and e-commerce brought together crowd and financial services in one place. Secondly, the increasing demand for loans and difficulties related to receiving them among small individuals and SMEs gave the crowdlending industry its audience.²²

A noticeable tendency of the current business environment is the decrease of the size of the business (for example, according to European Commission SMEs represent 99 % of all business in the EU), which can be explained by reduced trade barriers, developed transportation connections, improved technologies in the sphere of information and the appearance of global chains.²³ The role of SMEs in a global economy is highly significant since they maintain competition, encourage innovations, provide various goods and services, stimulate the growth of workspaces; as a result, they lead to the development of counties around the world.

At the same time, the foundation of SMEs' success depends on easy access to financial instruments.²⁴ Despite various ways of financing, their usage and access are not that simple. For example, equity investors tend to receive as much control as possible under organizations; venture capitalists prefer focusing on innovative technological startups at infancy stage; IPO is time-consuming, expensive and demands thorough preparation. Moreover, traditional financial institutes are reluctant in granting loans to SMEs, particularly after the worldwide crisis of 2008 due to the highly risky nature of startups and the lack of collateral.²⁵ As a result, the financial gap in the question of SMEs' fundraising has occurred; at the same time, such alternative financial method as crowdlending was established to fill this gap.²⁶

The worldwide crisis of 2008 has also affected individuals applying for bank loans because banks have become highly selective in the question of issuing loans. As a result, the peer-to-peer lending

²¹ (Ayal, Bar-Haim, and Ofir, 2018)

²² (Omarini, 2018)

²³ (Wto.org, 2016)

²⁴ (Hasan, 2015)

²⁵ (Lu, 2018)

²⁶ (Bointan,2016)

market has found a significant audience of borrowers receiving rejections from banks or having poor credit story and not wanting to be charged a higher interest rate by the latest. Such personal loans can have various purposes, for instance, business, mortgages, refinances, bad debt, studying, medical, auto loans.²⁷

It is essential to notice that the crowdlending concept is closely related to two other ideas - crowdfunding and Fintech; moreover, it has the features of the latest. According to Mollick,²⁸ crowdfunding is a financial method of raising capital for cultural, social or commercial purposes through collecting small contributions from a significant number of people via the Internet and without usual financial intermediaries. Since crowdlending is a form of crowdfunding, it can be determined as an investment method which includes collecting small investments from a great number of individual investors via the Internet. Also, peer-to-peer lending belongs to FinTech solutions which are described by the Financial Stability Board as a financial innovation based on technologies and leading to the creation of new business services, products, and processing having an impact and improving the financial markets.²⁹ Consequently, as a FinTech solution, crowdlending is aimed to provide efficiency of financial services and transparency, to improve clients' experience and access to them through the use of the Internet. Thus, it becomes an alternative to traditional financial services.

Other features of crowdlending can be seen in its comparison with other forms of lending, for example, with balance sheet lending.³⁰ First, the difference is in the sources of capital. In the crowdlending model, lenders invest small amounts directly in loans diversifying their investment and keep ownership of loans by using online crowdlending platforms, while balance sheet lending involves fundraising from various sources such as investment banks, high-net-worth individuals, financial markets and other listed investment institutions with a general exemption of retail investors. Secondly, the terms of loans and returns are different. In peer-to-peer lending, the term can be extended up to 5 years, and the return rate is higher than offered by traditional banks.³¹ At the same time, the term of lending of balance sheet lending model is usually shorter, and return is even higher. Thirdly, the funding process is significantly different. For the peer-to-peer lending model, it is crucial to find a balance between the borrowers' demand and investors' offer, while the second model allows using funding as soon as the lending application is approved. Finally, these two models differ in the issue of risks. The first model in contrast with second and the traditional banking sector does not cover any losses (unsecured loans), the only exemption is provision funds; thus, lenders accept risks and associated with these risks profit.³²

Crowdlending platforms have a special role of intermediaries in the crowdlending process. In contrast with traditional banks, they directly match potential lenders and borrowers together,³³ collect, evaluate, distribute information about future borrowers as well as inform about potential projects,³⁴ assign credit rating, provide online services, monitor lending and receive benefits from the administrative fee paid by borrowers and lenders.³⁵

²⁷ (Käfer, 2018)

²⁸ (Mollick, 2014)

²⁹ (Bis.org, 2017)

³⁰ (Fenwick, Vermeulen, and McCahery, 2017)

³¹ (Rose, 2019)

³² (Orca, 2019)

³³ (Morse, 2015)

³⁴ (Fenwick, Vermeulen, and McCahery, 2017)

³⁵ (Ayal, Bar-Haim, and Ofir, 2018)

The matching role can be active (a diffused model) and passive (a direct model). The diffused model allows a platform to allocate collected money from investors on different loans by itself, taking into consideration the level of expected risks by investors. The advantages of this model are that platforms try to mitigate risks by diversification, and every borrower has a good chance to receive a loan quickly. The direct model looks like a traditional crowdfunding campaign and allows selecting loans by investors themselves using data provided by potential borrowers which lead to a lower level of diversification, longer period of getting loans and the achievement of loan goals partly. Interestingly to notice, there are two types of platforms distinct from each other in the case that a loan was not funded fully; as a result, a borrower does not reach his funding goal. According to the one type, money should be returned to investors participating in this offer (principle «all or nothing»). However, some platforms choose another strategy establishing a bottom line, for example, collecting at least 80 % of a demanding amount, in such cases a borrower receives a loan partly.³⁶

There are two procedures for matching lenders and borrowers. The first one called «auction method» allows lenders to set the minimum interest rate which they are willing to have for a particular risk category, while borrowers can establish the maximum interest rate they are ready to pay.³⁷ Then, lenders and borrowers are matched by the platform rising interest rate until a full amount of loan is collected. At the same time, the platform restricts the amount invested by an individual investor; as a result, it provides diversification. The loan is declined if investors are not willing to finance at or below the highest rate approved by the borrower.³⁸ In contrast, the second procedure is named «offline method» through which parties are automatically matched at pre-defined by the platform interest rates taking into account lenders preferences in returns and risks.³⁹

There are several business models of operating crowdlending platforms, depending on the issue of exercising financial rights by lenders to a platform. The choice of a particular business model highly depends on local regulation. The first model is a notary model (existing in the USA) connecting investors and borrowers and transferring the amount of loan to the third intermediary – a partnering bank. The bank issues a loan which is then purchased by the platform selling this loan to the lender. The platform collects repayments made by the borrower and returns it to the lender.⁴⁰ As a result, contractual relationships are set between lenders and platforms which execute an active role in the whole process. The second is called segregated account model (existing in the UK, China), according to which a loan is kept on a separate client account and is not reported in balance sheets of a platform. This model does not include active bank' participation, and platform serves as a marketplace since lenders and borrowers conclude a loan contract directly, which provides independence of contractual parties from platforms. The third model called guaranteed return model (existed in China) according to which interest rate is applied by a platform and depends on risks taken by borrowers as well as on the specifics of loan, while a particular remuneration is guaranteed by a platform. Such guarantees from one side stimulate the participation of investors in crowdlending; however, from the other side, crowdlending platforms becomes a credit intermediary which frequently leads to collateral liability, credit risks and finally, to the default of a platform. The balance sheet model determines the role of a crowdlending platform as a pure financial intermediary which can issue loans and include them in a platform's balance sheets. Using these

³⁶ (Omarini, 2018)

³⁷ (Lin, Prabhala and Viswanathan, 2009)

³⁸ (Milne and Parboteeah, 2016)

³⁹ (Wei and Lin, 2013)

⁴⁰ (GAO, 2011), (Kirby and Worner, 2014)

platforms, lenders are very risky since the failure of a platform can lead to heavy losses by investors.⁴¹

2.2. The advantages and risks of crowdlending

Crowdlending has some advantages in comparison with the traditional banking sector for the long-lasting and efficient existence.⁴² The first advantage is expressed in lower transaction costs provided by the lack of financial intermediaries and the adaptation of cost-saving business structure which is a clear benefit, particularly in conditions of a great number of small transactions.⁴³ As a result of these features, all parties involved in crowdlending are in the position of win-win since administrative fees are low (one of the largest crowdlending platforms – Funding Circle requires just 1% of the loan)⁴⁴, return is higher for lenders (which is particularly essential in the conditions of negative interest rates offered by banks in comparison with the level of inflation)⁴⁵ and interest rates are lower for borrowers. The final cost of crowdlending loans is no higher than offered by banks.

Secondly, in contrast with the banking sector, this simple business model covers diverse funding sources which are not limited by geographical borders of traditional banks; as a result, it provides broader access of SMEs to financing.⁴⁶ For example, more and more government organizations, small investors, institutional investors, hedge funds, and corporations have become active participants in crowdlending activities since they are usually dissatisfied with deposition interest rates applied by banks. For instance, about 80% of all investments of the loan-based crowdfunding sector in the USA is provided by institutional investors.⁴⁷

Thirdly, peer-to-peer platforms encourage direct access of unprofessional small investors to the investment sector, which was previously available only for large institutional investors. Indeed, before the growth of crowdlending, the list of investment options was quite narrow and usually expressed in pension, mutual funds, bank deposits since the access to a traditional high-yielding product was restricted for non-high net-worthy investors by establishing a high threshold of investment.⁴⁸ The growth of peer-to-peer crowdlending has expanded investment opportunities for individuals due to the low threshold of investment justified by the sharing nature of crowdlending. For example, the cost of a standard lending product on the first peer-to-peer lending platform in the world (Zopa) is just £10.⁴⁹

Fourthly, diversification of crowdlending investments mitigates the risks and decreases the effect of potential default. It is expressed in the procedure when investor's money is divided into several small parts and arranged to various loans automatically.⁵⁰ Moreover, some platforms (for example, Landbay and Lending Works)⁵¹ provides additional protection for investors by the creation of provision funds.

⁴¹ (Omarini, 2018)

⁴² (Käfer, 2016)

⁴³ (Lu, 2018)

⁴⁴ (Fundingcircle.com, 2019)

⁴⁵ (Cunliffe, 2016)

⁴⁶ (Lu, 2018)

⁴⁷ (Cortese, 2014)

⁴⁸ (Lu, 2018)

⁴⁹ (ZOPA, 2018)

⁵⁰ (Lu, 2018)

⁵¹ (Evans, 2016)

Fifthly, crowdlending is a time-efficient method,⁵² in contrast with banking loans, presenting a transparent and straightforward procedure requiring borrowers to fill the application and download some financial documents, which takes no more than 10-15 minutes. Borrowers get information about the approval of loan application within 24 hours. Then, a platform informs potential investors about a new loan on its marketplace (the period of waiting is no more than seven days). Immediately after a loan is collected, money is transferred to a bank account mentioned by a borrower.⁵³ This straightforward procedure is impossible to imagine in the traditional banking sector.

Finally, crowdlending platforms, according to some researches, are more successful in overcoming of a long-lasting problem of information asymmetry than the old-fashion financial intermediary. Platforms exploit artificial intelligence and big data which help to evaluate the risks and creditworthiness of individuals and SMEs differently from traditional analytical methods.⁵⁴ Although SMEs are usually unable to provide comprehensive information about their past operations, which decreases their chances to receive a bank' loan, crowdlending platforms apply predictive algorithms such as industry dimensions, financial information about the owners of a company, the result of their current operations, plans for development and others; as a result, it increases chances for success in the issue of getting a loan. Also, local regulation sometimes demands transparency in the work of platforms, including disclosure of a platform's operation and particular requirements in disclosure information by borrowers.⁵⁵

Regardless of all these advantages, there is a disadvantage restricting crowdlending from establishing itself as a leader on a market of lending services, which is determined by a risky nature of this financial method. Dividing all these risks into several categories is possible.

The first category is related to the poor financial performance of a borrower. As we discussed earlier, one of the primary function of crowdlending platforms is evaluating the information provided by potential borrowers and assessing their creditworthiness. Frequently, this creditworthiness can be very low, which is usually compensated by high-interest rates in case of banking financing; however, platforms assume these poor risks, which lead to the growth of moral hazard. For example, one of the main reasons for the business collapse of the peer-to-peer platform Quakle in the UK was related to low-quality borrowers. Moreover, by no means all platforms have a reverse fund which provides an additional guarantee of returning a loan; usually, investors bear the loss of an investment and interest rate. Investors can prevent these losses or decrease them by diversification of portfolio (putting eggs in different baskets) or getting rid of under-performing loans on a secondary market created by the platform. However, not all investors have financial literacy, while the second opportunity depends on the existence of a secondary market and its liquidity (liquidity risks).

Poor financial performance of borrowers makes crowdlending particularly risky due to the problem of enforcement. Indeed, it is tough for a lender to enforce a claim against a borrower in case of late payment or default because lawsuit procedures are too costly for a small loan amount; as a result, they usually do not work. Furthermore, due to the unsecured nature of crowdlending loans, confiscation of assets in case of SMEs is generally not possible.⁵⁶

The second category of risks belongs to the due diligence of data belonging to a potential borrower. On the one hand, the process of application and receiving a loan is much faster and more relaxed in

⁵² (Fundingcircle.com, 2019)

⁵³ All information about the procedure was received from a crowdlending platform- Funding Circle.

⁵⁴ (Mills, 2019)

⁵⁵ (Lu, 2018)

⁵⁶ (Käfer, 2018)

comparison with banks. On the other hand, this simplicity hides a lot of risks since there are usually no regulatory obligations regarding mandatory due diligence of particular data which should be carried out by a platform on behalf of investors. In the absence of legal requirements, platforms are not willing to disclose their internal due diligence reports and only indicate short-hand rating – A, B, C. The lack of regulation leads to the assessment of the limited amount of information resulting in the misunderstanding of actual risks assumed by an investor. Moreover, platforms face obstacles in the determination of true creditworthiness of borrowers since they often have the problem of verification of data provided by a borrower, and unlike banks, they do not have enough resources to check their authenticity (particularly, non-financial information) which lead to the existence of inaccurate and misleading information.⁵⁷

The third category of risks related to the default of platforms which can be explained not only by poor trading and management but frequently by the malpractice of a platform or conflict of interests in the lack of proper regulation.⁵⁸ The main risks for lenders, in this case, is troubled execution of transactions, for instance, not getting repayment risks and the loss of investments carried on the bank account of the platform which is not willing to disclose its structure and financial information regarding their operation without particular requirements. As proved by practice, the lack of transparency in the operation of platforms and control under their operations increases risks of frauds significantly. For example, TrustBuddy platform illegally used lenders' money for lending to illegitimate borrowers, which resulted in a dramatic debt which platform was not able to return.⁵⁹

Moreover, if to compare the average default rate of banks and crowdlending platforms, the rate of the latest is much higher. According to some studies, the lack of comprehensive legislation is one of the reasons for the high rate of default.⁶⁰ Though there are different regulatory models, the lack of regulation particularly obvious in comparison with the banking sectors. If the latest has developed capital regulation covering strict capital requirement and safety mechanisms preventing an intermediary from the default, the crowdlending sector does not adopt such guidelines which lead to a poor capitalization and, as a result, make them especially frail.⁶¹ Consequently, the sophisticated regulation of platforms' operation is particularly significant since it can prevent possible default and decrease the possible risks for investors.⁶²

To sum it up, advantages such as low transaction costs, higher return for investors and lower interest rate for borrowers, diverse funding sources, wider access to investment for SMEs and unprofessional investors, the lack of geographic borders, time-efficiency, possible diversification of investment, the usage of artificial intelligence and predictive algorithms in evaluating creditworthiness of a potential borrower make crowdlending particularly attractive as an alternative method of raising capital. It gives SMEs and individuals, in contrast with traditional banking sectors, more chances to get financing while investors to receive a more favourable return. At the same time, this type of investment is risky due to the possible poor performance of a borrower, difficulties related to its enforcement, obstacles in determination of a factual creditworthiness of a borrower, the lack of mandatory disclosure borrower's data, the lack of liquidity of the second market, possible default of a platform and fraud operations. In this environment, the existence of a balanced legal

⁵⁷ (Atz and Bholat, 2016)

⁵⁸ (Ahern, 2018)

⁵⁹ (Alois, 2016)

⁶⁰ (Ayal, Bar-Haim and Ofir, 2018)

⁶¹ (Käfer, 2018)

⁶² (Ahern, 2018)

framework regulating the activity of platforms, its legal status, relationships between investors and borrowers, and stimulating the development of this industry seems particularly vital.

2.3. The examples of legal framework established for crowdlending

2.3.1. The features of legal regulation of peer-to-peer crowdlending in China

The twenty-first century has brought the boom of FinTech solutions in China, and crowdlending is not an exemption. This FinTech method was born in 2007 with the first crowdlending platforms called PPDai.com; however, wanton growth has occurred after 2012. Despite the considerably short period of time, China has justly achieved the position of leader of the crowdlending sector since it has created the biggest crowdlending industry in the world with the highest numbers of platforms and users, while the sector shows an unparalleled growth and the highest transaction value in the world (US\$163,917.3m in 2019). Moreover, it is predicted that the sector will almost double this result by 2023 (US\$270,577.0m).⁶³ Factors encouraging the development of Chinese crowdlending has covered growing access to the Internet and an increasing number of Internet users, the growing popularity of e-commerce and FinTech solutions stimulating people to participate in financial operations via the Internet, as well as such conventional factors as banks' reluctance to issue loans to SMEs and individuals.⁶⁴

Interestingly to notice that until 2016 this fantastic growth was accompanied by almost full regulatory vacuum (exemption "spreading out" rules across Criminal, Securities, and Consumer Law) which from the one side did not restrict the development of this sector but from the other side the lack of regulation led to instability, the growth of various risks and, as a result, dramatic market failures bringing significant losses to a great number of investors.⁶⁵ For example, sadly remembered peer-to-peer platform Ezubao operated as a pure Ponzi scheme offering nonexistent projects for financing. As a result of the collapse of this platform, about 900 000 investors lost approximately CNY 50 billion. Moreover, according to the survey analyzing problematic platforms in China in comparison 2012 and 2016, their number had increased from 16 platforms to 2,076 platforms. Basically, without regulation, Chinese crowdlending became «the huge elephant into a small room».⁶⁶

The first government regulatory initiative was dedicated to the whole FinTech sector (the Guiding Opinions on Promoting the Healthy Development of Internet Finance, 2015). This Guiding Opinion distinguished crowdlending platforms as information intermediaries from traditional banking institutions for the first time. As a result, functions of peer-to-peer lending platforms were restricted by information services excluding direct lending activities. The first comprehensive regulation of crowdlending came into effect in August 2016 (The Interim Administrative Measures for the Business Activities of P2P Lending Information Intermediaries, hereinafter⁶⁷, the Measures) and was aimed to balance the growth of crowdlending with the mitigation of high market risks.

The Measures help to follow Chinese regulatory approaches.

- 1) The status: The Measures confirmed the status of crowdlending platform (peer-to-peer and peer-to-business) as an informational intermediary responsible for collecting, evaluating and distributing information to facilitate loans which are originated by banks.

⁶³ (Statista a, 2019)

⁶⁴ (Chorzempa, 2016)

⁶⁵ (Lei, 2016)

⁶⁶ (You, 2018)

⁶⁷ (Hk.lexiscn.com, 2016)

- 2) The regulation: The Measures establish the straightforward administrative process regulating Chinese crowdlending market. The China Banking Regulatory Commission (CBRC)⁶⁸ is responsible for setting and implementing rules governing crowdlending. At the same time, local governances were given the power to control the operation of crowdlending platform registered in a particular region which is aimed to create regulatory conditions adequate to the environment of each region. This division of responsibility was criticized in several studies since it dilutes the role of the CBRC as a national regulator while crowdlending platforms assist businesses and individuals not only within a local province but across the whole country.
- 3) The requirements to parties: There are some requirements and restrictions preventing parties from possible fraud, for example, participants of platforms should prove their true identity; lenders should demonstrate the legitimacy of their financial sources, while borrowers prove the legality of their project by disclosure material information; financing from different platforms for one project is prohibited. Moreover, a cap system controls the size of loans collecting via crowdlending to provide only SMEs and individuals in need with micro-financing alternative and to protect investors from potential risks. A personal loan can be CNY 200,000 collected from one platform or CNY 1 million from several. For SMEs, these numbers are CNY 1 million and CNY 5 million respectively.⁶⁹
- 4) The requirements to platforms: Next approach is related to the operation of crowdlending platforms. There are only two obligations:⁷⁰ they are obliged to pass through mandatory registration and filing system (which is quite straightforward). Also, they are precluded from functions belonged to a financial intermediary (unlike American notary model). The explicit list of prohibited activities («negative list»)⁷¹ includes three groups: engaging in loan transaction directly (for example, financing their own projects via a platform); promoting loan transactions (for instance, promising guaranteed return); participating in high risk transactions (for example, offering equity crowdfunding services).
- 5) Disclosure and external control: The Measures have adopted disclosure approach according to which obtaining information regarding investors, borrowers, risk evaluation, credit ratings, the results of financed projects together with the information about current projects have to be available for a wide auditory on the website of the platform. Moreover, the platform is obliged to hire third parties such as law, audit, and cybersecurity firms which assess the actual implementation of disclosure regulation. The results of such collaboration should be publicly available.⁷²
- 6) The mitigation of the risks: For the reduction of the risks Chinese government has adopted an additional approach related to third-party gatekeepers. Since crowdlending platforms frequently had undertakings involved in financial activities, increasing the risks to the stability of the whole platforms, these entities are strictly controlled nowadays. At the same time, the role of third-party gatekeepers such as banks has been increased. Qualified third-party institutions have become a depositor since according to the negative list platforms cannot be financial intermediaries; as a result, they participate in depository contracts, operate and transfer collected funds between parties which accounts should be segregated from each other.⁷³

⁶⁸ (Frbsf.org, 2016)

⁶⁹ (You, 2018)

⁷⁰ (You, 2018)

⁷¹ (Huang, 2017)

⁷² (You, 2018)

⁷³ (You, 2018)

Despite the sufficiently detailed regulation, there are several issues which were not embraced by the Measures, among them the absence of rules governing illegal fund-raising activities. According to some studies, it leaves a room for frauds as well as the lack of regulations related to dispute resolutions (though the number of complaints and disputes is high) and to conflicts of interest in contrast with the UK regulation. At the same time, established law and the first results of this implementation show that it defends rights of crowdlending parties, decreases risks and the number of fraudulent platforms, encourages sustainable development of peer-to-peer lending.⁷⁴ Furthermore, this regulatory framework can be taken by other countries as successful examples of governing.

2.3.2. The features of legal regulation of loan-based crowdlending in the UK

Over the past decade, the UK has become a FinTech centre bringing together thousands of financial companies by the creation of a positive environment for their operation and development. Furthermore, the UK represents the largest alternative finance market in Europe, amounting to 74,3 % of the total market share. Interestingly to notice that the first peer-to-peer lending platform (Zopa, 2005) was established here; moreover, UK government adopted the first regulatory approach (2014) related to crowdlending or how it is called in the UK - loan-based crowdfunding. Most importantly, this legal framework has shown itself as a FinTech friendly regime keeping the balance between the development of the sector and minimization of risks.⁷⁵

Nowadays, it is not surprising that the UK is one of the mature leaders of the crowdlending industry with a high concentration of three platforms (Zopa, Rate Setter, Funding Circle). Pursue to the Peer-to-Peer Finance Association in the UK (P2PFA), the maturity can be proved by the achievements of this sector, for example, the last quarter of 2018 shows that more than £800 million of new loans were issued which includes £527 million to SMEs and £282 million to individual consumers. During 2018 UK platforms facilitated loans amounting to £3 billion.⁷⁶ According to the founder of UK P2P lending platform ThinCats, a crucial role of peer-to-peer lending in the whole UK economy is determined by essential funding access for SMEs which in their turn employ the majority of people living in the UK.⁷⁷ Consequently, these high achievements can be explained by an understanding of the UK government the significance of peer-to-peer lending sector and encouraging its growth.

The UK legal framework has its national features distinct from other models. First, self-regulation of peer-to-peer lending has substantial significance for the industry in the UK. The P2P Finance Association was established by Zopa, Funding Circle and Rate Setter in 2011 as a self-regulatory body for loan-based crowdlending, and now 90% of all UK peer-to-peer platforms have the membership.⁷⁸ The mission of this body is to improve the quality of services and industry's standards as well as to increase the level of investors' protection. Among functions of the P2PFA are a search of the optimal secure public regulation providing the industry with opportunities to develop and compete with other industries, maintaining a high standard of members' business promoting trust among investors in the industry, increasing awareness related to advantages and risks of this form of lending. Furthermore, in order to improve the standards of the industry this association established high-level principles regarding transparency of platforms' operations, their governance and the mitigation of risks (such as the segregation of clients' accounts disclosure

⁷⁴ (Nemoto, Storey, and Huang, 2019)

⁷⁵ (Lu, 2018)

⁷⁶ (Peer-to-Peer Finance Association, 2019)

⁷⁷ (Switzerland, 2018)

⁷⁸ (Peer-to-Peer Finance Association, 2019)

information about the volume of loans and clients' complaints quarterly etc.). However, after the implementation of official regulation by the Financial Conduct Authority (the FCA) in 2014, these guidelines got secondary importance.⁷⁹

Secondly, the FCA became the main regulatory body controlling the activities of the UK peer-to-peer platforms. In the beginning, the FCA put the crowdlending industry into the borders of the existing regulatory framework (article 36H of the Regulatory Activities Order)⁸⁰; as a result, platforms have been obliged to get a particular license. Then, the FCA included in «The FCA's regulatory approach to crowdfunding (and similar activities)» the number of rules aiming to defend the rights of investors.⁸¹ The first regulatory framework regarding crowdlending was established in March 2014 («The FCA's regulatory approach to crowdfunding over the internet, and the promotion of non-readily realizable securities by other media») and included comprehensive regulation of crowdlending activities.⁸²

- 1) The status: Loan-based platforms (peer-to-peer/peer-to-business) in the UK in comparison with China have the same status as an informational intermediary originating loans and facilitating them between investors and borrowers.
- 2) The regulation: The regulatory approach in comparison with China is more adaptive and featured by sandbox opportunities as well as self-regulation of industry aiming to maintain its reputation. For instance, the FCA actively collaborates with peer-to-peer lending companies providing references about the implication of regulation, while the FCA in its turn offers regulatory sandboxes to some platforms aimed to assess elaborated fresh models of regulation on the market.⁸³
- 3) The requirements to parties: the FCA do not set a particular requirement for participants of the crowdlending process giving this responsibility to platforms which can demand the scope of information which should be provided by borrowers and investors.
- 4) The requirements to platforms: In contrast with China, an authorization system and requirements for platforms' operation are significantly stricter. Such demands for authorization as submitting detailed business plan including comprehensive information about future operation and risks, obtaining knowledgeable and experienced management board, having sufficient financial resources, operational website and detailed resolution plans in case of a platform failure together with a long waiting process lead to a modest number of platforms after 2014.⁸⁴ During the process of operation, platforms are obliged to regularly submit reports to the FCA and include financial information about services, lending contacts, default rate, compliance, potential risks and others.⁸⁵ These reports help the FCA to assess not only the activities of a particular company but the environment of the whole industry, monitor the existing regulation and improve it for providing efficiency to the industry.

Also, the FCA established capital requirements to prevent excessive risks taken by platforms and to overcome future financial obstacles.⁸⁶ Furthermore, the FCA created administrative procedures

⁷⁹ (Lu, 2018)

⁸⁰ (Legislation.gov.uk, 2013)

⁸¹ (FCA, 2013)

⁸² (FCA, 2019)

⁸³ (Nemoto, Storey and Huang, 2019)

⁸⁴ (You, 2018)

⁸⁵ (You, 2018)

⁸⁶ (Lu, 2018)

regarding the platform's insolvency in order to protect investors and the economy from possible repercussions.⁸⁷

5) Disclosure and external control: The UK government, like many other countries, adopted mandatory disclosure requiring platforms to provide potential investors with truthful and sufficient information illustrating the advantages and risks of crowdlending. Among such information are platform's data, platform's services, financial rules, the results of lending activities, guarantees, safety protection mechanisms and others. There is no requirement related to external control.

6) The mitigation of the risks: the UK legal framework includes «client money rule» established in FCA's Client Assets Sourcebook (CASS)⁸⁸ providing sufficient protection of investments which consists of the segregation of clients' accounts, the creation of statutory trusts keeping clients' money, the distribution of information about a platform's default to receive client money timely.

The next rule related to a cancellation right of investors. Since peer-to-peer contracts fall within distant agreements, investors, according to the EU Distance Marketing Directive, have a right to get their money back without any penalties and reasons within the first 14 calendar days. It is possible to avoid this rule: a platform has a secondary market, or potential lenders should not have an opportunity to invest in a loan within the first 14 days after their registration with a platform.⁸⁹

One of the differences between Chinese and UK approaches covered in the issue of provision funds. While provision funds are prohibited in China since their possible effect on platforms' stability, provision funds are widely occurring in the UK. The risks are determined by the lenders' behaviour, which becomes riskier in case of guarantees, which can lead to default rates higher than can be paid by provision funds. At the same time, peer-to-peer platforms get more incentives to maintain and improve the standards of underwriting.

Finally, the FCA, in contrast with the Chinese CBRC, arranged dispute resolution approach according to which each platform should elaborate complaint procedure for clients who are not satisfied by the financial services provided by a platform. Passing through internal investigation, clients have an opportunity to go further to the Financial Ombudsman Service. Moreover, the UK body established regulation in case of conflicts of interest covering some requirement to the internal documents (including information about potential conflicts and measures to overcome them) of a platform which should be then reported.⁹⁰

To sum it up, that dialog-based approach together with the concentration of regulation in one hand of the FCA aiming to improve regulation in the interests of parties, the existence of trustworthy self-regulatory body ensuring that its members maintain the high-quality services, security mechanisms protecting investors' rights make crowdlending industry in the UK attractive for investors.

2.4. The conclusion of chapter II

In the process of analysis of the crowdlending nature, features related to FinTech, crowdfunding and lending sectors were identified. The features express this nature are a high number of small investors having the commercial purpose, the low profile of banks, risky nature, the attractiveness for SMEs and individuals, the existence of crowdlending platforms matching borrowers and lenders directly and choosing different business models for their operation. Although this financial method

⁸⁷ (Lu, 2018)

⁸⁸ (Icas.com, 2015)

⁸⁹ (Lu, 2018)

⁹⁰ (You, 2018)

has many advantages such as the lack of entry and geographical barriers in comparison with the banking sector, time-efficiency, the adoption of artificial intelligence and big data increasing chances of SMEs and individuals to get a loan, there are some disadvantages impeding crowdlending from the occupying the position of the leader on the lending market and demanding extensive regulation of the industry. For example, the poor financial performance of a borrower, enforcement and due diligence issue, the possible default of a platform. The significance of such drawbacks in Russian crowdlending industry will be considered in the third chapter.

The legal frameworks of two leaders of the crowdlending industry (China and the UK) were established to make the industry attractive for participants and were implemented successfully. The policies can be taken by other countries, for example, by Russia, as positive examples of governing which will be analyzed in the fourth chapter.

Chapter III The obstacles restricting the development of crowdlending in Russia

3.1. The internal environment

3.1.1. The analysis of crowdlending applications in Russia

Russian crowdlending was born in 2011 after the world economic crises of 2008 with the creation of the first peer-to-peer crowdlending platform Vdolg.⁹¹ Next year the first crowdlending platform called Town Money and focusing on business was established. It is vital to notice that since the regulation of the crowdlending industry in Russia is in its infancy, there is no registry of industry participants.⁹² The result of the search on the Internet shows that nowadays there are nine existing platforms and one is going to be launched in the nearest future.

Although factors for the development of crowdlending industry exist, for example, rapid growth of microfinancing and microcredit companies offering unreasonably high-interest loans, increasing number of overdue loans, deterioration of credit history, the necessity of refinancing of debt, decreasing bank activities in the issue of granted loans, tightening requirements to consumer loan borrowers, difficulties related to getting loans by SMEs, poor income of traditional banking deposits, the rapid development of the Internet, the growth of Russian crowdlending industry is comparably low.⁹³ Thus, this chapter is devoted to the investigation of problems related to the crowdlending sector in Russia. Firstly, it is highly essential to study the actual applications of crowdlending via analyzing operations of existing crowdlending platforms. There are several criteria which are taken into consideration:

- The name of the platform, the year of its creation, collected the amount of money via the platform, its website.
- The type of the platform: peer-to-peer or peer-to-business platform and its focus (if it exists).
- The business model of the platform, its features, the size of charter capital.
- The method of matching borrowers and investors, the role of the platform in this process.
- Guarantees and safety mechanisms aimed to protect the interests of investors.
- The number of transaction cost collected by the platform and possible return in the result of an investment.
- The minimum and maximum threshold for investors and borrowers willing to participate on the crowdlending platform.
- The term of the possible loan.
- The requirements for the scope of information sent by borrowers and assessed by the platform.
- The scope of disclosure by the company posted on the Internet.
- The role of the third parties in collaboration with the platform.

The results of this research are established below:

⁹¹ (Василенко, 2015)

⁹² (Безверхий, 2019)

⁹³ (Грахов, 2016)

The name of the platform, the year of creation, collected amount of money, website	P2P/ P2B platform	The business model of the platform, features, the size of charter capital	Auction or offline method	Diffused or direct model of matching parties	Any guarantee to investors, safety mechanisms	Transaction costs and returns	The minimum and maximum threshold for investors and borrowers	The term of loans	The scope of information sent by borrowers and assessed by the platform	The platform's disclosure	The role of the third parties
Penenza, a joint stock company 2015 26 billion rubles https://penenza.ru	P2B focuses on specific purpose loans	Informational intermediary, the status of an agency which facilitates and originate loans. Money is sent to the bank account of a platform. 1,5 million rubles	Offline method	Both models are possible	The possibility to sign a surety contract but not an obligation, cession of rights is possible in case of government tender.	Transaction cost – 0,1% of a loan. The maximum percent rate in the lowest categories of loans – 17%, Minimum (in highest) – 1,66%, Investors can decrease this but not lower than 1%	5 000 rubles-minimum, maximum is not restricted.	2 months max	Personal data of CEO, owners, corporate info about the company, financial info and favourable loan information (the standard package).	Corporate documents, financial documents, Auditor's reports, platform's policy, patterns of agreements.	They used the services of the external auditor in 2016, 2017. The participation of a partner bank as an operator of bank accounts.
Modul Money LLC 2017 895,4 million rubles	P2B focuses on companies winning government tenders	Information intermediary, facilitate and originate loans. Money is sent to the bank account of the platform. 5 million rubles	Auction method	Direct model	The platform has a right to reject the application after assessing internal documents. The penalty for the late payment to the platform's company (3%).	Transaction cost- 2% of a loan. 25%-35% - annual percent (lower than 30% can be possible only with positive	1ruble minimum, no maximum. For SMEs minimum loan is 300 000 rubles.	6 months max	The standard package as well as: criminal records, debts, lawsuits, Info about a state contract, credit history, execution of previous agreements.	Platform's rules, tariffs, no corporate or financial documents.	The participation of a partner bank as an operator of bank accounts.

https://moldul dengi.ru/						credit story on this platform)					
<p>Potok LLC 2015 5 billion rubles</p> <p>https://business.potok.digital/</p>	P2B	<p>Informational intermediary. According to official registration it also provides financial services. No information about the account where the money is kept. 104 million</p>	Both methods	Diffused model	<p>The platform uses bank scoring mechanisms since it is a subsidiary of a bank. The platform has a right to reject the application after assessing internal documents. The platform elaborated 4 stage process in case of borrower's default, including lawsuits on behalf of investors. A company should operate for at least 10 months.</p>	<p>Transaction cost- 4% of a loan. Credit rate 1,86% - month, return is 22,3%-annual percent.</p>	<p>10000 rubles – minimum. For SMEs the minimum loan is 100 000 rubles, the maximum is 5 million rubles.</p>	6 months max	Standard package plus credit history, law suites, data from the bank's statistics	Some information about borrowers' defaults, platforms' policy, forms of contracts.	Investments are sent to a bank account of a platform belonging to a bank subsidiary (it is a group of companies). They work together with a collection agency in case of borrower's default.
<p>Start Track LLC 2013 2,5 billion rubles</p> <p>https://starttrack.ru</p>	P2B Focus on investment form of crowdfunding including equity type	<p>Informational intermediary No information about the account where the money is kept. Official registration includes granting loans.</p>	Offline method	Direct model	<p>There are some restrictions for companies: exemption of segments- production and sale of alcohol and tobacco, construction, microfinancing; monthly recurring revenue at list 7 million rubles.</p>	<p>Transaction cost- 2% of a loan. 20-25%-annual percent.</p>	<p>100000 rubles – minimum. For SMEs minimum loan is 10 million rubles</p>	18 months - max	The lack of information for investors.	Platform's policy.	The participation of a partner bank as an operator of bank accounts.
<p>Town Money LLC 2012 3,2 billion rubles</p>	P2B	<p>Informational intermediary Money is kept on the separate nominal account.</p>	Auction method	Direct method	<p>The platform can sue the borrower on behalf of investors in case of borrower's default. To conduct a business assessment of a borrower,</p>	<p>Transaction cost for investors- 2% of a loan. Transaction cost for</p>	<p>50000 rubles – minimum.</p>	1 month-3 years	When registering at the site, companies provide the key information about themselves, their business and the	Templates of contracts.	The participation of a partner bank as an operator of bank accounts.

https://townmoney.ru/aboutus/		Official registration includes granting loans. 4 million rubles			experts from the platform personally go to the place of business and conduct financial analysis according to the methodology of the European Bank for Reconstruction and Development. Collaterals are encouraged. As collateral, liquid assets can be provided in the form of machinery and equipment, real estate, vehicles, as well as third-party guarantees. Otherwise, percent can be higher.	borrowers- max 6% (it depends on a term of a loan and the number of projects). Return is from 20%- annual percent (there are some projects with 36% - annual percent).			purpose of attracting investment. To conduct a financial analysis, companies need to provide financial statements, business information, information on collateral and a guarantee.		
<p>Sberbank Crowdfunding does not work yet. 2019</p> <p>https://simex.global.ru</p>	P2B	Not clear yet. Investments should be sent to a bank account of a platform belonging to a bank subsidiary (it should be a group of companies).									
<p>Zaimigo LLC 2013</p> <p>https://invest.zaymigo.ru</p>	P2P	Financial intermediary (microfinance company). The contracts are signed between	Auction method	Direct method	Hard copies of documents are signed personally. The platform can sue the borrower on behalf of	1.5% per day for a loan with a one-time repayment and 1% for a loan with	20 000 rubles minimum, 70 000 rubles max for borrowers.	5 months max in case of individ	Passport, credit history, social network.	Registration certificates, corporate, financial documents.	They used the services of the external auditor in 2018.

o.com/inv est_fix		the platform and borrowers. 50 000 rubles.			investors in case of borrower's default.	repayment once every 2 weeks.	1,5-5 million rubles from investors in case of investment in the platform.	ual borrow ers and 24 months in case of the investm ent in the platfor m's compan y.			
Loanberry LLC 2012 https://www.loanberry.ru	P2P	Financial intermediary (microfinance company). The contracts are signed between the platform and borrowers. 15 million rubles.	Auction method	Direct method	Borrower's age from 21 to 65. Bad credit history borrowers do not get loans at the platform. To ensure that lenders are able to return invested funds, the platform suggests taking the “Garant” option, which allows returning all investments in a transaction without a loss (100% guarantee of return on invested money).	Transaction cost is 1%-7% depending on the credit rate of a borrower. Return is from 12%- 40% annual percent.	20 000- 500 000 rubles max	3 months - 3 years maxim um	Certificates of income, scan or photo of passport and bank details.	Templates of contracts.	The participation of a partner bank as an operator of bank accounts.
Vdolg LLC 2011	P2P	Financial intermediary (microfinance company) 15 million rubles.	Auction method	Both methods	No information.	Transaction cost is from 1%-8,6% depending on a credit rate of the borrower.	500000 rubles max for one borrower. Lenders can invest from	18 months max	Certificates of income, scan or photo of passport and bank details.	Templates of contracts, Registration certificates.	The participation of a partner bank as an operator of bank accounts.

https://vdolg.ru/about/o-nas/		The contracts are signed between the platform and borrowers.				Return is from 15%-30% annual percent	4000- 10 million rubles.				
BezBanka LLC 2011 388 million rubles https://bezbanka.com/page/givelan/	P2P	Informational intermediary No information about the account where the money is kept. Official registration of the company includes granting loans. 3 million rubles	Auction method	Direct method	The platform provides an opportunity for a borrower to ensure their risks of disability for the duration of the transaction. There is a possibility to sign a surety contract but not an obligation.	Transaction cost is 2%. Return is from 15% of the loan amount; the end number is not restricted (for example, there are some projects with 100% and more return on loan amount.	3000 – 1,5 million rubles max for borrowers.	36 months max	Certificates of income, scan or photo of passport and bank details.	Templates of contracts.	No information.

It is possible to make some conclusions according to the information collected from the websites of all existing crowdlending platforms in Russia.

- 1) The Russian crowdlending market is represented by only nine platforms. Moreover, for the last two years, there have not established new platforms. Although the biggest Russian bank (Sberbank)⁹⁴ promises to open its crowdlending peer-to-business platform; it has not operated yet. Russian peer-to-peer platforms do not disclose information about the results of their operation and issued loans, while among peer-to-business platforms the highest granted amount belongs to Penenza (26 billion rubles), though it is a quite young platform. At the same time, it is inexecutable to check the trustworthiness of this information because platforms are not obliged to file reports to controlling state organizations; thus, it can be no more than an advertisement. Consequently, it is complicated to make an objective conclusion about the operation of crowdlending platforms in Russia.
- 2) The absolute majority of platforms are limited liability companies; consequently, their owners cannot be secondarily liable for the company's liability while only one company has the status of joint stock company; as a result, its owners can be held vicariously liable in case if the company's assets are not enough to satisfy a claims of creditors. At the same time, companies tend to include in their policy published on their official website provisions excluding any responsibility to parties of crowdlending process. Consequently, investors have restricted opportunities to demand something from a platform; at least existing court practice does not know such examples.
- 3) All peer-to-business platforms in the Russian market represent themselves as informational intermediaries. However, according to their websites, it is not clear whether they have separate client bank accounts or not. Only one company (Town Money) sets up a contract on a separate nominal bank account with their clients. Consequently, this situation can be potentially problematic in the case of platforms' defaults. One of the platforms (StartTrack) also operates in the sphere of equity-based crowdfunding. Moreover, according to the official registration of other platforms in Unified state register of legal entities, the majority can provide financial services, including loans. It is impossible to check whether these platforms operate as active financial players or not; however, the mixed status and activities can lead to possible frauds and defaults.⁹⁵
- 4) The three peer-to-peer platforms have the official status of pure financial intermediary; as a result, they are able to issue loans and take on the role of lenders in signed contracts. This status without appropriate control can have a significant impact on the stability of a platform and even encourage fraud. Furthermore, one of these microfinance platforms (Zaimigo) has seriously low charter capital, which can negatively affect its investors in case of company's default.
- 5) The majority of platforms have chosen auction and direct methods of matching parties which presume the more active role of investors. However, in the case of low financial literacy, the lack of information and the knowledge about the necessity of diversification, the absence of top line of investment can lead to severe risks among inexperienced investors. Only a minority of platforms offer their services for diversification or the right to choose among two methods. Moreover, Town Money permits borrowers to refuse from the offer if a potential investor wants to finance just part of a loan. Thus, the platform decreases the opportunity to diversify an investment portfolio.
- 6) Only one platform (Loanberry) offers guaranteed option for investors expressed in the full return of money which is included as a provision in a loan agreement; however, in this case, percent

⁹⁴ (РБК, 2019)

⁹⁵ (Чуланова, 2017)

return will be significantly lower. In case of borrower's default, several platforms offer insurance services in conditions of disability, services of their partner collector agency and suing the borrower on behalf of investors although the statistic shows that the possibility to receive the full loan back is very low. Furthermore, there is no secondary market where it will be possible to resell default loans. Surety contracts and collaterals are encouraged, but they are not obligations; as a result, they are unlikely to be widely used. Some platforms set restrictions regarding borrowers, for example, the age in case of individuals or the period of existence and the amount of asset in case of SMEs; as a result, platforms reserves a right to refuse some borrowers in participation. At the same time, high requirements can change nature from a safety mechanism to a barrier in raising capital. For example, StartTrack restricts some segments and demands monthly recurring revenue at list 7 million rubles, which are highly challenging to reach for startups; consequently, for them, this platform can be inaccessible. Also, platforms try to persuade their investors that scoring procedures are trustworthy, especially platforms being the part of banking group companies (there are three such platforms on the market) using banking mechanisms and information for scoring. Two platforms work with specific-purpose loans related to state tenders, which are considered as having lower risks. In general, it is possible to conclude that existing safety mechanisms are very superficial and are not adequate for the defence of investors' rights in the existing environment.⁹⁶

7) The average transaction cost is 2%. However, this number can be increased significantly if platforms set its dependence on the term of the loan and the category. For example, Town Money establishes the highest possible transaction cost at 6%; however, this platform has a role of just informational intermediary; it does not offer any guarantee. Thus, this number does not seem sensible.

8) The return rate is considerably higher than the deposit rate offered by banks. However, in some case this rate can be dramatically high - more than 100% (for example, in the case of BezBanka) which can lead to significant risks and default rate of borrowers.

9) Minimum threshold rate of almost all platforms (excluding Vdolg and StartTrack) is quite low, which stimulates the participation of a higher number of investors. At the same time, the majority of platforms do not restrict the top line of investment, which can lead to negative consequences in the case of inexperienced individuals putting «all eggs in one basket».

10) The scope of information sent by borrowers to a platform for assessment is usually restricted by corporate and financial documents in case of SMEs and passport, certificate of income in case of individuals. If borrowers want to get a lower rate, they have to send additional documents. Unfortunately, Russian platforms do not disclose information on the amounts and terms of the formation of overdue debts on borrowers, which seems highly essential for borrowers. Usually, platforms do not disclose even scope of documents sent by a potential borrower just category of a loan which has a status of advisory information; moreover, investors cannot review these documents due to the Federal Act on personal data protection. Thus, investors have a small clue about actual information and have to trust in scoring mechanisms and information provided by platforms.⁹⁷

11) The analysis of platforms' disclosure shows that the absolute majority of them are not willing to do this and usually put just templates of contracts and platform's policy. Some platforms disclose their corporate and financial documents; however, since they are not obliged to do this, it is more an exemption than a rule. Moreover, crowdlending platforms disclose little information regarding the risks associated with crowdlending. Consequently, investors and borrowers have to trust in platforms

⁹⁶ (Ахмадиева, 2017)

⁹⁷ (Суворов, 2016)

while they usually do not know almost anything about them as well as about risks associated with this investment.

12) Information about the relationships of platforms and third parties is almost missing. Only two companies disclosed information about their external financial audit; also, some platforms disclose information about their partner bank. There is no information about collaboration with lawyers, financial intermediaries, state organizations. Also, there is a lack of information about the rate of complaints, dispute resolution process and conflicts of interest issue.

To sum it up, the application of crowdlending in Russia presents «a grey area» including the lack of transparency in the work of crowdlending platforms and their risks, the absence of control and uniform state requirements as well as the lack of internal industry policy which encourage platforms to set their own rules which sometimes contradict interests of investors and borrowers but exist within modern legal framework. As a result of this policy, Russian investors are enforced to invest blindly, which does not encourage the development of this sector.

3.1.2. The analysis of the existing legal framework and the contracts used by Russian crowdlending platforms

Loan agreements bring together all crowdlending platforms regardless of their business type and focus. The only difference is that depending on the status of a peer-to-peer platform (informational or financial intermediary) an actual lender of an agreement can be changed from an ordinary individual investor to a company-owner of a platform (Zaimigo, Loanberry, Vdolg) while borrowers can be represented by SMEs or individuals. Loan relationships are regulated by section 1 part 2 of the Civil Code of the Russian Federation (hereinafter the Civil Code), which can be described as highly dispositive since parties can choose an object of the agreement freely, the number of interest-rate, the term of the agreement and other condition. There is only one obligation expressed in a written form of transaction which is provided by signing a contract with an electronic digital signature.

According to the table of Russian crowdlending platforms, microfinance companies having the role of financial intermediary get a special seat here which is not surprising since they are able to attract a wider audience, thereby Internet platforms. It is worth noting that over the last decade they have increased their popularity in Russia due to banks' reluctance issuing loans to individual consumers; however, the attitude of Russian society to these organizations is more negative than positive. It can be explained by unscrupulous behaviour of some of these companies at early stages of their development as well as aggressive policy toward borrowers and hidden conditions intentionally written in a small print; as a result, such companies were considered as moneylenders receiving profit from someone's grief.⁹⁸ The government tried to change this reputation by the regulation of this sector (The Federal Act on microfinance activities and microfinance organizations).⁹⁹ Nowadays, such entities willing to granting loans to individuals have to get an exclusive license for the operation as a financial intermediary and file reports to the Central Bank. However, the analysis of this sector shows that these measures are not enough, mainly if a microfinancing company is a crowdlending platform. For example, ill-reputed crowdlending platform Cashbery was a part of the group of companies which were registered as microfinance organizations and were used as an umbrella while Cashbery exploited Ponzi scheme for getting money out. This situation underlines the necessity of a unified regulated status of crowdlending platforms.¹⁰⁰

⁹⁸ (Липский and Ломакин, 2018)

⁹⁹(Consultant.ru, 2018)

¹⁰⁰ (Vklader.com, 2019)

While there is no centralized regulation, the majority of platforms choose the status of an informational intermediary. For organizing relationships with parties, companies use different types of contracts aimed to cover the scope of services provided by a platform, for example:

- 1) An Agency contract (provision 437 the Civil Code) and a License agreement (provision 1236 the Civil Code) - Penenza;
- 2) only a Service agreement (provision 779 the Civil Code) - Modul Money, Start Track, Town Money, BezBanka;
- 3) only a License agreement (Potok).

All these contracts have the same features; they are published on the official website of platforms as a public offer (provision 437 the Civil Code); as a result, parties using services of a platform automatically accept the conditions of their contracts even if they disagree with some provisions. Moreover, a platform has the right at any time to change an agreement without informing parties; it is the obligation of the latest to check the conditions of an agreement regularly. In case of any disagreements, parties should immediately stop using the platform's services and choose another one.

It is essential to notice that these agreements include provisions aimed to decrease the responsibility of a platform. For example, the agency agreement at Penenza is structured as transactions concluded by a platform on behalf of and at the expense of the principal; consequently, all duties and obligations arise for the principal and not for a platform. As a result, in case of any borrower's default, investors cannot demand anything from a platform which merely exists as an information intermediary. At the same time, platforms try to minimize their responsibility even for services provided by them. For example, according to the service agreement published by Start Track, they do not guarantee quality, accuracy, sufficiency and reliability of the information placed on the platform.¹⁰¹ Furthermore, in any case, the liability of the platform is restricted by 1000 rubles, which are equal to the absence of liability. Another example is the License agreement of Potok which includes a provision excluding responsibility of the company in case of non-fulfilment or improper fulfilment of obligations under this agreement which can be considered as illegal under the 16 provision of Law on consumer protection (Invalidity of the terms of the contract, infringing the rights of the consumer).

At the same time, platforms publish agreements aimed to defend the interests of investors according to a platform's policy. The first measure is a surety agreement which is encouraged by Penenza and BezBanka (provision 971 the Civil Code). This agreement gives an additional guarantee to investors that in case that a borrower cannot return a loan, a person in charge, for example, a family member of the individual borrower or the owner of SMEs will be jointly and severally liable. It is impossible to establish a particular number of loans involved such agreements, but since there are only two platforms offer the opportunity to sign it voluntarily, this number is not that big.

Town Money encourages to enter into a collateral agreement, which is another way to enforce obligation (provision 329 the Civil Code). This collateral can be expressed in the form of machinery and equipment, real estate, vehicles and other assets. Borrowers providing such agreement have an opportunity to pay a lower interest rate. At the same time, SMEs usually unable to provide such kind of guarantees due to their lack; as a result, it is difficult to predict the actual usage of collateral agreements on crowdlending platforms.

Some platforms offer cession of rights agreement (provision 432 the Civil Code) which can be used in case of borrower's default when a platform tries to return a loan and percent on behalf of investors.

¹⁰¹ (Краудинвестиционная площадка StartTrack, 2019)

It is essential to notice that there is no secondary markets and platforms or other parties do not buy default loan; at the same time, a platform can help to return investment partly and receive their own percent from this service. Thus, the probability of recovering the full amount of loan in case of borrower's return is low.¹⁰²

To make a conclusion, it is difficult to call the internal environment of crowdlending application in Russia advantageous for investors, which can have an impact on the development of the whole industry. The main problem is not related to the breach of Contract or Consumer Law since the majority of platforms operate in line with legislation (the only exemption is the tendency to decrease the responsibility for their own services). The major issue is the lack of determination of the status of crowdlending platforms. It leads to their freedom in the issues of disclosure information which can be absent, the usage of assessment mechanisms of borrowers' creditworthiness which can be not adequate, safety mechanism and defending measures which can actually not work, the scope of their operation which can be not balanced with taken minimized responsibility according to automatically accepted public agreements. As a result, unregulated industry without any control can encourage the growth of frauds and defaults not only from the platform side but also from borrowers performing financially poorly which particularly worsen in the problem of enforcement claims. Consequently, in current environment motivated by high return investors have only the option to trust in unknown borrowers and in a platform giving the minimum information about them which sometimes lead to putting money in a «black hole». In the interests of investors, this uncertainty should be regulated.

3.2. The external environment

3.2.1. The reasons for the slow growth of crowdlending in Russia

Obviously, legal uncertainty as an internal factor can hinder the development of Russian crowdlending. At the same time, there should exist external factors constraining society from the engagement in this industry. The Russian Institute of Public Opinion conducted research (March 2019) analyzing the attitude of Russian society to crowdlending.¹⁰³ In the process of the investigation, several questions were asked to about 1700 respondents reflecting the social-demographic parameters of the population of the Russian Federation (different age, social status, education, revenue, etc.). Among such questions were: Do you know about crowdlending? Have you ever participated in crowdlending? Do you trust in this fundraising mechanism? Do you trust in crowdlending platforms? Why do you not participate in crowdlending?

According to the received data, several conclusions can be done:

1. The majority of respondents (51%) do not know anything about this method; only 9% of respondents understand how it operates, while 40% of participants heard something about crowdlending. Thus, results can demonstrate a significant lack of knowledge about financial mechanisms and institutions.
2. The absolute majority of respondents have never participated in crowdlending (91%), for 7% of participants crowdlending was a one-time experience, and just 2% participate on regular bases. Consequently, the level of financial activity, at least in the crowdlending sector, can be assessed as dramatically low.

¹⁰² (Попова and Безвесельная, 2017)

¹⁰³ (Iom.anketolog.ru, 2019)

3. Moreover, more than 50% of respondents do not trust in this financial method, while only the third part of respondents trust in crowdlending platforms.

4. Among the main reasons to opt out of crowdlending are called the lack of trust, the lack of knowledge of this method and unsustainable financial status which does not afford to participate in a risky investment.

Obviously, these conclusions express the opinion of a small group of people; however, taking into account social demographic parameters of this group, it is possible to say that these tendencies in a varying degree mirror the opinion of Russian society. Indeed, the level of investment activity of Russians is low, and they prefer to keep their money on deposit accounts (despite their unprofitableness under the conditions of inflation) instead of investing them in any project.¹⁰⁴ This trend can be firstly explained by the lack of trust.

3.2.2. The obstacles to crowdlending

a) The lack of trust in crowdlending platforms

The lack of trust in crowdlending platforms can be closely related to the dramatic number of frauds in the Russian investment sphere, which has happened over the last two decades. These cases started after the collapse of USSR and was encouraged by society's idealization of private market institutions in contrast with socialist economy, the lack of any experience in investments, the lack of confidence in the state bank due to the depreciation of capital investment and high inflationary pressure, excessive credibility of society and increased attractiveness of risks. This environment established an illusion of investment potential and respectability of new risky financial institutions using aggressive marketing policy, window-dressing fulfilment of obligations related to the return of investment and the payment of percent at the beginning of their operation, scientifically based investment legend that in practice was nothing more than a fairytale. Moreover, the government did not try to destroy this illusion; there were no measures preventing abuse and defending interests of inexperienced investors. As a result, these investors were taken hostage by their gullibility. For example, the largest financial pyramid in the history of Russia «MMM» attracted funding from the society by selling 27 million shares and more than 70 million tickets of the company under promises of high return. The collapse of this financial pyramid leads to the loss amounted to 100 billion rubles by 100 million of deceived investors, many of whom lost all savings and property.¹⁰⁵ Furthermore, last researches show that due to the low financial awareness Russian society cannot distinguish a financial pyramid from other companies which encourages the establishment of new schemes, for instance, for the last three years more than 700 Ponzi schemes have been discovered. This tendency could not sidestep crowdlending industry, which becomes attractive for shady people due to the legal uncertainty assisting in exploiting the law. For example, the operation of such fraudulent platforms as Friends Money, Cashberry, Fast Big Money, Get Money Pro, SocRostCredit, FxEngine together with fraudulent activities of some microfinance organizations and the information that some platforms unduly increased the creditworthiness of some companies have dented the reputation of the industry. As a result, people lacking financial awareness and observing the high number of frauds have become much more suspicious about the new financial method as a whole and the operation of crowdlending platforms particularly.¹⁰⁶

¹⁰⁴ (Дискин, 2019)

¹⁰⁵ (ТАСС, 2019)

¹⁰⁶ (Горловская and Гимадиева, 2011)

b) The lack of trust in borrowers' performance

Distrust in borrower's performance is reasonable since crowdlending industry represents risky investment, and there is no accurate guarantee that money will be received back. Particularly in the existing Russian legal environment, which does not include liquidity reserves or obligatory safety and defending mechanisms, exempting court enforcement that in practice can be not efficient since the costs of bringing a claim to a court far outweigh an interest rate of investors. Indeed, in case of peer-to-peer lending for the last quarter of 2018, the number of loans decreased in 3 times according to the information of Central Bank which was explained by the lack of trust due to the unprecedented number of defaults on previously issued loans. The risk of default in the peer-to-peer segment is nowadays close to 50% since the majority of borrowers engaging on crowdlending platform choose this industry as the last chance to get a loan while the assessment mechanisms of borrowers' creditworthiness used by platforms are not perfect and transparent. In contrast with the peer-to-peer segment, the peer-to-business segment has the average rate of defaults in the market – 8-10%; at the same time, in case of default, the chance to get something from a startup is not high.¹⁰⁷

c) The lack of trust in the state institutional system

The next problem is related to the lack of trust in the whole state institutional system, which hurts the growth of investments as well as the development of the Russian economy.¹⁰⁸ Obviously, lenders invest in loans in order to receive future profit, but at the time of investment, they have only expectations regarding this investment which demand the high level of trust in the system of institutions participating in the crowdlending process. As was mentioned above, banks do not play an active role; however, they have the profile of depository of funding. Over the last decade, the Central Bank has seriously questioned the reliability of some banks. In the process of such an investigation, there have been established major breaches of the law such as money laundering and queer transactions. As a result, several hundreds of banks have been losing their licenses, while individuals and companies have lost their savings. It is important to notice that economic crises occurred in Russia (the beginning of 90-s, 1998, 2008-2009, 2014-2015, etc.) were also related to the mistakes in policy, in the quality of legislation; thus, to «human factor» affecting the trust of the society. Furthermore, although the number of startups is increasing, there are various institutional problems hindering their development such as frequent, unpleasant change of legislation which results in the difficulties to plan the operation of a business. Indeed, for each business, the issue of keeping the rules of the game at least until they can get the investment back is highly significant. Moreover, the number of projects with quick self-repayment is quite limited; usually, the payback period can take more than 7 years. Thus, the decision to invest and to develop a new business idea is complicated not only for the founders of business but also for investors in conditions of the fast-changing environment. Among other problems is bureaucracy and corruption; there are about 97 state institutions performing around 236 functions and monitoring compliance of the business with 2 million requirements; as a result, legitimate companies tend to go underground. While regional and department lobbyism of «favourable» companies leads to the mistrust of startups in a real opportunity of implementation of projects in Russia, and their ultimate escape to other countries.¹⁰⁹

d) The lack of financial literacy

¹⁰⁷ (finanz.ru, 2018)

¹⁰⁸ (Белицкий, 2010)

¹⁰⁹ (Дискин, 2019)

Financial literacy is a vital skill nowadays since everyone uses financial services to one degree or another.¹¹⁰ Although, the Russian market economy has existed for 27 years, the majority of Russians have a lack of knowledge in the financial sphere. For example, according to Global Financial Literacy Survey (2015) more than half of the country's citizens (62%) do not understand financial issues which are quite a big number in comparison with the USA or other European countries. Other surveys conducted by the Organization for Economic Cooperation and Development (2016, 2017), the National financial research Agency (2017), the Analytical Center of the National Agency for Financial research (2018) also claim that in general Russian citizens assess their financial knowledge as insufficient. There are several reasons which can have an impact on a level of literacy. Firstly, the generation growing up in the Soviet Union were familiar with bank accounts and deposits; however, there was just one state bank, one insurance company and very limited scope of services; thus, the problem of choice did not exist. Secondly, society was used to fully rely on the government in financial issues such as the payment of education, medical services, housing and others; as a result, after the collapse of the USSR people did not have the foggiest idea about the operation of financial system in the market economy which lead to the high number of frauds and abuses resulting in the lack of trust in financial institutions, the loss of interest to them and their evasion. Moreover, in the modern country, people continue to wait for assistance from the state in ensuring their well-being, which is explained by some researches as the feature of Russian mentality.¹¹¹ Thirdly, the conducted investigation of platforms shows that the position to disclose the minimum information about their operation and the risks related to crowdlending does not increase the financial literacy of the society.

e) **Unsustainable financial status**

As was mentioned in the survey, some respondents claim that they do not have surplus funds for participating in crowdlending. The Federal State Statistics Service reports (2018) that the average income of a citizen is about 43 400 rubles (690 \$); however, some researches claim that official data can be overstated significantly.¹¹² According to a survey conducted by the Russian research company Romir, about 43% of Russians said that they can afford only necessary things as food and clothing, the third of respondents can buy some household appliance but cannot afford a car. Every tenth person said that having money only for food.¹¹³ Also, due to the increasing price for goods and services, the society has to pay more for them; as a result, there is nothing to save or invest. Consequently, low income can be a reason for the low financial activity of society.

3.3. The conclusion of chapter III

The operation of crowdlending platforms shows the existence of problems related to the lack of regulation; for example, platforms disclose minimum information about themselves, borrowers, and the risks of crowdlending; the lack of status affords to participate not only as an informational intermediary but also as a financial player which are not controlled. They can also have just one bank account for all operations, including transactions between borrowers and lenders; thus, the default of platforms can lead to the loss of investments. The Civil law and the Consumer law do not cover such issues; consequently, crowdlending requires appropriate legislation, which will not only regulate the sphere and defend the interests of investors but also stimulate the development of the industry.

Several factors hindering the growth of crowdlending are related not only to legal but also to the economic sphere, including low financial awareness and financial state, the distrust of society, and

¹¹⁰ (Белехова, 2014)

¹¹¹ (Ковальчук and Сайбель, 2018)

¹¹² (Gks.ru, 2018)

¹¹³ (Скопинцева, 2019)

their avoidance of this financial method. Although the complete liquidation of the distrust, poverty, and the establishment of total financial literacy is unlikely, the creation of a favourable environment for crowdlending stimulating the development of the industry is particularly significant at this stage. The necessary conditions from the legal point of view will be considered in the next chapter.

Chapter IV The solutions to the obstacles restricting the growth of crowdlending

4.1. The legal solutions

4.1.1. The legal framework for Russian crowdlending: the analysis of the Federal project on crowdfunding

One of the main policy directions in the contemporary Russian economy is the development of SMEs. According to the instructions of the president V.V. Putin to the Government and the whole executive branch (2018) the amount of procurement from SMEs should grow in more than 1,5 times by 2024; the proportion of SMEs in GDP should increase by 40% in 2025; and subsidies to SMEs should be elaborated for the achievement of these goals.¹¹⁴ From the legislative point of view, there are several Federal acts aiming to maintain and provide the growth of SMEs.¹¹⁵

The project of the Federal Act «On alternative ways of attracting investments (crowdfunding)» was submitted for consideration to the State Duma on 20 March 2018. In accordance with the clarification of this project, it is aimed to suggest solutions related to the development of an alternative source of financing for small and medium-sized businesses. It has become the first government attempt to specifically regulate relationships related to fundraising through investment platform by entities and self-employed entrepreneurs as well as to define the legal foundations for companies-operators of the platform. In this project, crowdfunding was described as retail financing focusing on investment type of crowdfunding – crowdlending and crowdinvesting intentionally excluding donated-based, pre-selling and reward-based crowdfunding from regulation. In the process of consideration, the previous name of the legislative act has been replaced with «On attracting investment using investment platforms». It was caused by the elimination of term crowdfunding, although the text of the first version was saved with minimum changes.¹¹⁶ Provisions of this legislative act have given rise to heated discussions not only among members of parliament but also among investors, platforms and borrowers; at the same time, the project was adopted on the first reading (dated 22.05.2018) and now is waiting for approval in the second reading.

It is possible to make some conclusions about the potential legal framework for crowdlending based on the analysis of this Federal Act:

- Platforms will operate as an information system on the Internet affording to attract investments via technologies and will not combine this status with functions of a bank or other financial institutions. Consequently, platforms will not be responsible for the obligations of borrowers. Furthermore, crowdlending platforms will be obliged to have a separate bank account for keeping clients' investments, since according to this Federal Act lenders' money cannot be stored on the bank account where a platform saves its own money. These provisions can be assessed as favourable for parties because they will prevent platforms from possible financial scams with clients' investments.
- One of the essential innovations is that the platforms will have to be the members of the operators' registry of investment platforms; thus, their operation will be controlled by the Russian Central Bank. In this regard, there are several requirements to platforms: the company should have at least 5 million rubles as the size of charter capital and should disclose information about its operation. The CEO of the company as well as the person/entity whose decisions can have an impact on charter

¹¹⁴(Life.ru, 2018)

¹¹⁵ (Безверхий, 2019)

¹¹⁶ (Липский and Ломакин, 2018)

capital should comply with some restrictions (for example, no convictions that have not been lifted or outstanding for crimes in the sphere of economic activity or crimes against state power). Furthermore, the Russian Central Bank will be considering applications of potential companies-operators of platforms for no more than one month and can refuse in registration only in circumstances of the failure to submit all documents, providing non-correct information, non-complying with requirements regarding CEO and influencing person/entity. This provision of control can also be assessed as necessary in «a grey area», while the process of registration for platforms operators can be determined as uncertain since there is the lack of information about documents which should be sent for consideration.

- A company as an operator of the investment platform takes liability for: disclosing inaccurate, incomplete and/or misleading information about the platform and itself; non-keeping of register of contracts signed by crowdlending participants; violations of the platform rules which should include the order of identification of participants, the requirements to investment projects and borrowers, standard forms of agreements, the types of investment, the order of money transfer, transaction costs, the order of exchange of information between parties. Thus, platforms cannot minimize their responsibility more than it is set in this project; at the same time, the platforms are free in the decisions related to their operation.
- According to the Federal Act on crowdfunding, there are two agreements: an investment attraction services agreement (between a platform and borrowers) and an investment assistance services agreement (between a platform and lenders) which will work as adhesion contracts; thus, parties will not be able to affect their provisions. Both agreements aim to give access to information resources on a platform; at the same time, there is no information regarding the nature of provisions which should be included in these contracts; thus, they will be determined by a platform.
- Russian legislator includes a comprehensive provision regarding disclosure of platforms. General information about the operation of the platform, annual report about the results of operation, corporate structure and influencing people/entities inside the structure, financial information including balance sheet report, information about platform's service commission, the mechanism of crowdlending should be published on platform's website. Moreover, a platform should disclose certain information about borrowers (entities) such as financial and corporate information, information about influencing people/entities inside the structure, types of business activity, investment project and data about material facts which can have an impact on compliance with the obligation. Since the majority of platforms tend to hide information about their operation and give the minimum data about potential borrowers, these provisions will help to provide transparency and traceability to the platforms' operation.
- The main disadvantage of this project is the elimination of peer-to-peer crowdlending sector, which contributes the highest value in the world and Russian crowdlending industries. According to the project, borrowers can be only entities and self-employed entrepreneurs; thus, in case that the project is approved in the current version, people will lose internet platforms as a source of lending and will be able to base only on microfinance organizations and banks with their high-interest rates and access barriers. This policy can be explained by the high level of peer-to-peer defaults in the sector; at the same time, this tendency can be related to the weak assessing mechanisms adopted by platforms and non-properly working enforcement mechanisms. Consequently, this measure will

significantly hinder Russian crowdlending from the development, taking into consideration that the percent of SMEs in Russian GDP (2019) amounts to just 22%.¹¹⁷

- There are some measures aiming to defend the interests of investors or prevent possible infringement of rights. Firstly, the Central Bank will be responsible body for determination of the maximum investment which can be made by non-qualified institutional investors as well as the amount of money which can be collected by SMEs during one year. Several offers related to a particular amount of restrictions were sent by financial regulatory bodies and stirred up heated controversies.¹¹⁸ Although these top-lines are aimed to protect the interests of investors, the establishment of too low possible investment can lead to the crisis of the industry since SMEs will not be able to receive sufficient amount for the development of business. Secondly, platforms should provide potential investors with information about risky nature of lending investment and the probability to lose the full amount of money which is particularly essential nowadays due to the objective lack of knowledge about crowdlending risks and platforms' reluctance to disclose this information. Thirdly, platforms should elaborate on their own policy regarding the conflicts of interests and publish this information. At the same time, the project does not cover issues related to the measures of conflict resolution as well as the scope of such policy.

To sum it up, there is an evident influence of foreign legislation on the Federal project on crowdfunding.¹¹⁹ The project introduces the essential innovations such as the control of the Central Bank under industry, the obligatory disclosure information about the platform's operation and borrower's data, the determination of the status of platforms, the elimination of financial players from this market and the establishment of the minimum amount of charter capital as well as platform's responsibility and separate bank account. At the same time, the majority of provisions seem crude, include short mentions of some mechanisms and the significant number of references to other Acts which show that sustained efforts should be made in the future. For example, there is no information about the dispute resolution process, safety mechanisms, the opportunity for an external audit, default rate disclosure. Moreover, the project covers two types of crowdfunding, which have investment features; however, the nature of these industries and risks are significantly different, which is left out of consideration by the legislator. Finally, the project focuses only on SME's business and leaves peer-to-peer lending beyond regulation, which will hurt the development of the whole industry.

4.1.2. The analysis of the Federal project on crowdfunding in comparison with Chinese and the UK frameworks

Although crowdlending in such countries as China and the UK started developing considerably at the same period as in Russia (after the world economic crisis), the results of such growth and the difference in comparison with the Russian pace are tremendous. The government of the UK and China recognized that comprehensive regulation is particularly significant for such a risky financial instrument. The established regulations have even boosted the growth of crowdlending and have created the environment defending the interests of parties and preventing possible frauds. These countries adopted policies mirrored the features of their economy and crowdlending sector in general. Although some disadvantages existing in these policies, their implementation was very successful. Their experience should be taken into consideration by the Russian legislator for the improvement of the Project on the crowdfunding with respect to local conditions.

¹¹⁷ (Secretmag.ru, 2019)

¹¹⁸ (ПРАВО.Ru, 2018)

¹¹⁹ (Дискин, 2019)

Regulatory feature	Russia	The UK	China
The status of platforms	Segregated account model Informational intermediary	Segregated account model Informational intermediary	Segregated account model Informational intermediary
The type of platforms permitted	Peer-to-business	Peer-to-peer; Peer-to-business	Peer-to-peer; Peer-to-business
The role of platforms	Is not determine yet since the role of banks is not clear but presumably the UK system	Facilitator of loans between lenders and borrowers	Facilitator of bank loans to borrowers
The originator of the loan	Is not clear	Platform	Bank
Regulation, External control	Centralized system The lack of external control	Centralized system The impact of self-regulated organization	The division of responsibility between central and local government. The control of third parties.
Regulatory sandbox opportunity	No	No	Yes
Registration requirements	Uncertain but presumably not strict due to the objective criteria for refusal	Strict	Affordable
The requirements for parties	Cap system; information requirements to borrowers.	No particular requirements	Different requirements regarding true identity, the source of financing, cap system etc.
The requirements to platforms	Mandatory registration, Charter	Tough authorization, filing system, charter capital requirements, administrative	Mandatory registration, filing system + compliance

	capital requirements, filing system	procedures regarding the platform's insolvency	with the list of prohibited activities
The explicit list of prohibited activities	No	No	Yes
Disclosure	Yes	Yes	Yes
«Client money rule»	Partly	Yes	Partly
Cancellation right of investors	No	Yes	No
Conflict of interest regulation	Mentioned	Yes	No
Provision funds	No information	Permitted	Prohibited
Rules governing illegal fund-raising activities	No	Yes	No
Dispute resolution regulation	No	Yes	No

According to the conducted analysis of three legal frameworks, several conclusions can be made:

- 1) All these countries have chosen segregated account model for the operation of crowdlending platforms registered on their territory which contradicts the model chosen by American legislator (notary model) where platforms take financial responsibility buying loans from banks and selling these loans to lenders. The choice of information intermediary model seems sensible particularly at an early stage of industry development since the status of financial intermediary demands stricter control under industry, tougher process of authorization as well more imperative legislation which in case of the immature industry can have an adverse impact expressing in leaving the market by crowdlending companies. Taking into consideration the small number of crowdlending platforms in Russia, slow development of the industry and the high number of fraud in Russian economic sphere, segregated account model together with the status of information intermediary are the most favourable.
- 2) The analyzed regulations existing in the UK and China cover both peer-to-peer and peer-to-business platforms. The decision to exclude the peer-to-peer sector from crowdlending regulation and the market can lead to repercussions in the whole sphere as well as can negatively affect individuals for whom crowdlending is a vital source of financing.
- 3) The role of the platform and the originator of the loan in the Russian project is not clearly determined, but presumably, banks will have the passive role of depository adopted from the UK legal framework. China has collaborated comprehensive regulation regarding the place of banks in

crowdfunding process and its functions which cover the origination of loans.¹²⁰ Economic researches on this issue do not identify the advantages and disadvantages of these mechanisms. Consequently, the main issue here is to explicitly determine the status of banks as well as the role of other financial institutions in the crowdfunding industry since it is not clear, for example, the possibility for companies-operators to have financial organizations as a subsidiary which is prohibited in China.

4) The regulatory approach in the UK can be described as partly centralized and the most adaptive since there is a significant impact of self-regulatory authority as well as a sandbox system which help legislators to work closely with the business and take into account its reality. In contrast, the Chinese approach seems more dispersed since the central authority delegates responsibility to the local government, which does not make sense due to the operation of platforms on the territory of the whole country.¹²¹ Finally, the Russian approach is the most centralized since there is just one body responsible for the whole sector – the Central Bank.

5) According to the preliminary draft, the process of platform' registration in Russia should not be very complex since the period of consideration is just one month and the reasons for refusal are restricted by the project which is in line with the Chinese legal framework.¹²² At the same time, there is no list of documents necessary for regulation so far, which makes it impossible to have a conclusion at this point. The UK approach is much more complicated in the sphere of authorization, which can finally hinder the growth of the sphere, which is particularly dangerous when the crowdfunding market is at the beginning of its development.

6) From the requirements to parties point of view, the Chinese framework is the strictest one demanding a lot from lenders and borrowers which aims to prevent frauds from their side as well as to defend the interests of borrowers.¹²³ The Russian legislator adopts a Cap system approach setting the top-line of investments made by non-professional investors and trying to protect their interests. It seems sensible since in several fraud schemes people lost fortune; however, the amount of top-line should reasonably satisfy the interests of all parties. Another Russian requirement is related to the mandatory disclosure of data provided by companies-borrowers which can be highly appreciated since it will help to provide the necessary transparency and will increase the level of trust not only in platform operation but also in borrowers' performance. In this case, the UK refused from any restrictions and requirements, giving this right to platforms which are quite selective and caring about an image.

7) In contrast with requirements to parties, the UK set strong requirements to platforms including charter capital requirements and the behaviour of companies in case of insolvency.¹²⁴ China establishes another approach related to «negative list» of prohibited activities. At the time of project approval in the first round of consideration, the Russian legislator adopted the filing system and the requirement to have certain charter capital. Thus, the Russian system seems softest in the issue of requirements to platforms which can be favourable at this stage upon the condition of appropriate control under their operation.

8) Mitigation of the risks is a highly essential part of the framework since it helps to prevent any fraud and abuse and defend the interests of investors which are in a vulnerable position. The most comprehensive framework regarding risks was collaborated by the UK, for example, the legislator

¹²⁰ (Lei, 2016)

¹²¹ (You, 2018)

¹²² (Huang, 2017)

¹²³ (Nemoto, Storey, and Huang, 2019)

¹²⁴ (Lu, 2018)

permits provision funds which are very helpful in case of borrower's default and force platforms to be more selective in the issue of originating loans. The Chinese legislator has the opposite opinion since the collapse of a provisional fund can lead to the collapse of a platform; that is why provision funds are recently prohibited there. Among other measures are cancellation rights of investors policy, rules governing illegal fund-raising activities, conflicts of interest regulation, dispute resolution regulation and the mechanism of insolvency. Excepting conflicts of interest regulation, which was mentioned by Russian legislator, other methods were ignored. Mitigation risk measures are not that collaborated in China as well, which receives criticism from Chinese researchers.¹²⁵

Consequently, despite the external similarity, legal frameworks are not the same. The UK legislation focuses on the strict requirements related to platforms and their operation, keeping only decent companies in the industry; however, these requirements were set in the result of close collaboration with lending business. Thus, it is not surprising that fraud in the UK crowdlending industry is almost absent. In contrast, the Chinese legislation focuses more on the requirements to parties establishing a favourable environment for the whole industry; at the same time, the industry is strictly controlled by the government, and legislation also covers the lists of activities prohibited for platforms which balance legal framework. It is beforehand to make a conclusion about the Russian approach since this draft needs obviously much additional work. At the same time, the legal framework seems too dispositive, giving much freedom to platforms and almost not covering the mitigation of risks which can be dangerous in the existing crowdlending environment.

4.1.3. The recommendations related to the improvement of the legislative approach in the Russian crowdlending industry

It is necessary to admit the difficulty to give recommendations about the improvement of legislation in Russian crowdlending sphere since this market is very young and excessive regulation can finally impede its development; at the same time, the existing environment is favourable for scams.¹²⁶ Thus, it objectively needs consistent regulation and control; however, this regulation should be balanced, encouraging the growth of industry and preventing potential frauds. At the same time, based on the approaches chosen by China and the UK, it is possible to recommend the following changes:

- To divide regulation for equity-based crowdfunding and loan-based crowdfunding since their nature and the level of risks are different, which can lead to an imbalance of legal framework for one of the industries.
- Peer-to-peer lending should continue to be a part of the lending industry. The issue here is that the legislator prohibits financial companies from participation in the industry while personal loans should be granted by microfinance organizations which operation is under state control. However, the last requirement was necessary due to the high number of frauds and defaults regarding individual loans; thus, the government has started regulating this sphere by the determination of the special status of organizations operating in the industry. At the same time, with the new legislative act controlling crowdlending platforms, peer-to-peer lending does not constitute a danger, while can be an alternative to bank loans and loans of microfinance organizations.
- The role of banks and other financial intermediaries in the crowdlending industry should be determined. For examples, companies-operators can use its subsidiaries actually to perform financial functions and participate in fraud schemes; consequently, a company's structure should be controlled.

¹²⁵ (You, 2018)

¹²⁶ (Чуланова, 2017)

At the same time, collaboration with banks can improve the process of the assessment of creditworthiness significantly since the latest have more resources for checking the authenticity of the information provided by borrowers.

- Another recommendation is related to the adoption of sandbox mechanisms to take into consideration the actual interests of Russian business and to create a beneficial environment for its development. Also, the UK shows a successful example of a self-regulated body establishing the reputation of the industry, which is much more trustworthy. Consequently, close collaboration with crowdlending business together with a self-regulated organization aiming to increase the level of trust in crowdlending platforms can have a positive impact on the whole industry in general.
- Regarding the requirements to parties, they should not be excessively high since the number of participants can decrease. At the same time, using obligatory information set by the project and provided by borrowers, platforms should be selective and should also use qualified mechanisms of creditworthiness assessment preferably with the usage of bank' data in this process. The only thing which can be suggested is the prohibition to ask financing on different crowdlending platforms for one project and setting mechanisms giving professional lenders opportunity to diversify their portfolio and for non-professional lenders establishing the requirement of diversification aiming to defend their interests.
- Requirements to platforms should also be balanced, they should not create additional barriers to the market, but it should be controlled. The considered project includes only the charter capital system as the requirement, taking into consideration that compared frameworks pay high attention to the quality and the legality of platforms' operation. In this case, the recommendation can be to include the explicit list of prohibited activities which should be agreed upon with crowdlending business. Another option is to provide platforms with external control, for example, audit control which is, on the one hand, will increase trustworthy of the industry; however, on the other hand, it can lead to excessive costs and control which can be added on further stages of crowdlending development in Russia.
- Regarding mitigation of risks, there can be several suggestions. First, it seems reasonable to set the maximum possible interest rate since the ambiguously high-interest rate used by some platforms as clients' attraction can be the first characteristic of Ponzi pyramids or at least to observe this rate constantly in order to elicit potential fraud schemes. Second, to determine the policy regarding dispute resolution process, conflict of interest, default rate disclosure, illegal fundraising activities and activities in case of company-operator insolvency. These measures can be sensible since without explicit regulation companies can completely avoid them, while it is highly essential for investors to know what they should do in case of platform default as well as what will be with their money. Regarding provision funds, the situation is not that obvious. Indeed, they add trustworthiness to the whole process; at the same time, they bring some risks since the assessment mechanisms of platforms can be not sufficient and accurate which can lead to borrowers' defaults, fund activation and finally to platform's default. The level of default in the Russian peer-to-peer sphere proves that assessment mechanisms do not work properly. Consequently, at this stage, the implementation of provision funds can become a collapse of the whole industry and can increase transaction and interest rate costs for fund financing.

4.2. The alternative solutions

4.2.1. Banks as a tool for risk mitigation in crowdlending

Undoubtedly, balanced legal measures can help to create a favourable legal climate for the growth of the crowdlending market, to increase awareness on this sector since the adoption of laws usually is accompanied by disputes in society and to raise the level of trust in the previously unrecognized legal mechanism. However, it seems that the complex of non-legal measures is also required for the establishment of the positive crowdlending environment such as improving investment and economic climate, increasing legal and financial literacy. As was mentioned above, the lack of trust represents one of the main problems of non-popularity of crowdlending which expressed in several dimensions including the lack of credit related to the high number of defaults and frauds in the industry. In this case, the collaboration of crowdlending platforms with a banking sector can become an alternative solution aiming to increase the level of trust by mitigating the risks in the crowdlending procedures.

The crowdlending sector got the driver for growth and development immediately after the global financial crisis when banks became particularly reluctant granting loans to risky SMEs and economically non-stable individuals by establishing higher interest rates and more stringent requirements. Thus, the banking industry intentionally gave to crowdlending platforms a new audience eager to receive investment. The representatives of traditional financial intermediaries express an opinion about the absence of threat or competitive force from crowdlending and consider this as an additional source of financing.¹²⁷ At the same time, it is vital to notice that in 2014 only minimal banks' lending activities (2%) were on par with the lending capacity of peer-to-peer platforms, while the amount of lending capacity of peer-to-peer platforms is predicted to reach 10% of bank loans by 2020 which should not be underestimated.¹²⁸ Moreover, the growth of financial technical solutions on the market changing traditional industry lead to the significant decrease of consumer visits to retail bank branches (36%, 2017-2022), while the usage of bank' apps and mobile transaction raise to 121% for the same period which inevitably results in the drop of the number of banks being unable to maintain the quality of products and compete in the modern era of software as a service.¹²⁹ This tendency motivates banks to reconsider the long-lasting concept of industry development and expansion, and start collaborating with new FinTech startups, including crowdlending platforms aiming to improve traditional financial products.

Collaboration between crowdlending and bank sectors can be expressed in different business models:¹³⁰

1) Crowdlending platforms and the infrastructure of a bank

Platforms can be provided with banking infrastructure services such as payment service providers, gathering and fund allocation, origination and loan management. For example, the management service infrastructure of Web bank was adopted by Lending club while Credit.fr (a French crowdlending platform) actively collaborates with BPSE using its flow management service.

2) Crowdlending platforms and banking investment

Banking funds in the form of loans can be invested in a platform in two ways: by division financing into parts of the aggregated loans of the platform or by the straight acquisition of certain loans. The

¹²⁷ (BNP Paribas Fortis, 2016)

¹²⁸ (Switzerland, 2018)

¹²⁹ (The Financial Brand, 2019)

¹³⁰ (Nicolasguillaume.fr, 2016)

first way is used by Groupama bank on Unilend platform; the second way is adopted by LendingClub, which also integrates made financing into an investment fund and distributes it to its clients.

3) Crowdlending as a new banking product

Some banks offer a crowdlending mechanism to their clients searching for an alternative investment product promoting by bank's partner platforms. Among such platforms built by traditional financial intermediaries are Potok (Alfa Bank), Funding circle (RBS).

4) Crowdlending as a mechanism for expanding client network

The obvious advantage of crowdlending platforms is a huge client acquisition which does not require special costs since all procedures and interaction with clients occur in online regime. This advantage can be used by banks which can offer complementary banking products such as different saving accounts via partner-platforms (for example, Goldman Sachs and Mosaic, Proximea and Banque Populaire).

5) Banks as platforms-intermediaries

Banks based on intermediary model can use the projects of its financing operations to offer its clients refinancing through crowdlending investment products, for example, Rabo & Co and Rabobank.

Thus, the main benefits for banks are the opportunity to increase a competitive level by expending the quality and range of financial products, expansion to another market which is on the unprecedented rise, growing client base and new option for investment.¹³¹ Consequently, it is not surprising that banks «have jumped» into the new industry using its advantages. At the same time, the participation of banks in the sector and their collaboration with platforms lead particular benefits to the latest. The first advantage is related to a reputational aspect. Although Russian people are suspicious to financial institutions, they continue to keep significant amounts on saving accounts considering them as a more or less safe mechanism for storing. Nowadays, there are about 24 trillion rubles held on Russian bank deposits, and this vast amount does basically not work.¹³² Thus, the participation of banks building a high reputation in the crowdlending sector can enhance the credibility of such a financial instrument like crowdlending and especially the credibility of platforms. At the same time, it is worthy to notice that the system of Russian bank sector is represented by several hundred banks having their own ranking. Over the last five years, banks with different ranking have lost their licenses damaging the reputation of the whole sector. Consequently, the actual impact of bank-platform collaboration on the credibility of the crowdlending industry can be made only on conditions of old reputable bank's participation.

Another advantage related to bank data. The operation of Russian crowdlending platforms, particularly peer-to-peer platforms faced with the high rate of borrowers' default, have proved their inadequacy from the perspective of assessment credibility mechanisms. The solution of this problem can be found in the usage of banking data helping to identify any uncertainties, errors and deception in the information provided by borrowers; as a result; banking mechanisms can mitigate risks related to the information asymmetry.

To sum it up, the collaboration of banking and crowdlending industries is favourable for both sides and traditional financial intermediaries ignoring this fact can put out of commission. At this point only the minority of Russian platform has recognized this trend and operates in close collaboration

¹³¹ (Fenwick, Vermeulen, and McCahery, 2017)

¹³² (Forbes.ru. 2017)

with the banking sector; however, it is possible to predict entry into market other bank-players if the government does not close the entrance for such cooperation.

4.2.2. Smart contracts, blockchain technologies and decentralization as a way to eliminate the issue of trust in crowdlending

Another angle of trust problem is related to the lack of credit in the state institutional system forced by the significant level of corruption and inflation, constantly changing legislation, an unsuccessful monetary policy¹³³ which hurt the growth of crowdlending industry and the development of Russian economy as a whole. This problem can be solved by decentralized peer-to-peer lending solutions which do not base on any state institution system and blockchain technologies using smart contracts which provide lenders and borrowers with the opportunity to transact directly in a decentralized and democratic way. It means that this system has an ability to eliminate the need for the trust since the execution of the code does not require government, managers, banks and other intermediaries for the participation in conducting of loan agreements.¹³⁴ Moreover, the network of borrowers and lenders is anonymous, and lenders do not need to trust in borrowers due to the fact that blockchain is responsible for the execution of transactions. It means that the code always works in the same manner and executes transactions automatically when conditions established by parties occur while no one can manipulate or interfere in a loan process. Also, this system is more transparent in comparison with the traditional centralized lending solution since everyone can observe the scope of blockchain ledger with its deployed transactions. Furthermore, the network of lenders and borrowers creating a new decentralized eco-system takes a decision making power instead of giving power to centralized authority.¹³⁵

There are several self-called decentralized peer-to-peer platforms on the world crowdlending market, for example, Ripio,¹³⁶ Lendoit,¹³⁷ ETHlend,¹³⁸ Elix¹³⁹ and others. These platforms base on blockchain technologies, use Ethereum smart contracts and offer two lending solutions: cryptocurrency-to-fiat solution or pure cryptocurrency solution. It is essential to notice that these legal solutions and decentralization in a form existing nowadays have some black sides. Although platforms represent themselves as fully decentralized systems, it is possible to conclude that a certain level of centralization exists. For instance, records and data are analyzed, scored and stored by the central party, which can result in human errors. Disadvantages of some centralization are expressed not only in a human factor but also the vulnerability of these platforms to countries' legislation which can be different in its requirements.¹⁴⁰

An in-depth examination of the first solution shows that the difference with the usual peer-to-peer lending industry is expressed in cryptocurrency option together with fiat which is quite practical, from one side, since the majority of operations nowadays conduct in local currencies. However, from another side, it leads to a higher level of centralization in comparison with the pure solution since transactions are linked to governmental monetary policies.¹⁴¹

¹³³ (Imf.org, 2019)

¹³⁴ (Henriquez, Cohen, Bittan, and Tulbassiyev, 2019)

¹³⁵ (Medium, 2018)

¹³⁶ (Ripiocredit.network, 2019)

¹³⁷ (Lendoit.com, 2019)

¹³⁸ (GitHub, 2018)

¹³⁹ (Coin Bureau, 2019)

¹⁴⁰ (Gomber, Kauffman, Parker, Weber, 2018)

¹⁴¹ (Gonzalez, 2019)

The pure cryptocurrency solution is more decentralized, but it has one limitation which is expressed in the stuck in a particular blockchain and cryptocurrency ecosystem which is restricted by the most popular crypto-assets, particular payment services and usually linked to native tokens of platforms received in ICO. This tendency closes the system then makes it open.¹⁴² At the same time, pure cryptocurrency solutions have obvious advantages such as the simplicity of transaction, the lack of dependence on the inflation-adjusted / financial crisis-adjusted interest rate as well as ambitious goals regarding the global access for any person including unbanked people since using the structure does not need the participation of banks for transfer. One issue raising here is the risk of default. In the traditional system, this issue usually solved by the decrease of credit rating; thus, the borrower will be not able to get a new loan. In a decentralized system, platforms use generally collateral as a guarantee of payment (for example, in the case of ETHlend, Ethereum-based ERC-20 tokens are used).¹⁴³ Unfortunately, the main barrier here is that not all unbanked people will be able to provide collateral.

It is essential to notice that the Federal project on crowdfunding includes the term «smart contract» and allows the possibility of its usage for the conclusion and execution of lending contracts between investors and borrowers attracting investments. This project does not cover the definition of smart contracts and qualifying remarks; however, it refers to a project of the Federal Act «On digital financial assets» defining smart contract as an electronic contract according to which the performance of rights and obligations is carried out by committing to automatic order of digital transactions in a distributed registry of digital transactions strictly defined by contract sequence and upon the occurrence of certain circumstances. This project was approved in the first round of consideration in the State Duma. However, it was differed in the second round because of the high number of disputes since the project affects the interests of state organizations as well as business and establishing the balance between these interests is not that easy while a rush decision can hinder the development of Russian crypto industry. Moreover, there are a lot of issues regarding the project which have been not solved or covered by now. For example, there is no definition of cryptocurrency and tokens, there is no opportunity to create decentralized systems only close centralized systems, there are no procedures of working with blockchain and no technical and certification requirements; the measures preventing money laundry are not established. Furthermore, the project has a framework character, which means that it establishes just some requirements which should be further elaborated in the legislation of the Central Banks. This shift of responsibility can lead to the creation of future obstacles and unpredictable nature of the crypto sector, which is not favourable for business.¹⁴⁴ Thus, at this stage the legislator has to take into account the opinion of business and foreign experience, otherwise local investors interested in the development of this sphere will move abroad while foreign investors will not be attracted by the established environment which will lead to the crisis of the industry and a negative impact on the economy.

To sum it up, the genuine decentralization together with blockchain technologies and smart contracts have a huge potential to solve the problem of trust faced by Russian crowdlending sphere. At the same time, although it seems that the impact on decentralized peer-to-peer platforms from the Russian government is not possible, the latest can restrict consumers with the opportunity to use the services of a decentralized platform on the territory of Russia, particularly after the approval of new «Internet isolation» legislation.¹⁴⁵ Also, the certain level of platforms' centralization and the possibility to

¹⁴² (Medium, 2018)

¹⁴³ (GitHub, 2018)

¹⁴⁴ (Bitnovosti.com, 2019)

¹⁴⁵ (Meduza.io, 2019)

establish the company of a platform-operator can lead to dependence on local legislation. Consequently, the access to such kind of platforms on the territory of Russia will depend to a large extent on a government position.

4.3. The conclusion of chapter IV

The analysis of the project on crowdfunding shows that regardless of some advantages such as the establishment of the status of crowdlending platforms, responsibility and control under their operation, the requirements to have a separate account, to disclose information about some platform's operation and potential borrowers, this draft has many gaps and issues which are not solved yet. For example, the same treatment of two different types of crowdfunding (equity and loan types), the exemption of peer-to-peer lending, the lack of information about dispute resolution process and safety mechanisms and others. In this regard, the comparative analysis of two legislations and the crowdlending experience of countries-leaders of the industry should be taken into account. As a result, several recommendations were established for the improvement of the legal environment.

At the same time, the analysis of obstacles to crowdlending demonstrates that only legal measures are not enough to solve existing problems, for example, a trust problem. In this case, alternative solutions such as banks participating in crowdlending as a way to mitigate risks and decentralization of platforms excluding the constant reliance on government systems and their policies can be used to increase the level of creditworthiness in such investment and fundraising mechanism as crowdlending.

V Conclusion

This thesis analyzed major obstacles restricting the development of Russian crowdlending. The main purpose of this research was to offer measures suitable to overcome these obstacles through the establishment of a favourable environment for the growth of the industry.

Crowdlending is a revolutionary method of alternative financing belonging to the investment form of crowdfunding and FinTech solutions. It provides lenders with the opportunity to invest, with commercial purpose, small amounts directly into loans, diversifying their investment while maintaining ownership of the loans by using online crowdlending platforms which belong to the non-traditional banking sector and usually have a low profile of depository without any influence on the participants of lending. As previously mentioned, the crowdlending sector has experienced unprecedented growth and potential around the world and has become an alternative to traditional financial institutions for individuals and SMEs. Such popularity in the lending sector is determined by the advantages of social lending, such as lower transaction costs due to the lack of financial intermediaries; the adaptation of a cost-saving business structure; diverse funding sources that are not limited by the geographical borders of traditional banks; direct access to the investment sector for small unprofessional investors, which was previously only available to large institutional investors; diversification of crowdlending investments, which mitigates the risks and decreases the effect of potential default; time-efficiency of the method; and artificial intelligence, which help to evaluate the risks and creditworthiness of individuals and SMEs in a different way to traditional analytical methods.

At the same time, crowdlending brings different risks that do not allow platforms to become leaders of the lending sector. These risks include the poor financial performance of a borrower, which is related to the low creditworthiness assumed by platforms; obstacles in the determination of the actual creditworthiness of borrowers; the lack of provisional funds; the lack of financial literacy regarding the necessity to diversify portfolios; the problem of enforcement; possible absence of regulatory obligations regarding mandatory due diligence of particular data; the lack of liquidity of the second market; possible default of a platform; and fraudulent operations. In this risky environment, the existence of a balanced legal framework regulating the activity of platforms, their legal status, the relationships between investors and borrowers, and stimulation of the development of this industry, seems particularly essential.

To understand the problems of the crowdlending sector in Russia, the operation of all existing platforms was investigated. As a result, it was established that crowdlending in Russia represents ‘a grey zone’ created by the lack of transparency in the work of platforms and their collaboration with third parties, the information about borrowers and the risks, the absence of maximum threshold for participation in crowdlending and the secondary market. The lack of control, and uniform state requirements as well as the lack of an internal industry policy which encourages platforms to set their own rules. This can sometimes contradict the interests of investors and borrowers, although the rules might exist within contract and consumer laws. Consequently, Russian investors are forced to invest ‘blindly’, which does not stimulate the growth of this sector.

Moreover, the analysis of existing regulation (the internal environment) shows that a significant barrier is the lack of determination of the status of crowdlending platforms. This leads to their freedom in issues such as disclosure information, which can be insufficient or absent; the use of assessment mechanisms to check borrowers’ creditworthiness that may not be satisfactory; mechanisms aiming to mitigate risks, which can be inefficient; the scope of their operation, which can include financial

services with minimal responsibility taken according to automatically accepted public agreements. As a result, an unregulated industry without any control can encourage the growth of frauds and defaults, not only from the platform side, but also from borrowers performing poorly financially, while investors inspired by high returns only have the option of trusting unknown borrowers and a platform that discloses insufficient information.

Among the external problems identified were the lack of trust in crowdlending platforms; borrowers' performance; the state institutional system; the lack of financial literacy; and the unsustainable financial status of society. At the same time, it is clear that legal solutions are not sufficient to overcome the long-lasting problems existing in Russian crowdlending. There should be legal, economic, and learning measures that aim to improve the crowdlending environment, increase the level of trust, improve financial literacy, and support economic development and the investment climate. This research focuses on overcoming legal and trust problems.

To achieve these goals, the Federal project on crowdfunding was investigated. The project introduces necessary provisions, such as the control of the Central Bank under industry; the obligatory disclosure information about each platform's operation and borrower's data; the determination of the status of platforms; elimination of financial players from this market; and establishment of the minimum amount of charter capital, as well as a platform's responsibility and separate bank account. However, the majority of provisions seem superficial, including brief mentions of some of the mechanisms, for example, dispute resolution process or safety measures, and the significant number of references to other Acts, which underline that the project requires further elaboration. Furthermore, the project regulates equity-based and loan-based crowdfunding similarly; however, the nature of these industries and associated risks are significantly different. Finally, the project only focuses on SME business and leaves peer-to-peer lending, which traditionally amounts to the highest percent of crowdlending, beyond regulation, which will damage the development of the entire industry.

The project was also compared to approaches adopted by the leaders of the industry – the UK and China – which revealed that, although there are some similarities, the frameworks have different features. The UK legislation focuses on the strict requirements surrounding collaboration with lending business and related to platforms and their operation, retaining only reputable companies in the sphere. In contrast, the Chinese legislation focuses more on the requirements for investors and borrowers participating in crowdlending; at the same time, the industry is strictly controlled by the government, covering the lists of activities prohibited for platforms, which balances the legal framework. To reach a conclusion about the Russian approach is premature since the draft still requires substantial additional work. At the same time, the legal framework seems to give too much freedom to platforms and almost no coverage for the mitigation of risks, which can be dangerous in the established conditions.

According to the comparative analysis and the features of the Russian environment, recommendations regarding improvement of the legal approach are:

- 1) to divide regulation for equity-based crowdfunding and loan-based crowdfunding;
- 2) to include peer-to-peer lending as a part of the crowdlending industry;
- 3) to determine the role of banks and other financial intermediaries in the crowdlending sector, which can improve the assessment of creditworthiness significantly;
- 4) to adopt the sandbox mechanism, taking into consideration the interests of Russian business;

- 5) to encourage the creation of a self-regulated body to establish the reputation of the industry;
- 6) to restrict borrowers from requesting finance for a specific project on more than one crowdlending platform;
- 7) to set mechanisms that allow professional lenders the opportunity to diversify their portfolio and to establish the requirements of diversification in order to defend the interests of non-professional lenders;
- 8) to include an explicit list of prohibited activities, which should be agreed upon by crowdlending businesses;
- 9) to set provisions related to risk mitigation.

To increase the level of trust in the crowdlending industry, banks can be used as a tool for risk mitigation. This research demonstrates that this collaboration is in the interests of all parties. Crowdlending platforms can receive benefits from a reputational aspect in the form of big data and assessment credibility mechanisms operated by banks, and can increase their competitive level by expanding the quality and range of their financial products, expansion to another unprecedentedly developing market, a rising client base and new options for investment. Consequently, it is possible to predict the growth of bank-players on the market if the government does not close down the possibly of such collaboration.

Decentralized peer-to-peer lending solutions can overcome the problem of lack of credit in the state institutional system, which has arisen due to corruption, inflation, constantly changing legislation, and unsuccessful monetary policies, since such platforms do not rely on any state system, legislation, banking restriction, or monetary policy, and do not have any borders. In addition, blockchain technologies and smart contracts allow lenders and borrowers to transact directly. At the same time, access to such kinds of platforms on Russian territory will largely depend on a government position influencing end consumers since the state can prohibit the use of the services of a decentralised platform. Furthermore, in the process of this research, a certain level of platform centralisation was identified, which can lead to dependence by these platforms and company operators on local legislation.

In conclusion, with its advantages for individuals and SMEs, the crowdlending industry has significant potential and demand for expansion in Russia. However, the existing legal environment and problems in the economic sphere impede the growth of this sector, which is unable to achieve the results of China, the UK or the USA at this stage. At the same time, the future of the industry and its results will ultimately depend on the position of the Russian legislation, the state's collaboration with businesses, and the condition of the Russian economy.

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