

**Online peer-to-peer lending: challenging consumer protection rationales, orthodoxies
and models?**

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Abstract: Online peer-to-peer lending presents challenges to consumer protection rationales and orthodoxies as it enables inter-consumer unsecured loan transactions brokered by platforms. This article therefore assesses relevant consumer protection justifications and the disclosure versus interventionist approaches debate in the light of the crowdfunding regulatory regime recently established by the Financial Conduct Authority.

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Introduction

Online peer-to-peer lending (P2PL) is a fast growing financial service industry that presents challenges to consumer protection rationales and orthodoxies by enabling individuals to borrow and lend to one another principally through unsecured loan transactions brokered by an online platform. P2PL has been acclaimed as a phenomenon that could help fill the space left by traditional bank and non-bank lending.¹ Apparently existing in the peripheral lending economy for centuries in the form of friendly societies, credit unions, payday loans and microcredit,² P2PL has “re-emerged” on a larger scale thanks to the internet which allows people to connect and interact through organised online networks. The emergence of online P2PL is also due to the recent global financial crisis which has caused banks to tighten lending guidelines.³ Consumers, who have consequently found it difficult to obtain credit, now have an alternative means of doing so.⁴ Internet technology has transformed the lending market in various ways and facilitated the ease of contact between lenders and borrowers. For example, it has enabled the execution of a lending contract by clicking on an acceptance

¹ M. Pagano, ‘Peer-to-peer lending boom could make banks obsolete’ *The Independent*, Monday 17 December 2012, <http://www.independent.co.uk/news/business/news/peertopeer-lending-boom-could-make-banks-obsolete-8421241.html> [Accessed May 10, 2014].

² A. Brill, "Peer-to-peer lending: innovative access to credit and the consequences of Dodd-Frank" (2010) 25 *Wash Leg Found Leg Backgrounder* 1.

³ Brill, "Peer-to-peer lending: innovative access to credit and the consequences of Dodd-Frank"(2010) 25 *Wash Leg Found Leg Backgrounder* 1.

⁴ J.R. Magee, "Peer-to-peer lending in the United States: surviving after Dodd-Frank" (2011) 15 *NC Bank Inst* 139 at 140.

button.⁵ However, the internet has also led to the emergence of virtual consumer protection concerns such as unlicensed and shadowy lending⁶ and pyramid schemes.⁷

Online P2PL is a relatively new area for regulation and legal research and has not been subjected to much legal analysis outside of the U.S., including the UK where the business model first emerged.⁸ In fact, existing legal and regulatory scholarship on P2PL has focused on the U.S. securities law.⁹ Although the pioneering regulation of P2PL in the U.S. suggests a more established regulatory and legal treatment, a very simplistic approach that glosses over the issues is apparent. In the U.S., P2PL has been classified as securities and regulated under that body of law, with the Securities and Exchange Commission requiring that P2PL platforms register as issuers under the Securities Act of 1933.¹⁰ Regulatory responses to online P2PL in the UK and elsewhere have been slow partly due to the view that it is essentially a private affair of the individual participants.¹¹ The novelty of P2PL is another

⁵ See *Bassano v Toft and others* [2014] EWHC 377 (QB).

⁶ R. Mayer, "When and why usury should be prohibited" (2013) 116 *Journal of Business Ethics* 513 at 524.

⁷ See, for example, *Afinance UAB v Valstybinė vartotojų teisių apsaugos tarnyba and another* (Case C-515/12) [2014] Bus LR 574.

⁸ In light of the scarcity of much legal and regulatory scholarship on P2PL in the UK, this article draws on existing U.S. focused literature that compares different regulatory approaches, motives and treatment of key issues and offers lessons for the UK.

⁹ Brill, "Peer-to-peer lending: innovative access to credit and the consequences of Dodd-Frank"(2010) 25 *Wash Leg Found Leg Backgrounder* 1; A. Verstein, "The misregulation of person-to-person lending" (2011) 45 *UCDL Rev* 445.

¹⁰ Verstein, "The misregulation of person-to-person lending" (2011) 45 *UCDL Rev* 445 at 448.

¹¹ J.A. Gardner, *Innovation and the future proof bank: a practical guide to doing different business-as-usual* (Hoboken, NJ: John Wiley, 2011); P. Manbeck and S. Hu, "Peer-to-peer lending: a summary of the principal and regulatory issues (2014 Update)" (Chapman and Cutler LLP, 2014), http://www.aba.com/Tools/Offers/Documents/Chapman_Regulation_of_Peer-to-Peer_Lending_0414.pdf

possible reason for the regulatory inertia. For example, the P2PL business model was not regulated by the UK Financial Services Authority (FSA) since it did not fall within the categories of regulated activities under the Financial Services and Markets Act 2002.

However, on 1 April 2014, P2PL fell under the regulatory remit of the Financial Conduct Authority (FCA), which replaced the FSA in 2013 and has recognised a new regulatory activity of “operating an electronic system in relation to lending”.¹² The FCA has recently detailed a new regime for regulating internet loan-based and investment-based crowdfunding platforms.¹³ P2PL falls under the loan-based type of crowdfunding,¹⁴ an umbrella term used by the FCA for a wide spectrum of internet-based business models involving the participation of a large number of people contributing relatively small amounts. The FCA’s approach is in marked contrast to the U.S. simplistic strategy of fitting P2PL within existing financial regulatory structures. Nevertheless, P2PL was not expressly considered in the heavily debated consumer protection objective of the FCA regime. It is, for instance, arguable that

[\[Accessed May 10, 2014\]](#); M.J. Scire, *Person-to-person lending (PPL): new regulatory challenges could emerge as the industry grows* (Darby, PA: Dianne Publishing, 2011); R. Zeng, “Legal regulations in P2P financing in the U.S. and Europe” (2013) 10 *US-China Law Review* 229 at 234.

¹² Financial Conduct Authority, *Consultation Paper CP13/17 High-level proposals for an FCA regime for consumer credit*, 6 March 2013, 68; S. Read, “Peer-to-Peer Lenders Get a Boost from Regulation - Spend & Save – Money”, *The Independent*, 8 December 2012) <<http://www.independent.co.uk/money/spend-save/peertopeer-lenders-get-a-boost-from-regulation-8393637.html>, [Accessed 21 March 2013].

¹³ Financial Conduct Authority, *The FCA’s regulatory approach to crowdfunding over the internet, and the promotion of non-readily realisable securities by other media* (Policy Statement, PS14/4) (March 2014), <http://www.fca.org.uk/news/firms/ps14-04-crowdfunding> [\[Accessed May 10, 2014\]](#).

¹⁴ Financial Conduct Authority, (Policy Statement, PS14/4) at 11.

the FCA's classification of P2P lenders as retail investors¹⁵ demonstrates a lack of recognition that P2PL can involve consumers- lenders and borrowers- on both sides of a loan transaction.

The emergence of online P2PL appears to challenge certain fundamental assumptions, objectives and frameworks of consumer protection law and policy of the EU and UK. P2PL raises questions about the definition of a "consumer of financial services" by altering the characteristics of key participants in a lending transaction. In particular, there is the twin problem of the status of P2P lenders and the appropriate degree of protection that should be afforded to them. This, in turn, appears to challenge the orthodox business-consumer terminology that is considered "a starting point"¹⁶ in consumer law and policy. It also reignites the long-standing information versus intervention debate on consumer protection.¹⁷ There are implications for consumer lending, wider consumer protection and financial regulation if, for example, the roles of platforms in the P2PL processes are not properly recognised. A condition precedent to appropriate regulation of any financial intermediation is to identify and recognise the distinctive features of relevant intermediaries.¹⁸ Moreover, topical consumer lending issues such as fairness of commercial practices and responsible

¹⁵ Financial Conduct Authority, (Policy Statement, PS14/4) at 16, 31. Contrast Financial Services Authority, "The Financial Conduct Authority: approach to regulation" (June 2011) at 16.

¹⁶ D.M. Collins, "Misleading APRs in consumer credit agreements: a new influence?" (2012) 7 *Journal of Business Law* 629 at 635.

¹⁷ G. Howells, "The Potential and Limits of Consumer Empowerment by Information" (2005) 32 *Journal of Law and Society* 349; S. Weatherill, *EU consumer law and policy* (Cheltenham: Edward Elgar, 2005).

¹⁸ P.K. Staikouras, "A novel reasoning of the UK Supreme Court decision in Lehman Brothers: the MiFID segregation rule from the angle of financial intermediation and regulation theory" (2014) 2 *Journal of Business Law* 97 at 104-109.

lending¹⁹ heavily tilt towards controlling the behaviour of the business supply side of lending transactions.

The aim of this article is to assess the consumer protection justifications for regulating P2PL, demonstrating the appropriateness and suitability of a more interventionist consumer protection approach. We argue that regulation ought to recognise the consumer-to-consumer transaction model of P2PL and consequently reflect the need to protect two very different types of consumers: lenders, who may begin to increasingly include inexperienced investors as the P2PL investment form grows in popularity; and borrowers, the party typically associated as consumers. In the first part of the article, we will analyse the prototypical scheme, participation structure and intermediation role of platforms. The second part will evaluate the challenges P2PL poses to the orthodox definition of consumer and bilateral business-consumer protection approach as well as the implications of P2PL to the pre-contract, rational choice and information focus of traditional consumer protection regime. The final part will critically consider the potential and limitations of key components of the P2PL regulatory regime the FCA recently established.

P2PL intermediation

In online P2PL, a platform facilitates direct finance between individuals by enabling them to lend and borrow money from each other without the intermediation of institutional lenders.²⁰

¹⁹ S. Brown, "Using the law as a usury law: definitions of usury and recent developments in the regulation of unfair charges in consumer credit transactions" (2011) 1 *Journal of Business Law* 91.

²⁰ Brill, "Peer-to-peer lending: innovative access to credit and the consequences of Dodd-Frank" (2010) 25 *Wash Leg Found Leg Backgrounder* 1 ; Magee, "Peer-to-peer lending in the United States: surviving after Dodd-Frank"(2011) 15 *NC Bank Inst* 139 at 140; Verstein, "The misregulation of person-to-person lending" (2011) 45 *UCDL Rev* 445 at 452.

P2PL platforms are not structured as the online versions of institutional intermediation such as banks and credit unions. For example, there are significant differences between P2PL and credit unions although both are tripartite schemes for pooling savings from individuals for lending to other persons. Credit unions are largely democratic associations of members sharing a common bond of residence or occupation and can be for profit or the social goals of financial inclusion and poverty alleviation.²¹ The profit-oriented P2PL, in contrast, is not structured democratically and does not require associational common good for participation. In fact, P2PL participants are often unknown to one another.

A key point here is that ‘lending’ activities are brokered by an online platform and in most cases lenders do not lend directly to borrowers. Rather, lenders each fund a portion of a loan and recuperate a pro-rated share of the principal and interest payments.²² There are normally three participants in online P2PL- platforms, borrowers and lenders- although it is an industry with varying business models and structures that are susceptible to changes as it continues to grow. What follows is a description of how a platform, Zopa,²³ works since it represents a fairly typical idea of the structures and operations of online P2PL platforms generally.

²¹ N. Ryder, “Banking on credit unions in the new millennium?” (2001) Sep *Journal of Business Law* 510 at 511; N. Ryder, “Credit unions in the United Kingdom: a critical analysis of their legislative framework and its impact upon their development” (2003) Jan *Journal of Business Law* 46 at 45-51; N. Ryder, “Out with the old and in with the new? A critical analysis of contemporary policy towards the development of credit unions in Great Britain” (2005) Sep *Journal of Business Law* 617 at 617-624; N.R. Ryder and C. Chambers, “The credit crunch – are credit unions able to ride out the storm?” (2009) 11(1) *Journal of Banking Regulation* 76 at 81.

²² I. Galloway, "Federal Reserve Bank San Francisco: peer-to-peer lending and community development finance" (2009) 21 *Community Invest* 4.

²³ Zopa, *A smarter way to manage your money*, <http://www.zopa.com/>, [Accessed May 1, 2014].

Zopa was the first online P2PL website in the UK and indeed worldwide,²⁴ there are now several other platforms including Ratesetter and Funding Circle in the UK and Prosper in USA. Set up in March 2005, Zopa, which stands for “zone of possible agreement”, is the range between the lowest one person is prepared to get for something and the highest another person is prepared to give up for something.²⁵ Zopa users set up an account and register as either a lender or a borrower, usually using pseudonyms. Borrowers fill out an application similar to a bank application form and give Zopa permission to access data on them. A combination of information that borrowers provide and information that Zopa purchases from Equifax and Credit Bureau enables Zopa to manage the risk of borrowers’ default for lenders by undertaking a unique credit scoring system of categories A*, A, B and C. A* is reserved for borrowers with the highest credit score.

Prospective borrowers request a quote by stating the amount and length of proposed borrowings. Zopa matches this information with potential lenders, who have previously set out the conditions on which they are prepared to lend. Lenders, for example, can state their desired interest rates, the length of time they are prepared to lend for and the credit ratings of borrowers they prefer to lend to.²⁶ Compared with traditional bank lending which is funded by customers’ deposits and lent out to other bank customers unknown to the depositors,

²⁴ S. Freedman and G.Z. Jin, "Do social networks solve information problems for peer-to-peer lending? evidence from Prosper.Com" (SSRN Scholarly Paper, Social Science Research Network 14 November 2008) 1; A.C. Briceño Ortega and F. Bell, "Online social lending: borrower-generated content" (14th Americas Conference on Information Systems- AMCIS 2008, Toronto, Canada, August 2008) 4, <http://aisel.aisnet.org/amcis2008/380>, [Accessed April 10, 2014].

²⁵ Zopa, *How can we help you? About Zopa*, <http://help.zopa.com/customer/portal/topics/349034-about-zopa/articles#regulated> [Accessed March 11, 2014].

²⁶ G. Andrews, (chief executive of Zopa) Interview with Evan Davis, “Alternative Finance” *The Bottom Line* BBC, February 17, 2013.

lenders on Zopa are apparently invested with greater decision-making responsibilities.²⁷ Zopa suggests that lenders can decide their own interest rates by looking at what other lenders are doing and choose to lend at their own risk, while it only provides lenders with relevant information to make their own choices. Whilst lenders have increased involvement in the lending process, they therefore bear the risk of a borrower's default in making repayments. As with most lending platforms, Zopa is not party to the loan contracts that it matches.

Thus, Zopa purports to assume a background role in the spirit of providing a truly direct consumer-to-consumer exchange. Its role is merely to facilitate the making of contracts by managing risk, ensuring that lenders' losses are as low as possible and within the expectations it has set, and providing information to participants. Zopa also spreads risk by diversifying the lenders' funds. Whilst the average lender on Zopa makes £5000 available for lending, this can be spread across numerous borrowers in units of £10.²⁸ Zopa assembles the cheapest loan it can out of the £10 units and presents them to a borrower as a quote. Each loan is unique to the borrower's request for a quote and assembled in real time, suggesting that loans are not pre-packaged products that are sold to the borrower.²⁹ Online P2PL lenders/investors can see the details of each loan, unlike traditional securitisation markets where loans are packaged into complex bundles and sold to investors.³⁰

²⁷Briceño Ortega and Bell, "Online social lending: borrower-generated content", <http://aisel.aisnet.org/amcis2008/380>, [Accessed April 10, 2014].

²⁸ Brill, "Peer-to-peer lending: innovative access to credit and the consequences of Dodd-Frank"; Magee, "Peer-to-peer lending in the United States: surviving after Dodd-Frank" (2011) 15 *NC Bank Inst* 139 at 140; Verstein, "The misregulation of person-to-person lending" (2011) 45 *UCDL Rev* 445.

²⁹ Andrews, "Alternative Finance" *The Bottom Line* BBC, February 17, 2013.

³⁰ J.J. Kim, "Peer-to-peer lender relaunched - marketwatch" (*The Wall Street Journal*, April 28, 2009) D5, <http://www.marketwatch.com/story/peer-to-peer-lender-relaunched> [Accessed March 7, 2014].

P2PL platforms promise a simpler, more transparent lending landscape where borrowers know who they are liable to and lenders know which borrowers owe them money.³¹ A selling point for P2PL is that it saves money by eliminating the need for an intermediating bank. Consequently, borrowers are offered much lower interest rates and lenders can expect higher returns.³² P2PL provides individuals, small businesses and entrepreneurs with access to cheaper credit when they may be excluded from traditional loan sources.³³ It allows investors to diversify their portfolios, thus reducing risk.³⁴ However, P2PL in addition to consumer protection concerns can involve money laundering, privacy, data protection, terrorism financing and identity theft and other risks³⁵ associated with traditional banking forms because platforms connect borrowers and lenders over matters of shared identity in a virtual environment. Individual participants are unlikely to have adequately researched or understood the risks of P2PL. As with other online transactions, the risk of fraudulent borrowing may be higher in P2PL than face-to-face negotiated loans.³⁶ Inexperienced lenders may be susceptible to intentionally misleading conduct,³⁷ particularly in P2PL models

³¹ Verstein, "The misregulation of person-to-person lending" (2011) 45 *UCDL Rev* 445 at 463.

³² Manbeck and Hu, "Peer-to-peer lending: a summary of the principal and regulatory issues (2014 Update)" http://www.aba.com/Tools/Offers/Documents/Chapman_Regulation_of_Peer-to-Peer_Lending_0414.pdf [Accessed May 10, 2014]; Verstein, "The misregulation of person-to-person lending" (2011) 45 *UCDL Rev* 445 at 457.

³³ Magee, "Peer-to-peer lending in the United States: surviving after Dodd-Frank" (2011) 15 *NC Bank Inst* 139; Verstein, "The misregulation of person-to-person lending" (2011) 45 *UCDL Rev* 445 at 460.

³⁴ Magee, "Peer-to-peer lending in the United States: surviving after Dodd-Frank" (2011) 15 *NC Bank Inst* 139; Verstein, "The misregulation of person-to-person lending" (2011) 15 *NC Bank Inst* 139 at 460.

³⁵ See J. Lane, V. Stoddern, S. Bender and H. Nissenbaum (eds.), *Privacy, big data and the public good: frameworks for engagement* (New York: Cambridge University Press, 2014).

³⁶ Verstein, "The misregulation of person-to-person lending" (2011) 45 *UCDL Rev* 445 at 470.

³⁷ Verstein, "The misregulation of person-to-person lending" (2011) 45 *UCDL Rev* 445 at 466.

where lending decisions are influenced by personal stories presented to lenders by prospective borrowers describing the purpose of their borrowing. The need to protect such inexperienced lenders appears clear, especially given their status as consumers. Yet, it is that very status of the lenders that also challenges the orthodox definition of consumer. The implications of P2PL to the notions of consumer and consumer approach must consequently be discussed.

Financial consumer: status, information and responsabilisation

In order to provide appropriate protection, a regulatory regime ought to display an awareness of the subjects it aims to protect and their typical behaviours, characteristics or background. As such, the EU consumer law and policy typically defines a consumer as a natural person acting for purposes outside of his or her normal business, trade or profession.³⁸ Users of P2PL platforms appear to satisfy this orthodox definition of consumer. Although no empirical evidence of the P2PL users' characteristics is available, comparisons can be drawn from a 2013 report of the typical features of peer-to-business (P2B) lenders.³⁹ Focusing on the UK-based platform, Funding Circle, the report found that the typical P2B lender was male, highly

³⁸ A. Roosendal, and S. Van Esch, "Commercial websites: consumer protection and power shifts" (2007) *Journal of International Trade Law and Policy* 13 at17-19; B. Schüller, "The definition of consumers in EU consumer law" in J. Devenney and M. Kenny (eds), *European consumer protection: theory and practice* (Cambridge, Cambridge University Press, 2012) at 124. See also Proposal COM (2008) 614/3, Directives 2005/29/EC, 85/577/EC, 97/7/EC and 99/44/EC.

³⁹ Pierrakis and Collins, "Banking on each other. Peer-to-peer lending to business: evidence from funding circle" (April 2013), http://www.nesta.org.uk/sites/default/files/banking_on_each_other.pdf, [Accessed April 10, 2014]; Pierrakis and Collins, "Banking on each other: the rise of peer-to-peer lending to businesses" (April 2013), <http://www.nesta.org.uk/publications/banking-each-other-rise-peer-peer-lending-businesses>, [Accessed April 10, 2014].

educated, relatively wealthy, and had a science, business or finance degree.⁴⁰ The report revealed that financial return was the main reason for lenders' decision to lend money to companies and key considerations include the interest offered, the financial track record of the borrowing company and the risk rating. As the study centred on the typical users of just one platform and the P2B business model, one must be wary of relying on it for extrapolating the status quo demographic of P2PL models. As the P2PL industry expands and grows in popularity, the demographic of its lenders may change and become less predominantly male, highly educated and wealthy. Nevertheless, nothing suggests that users of P2PL platforms are not ordinary people acting outside their *business, trade or profession*.

Lenders on P2PL platforms are often described as investors rather than consumers because they lend money directly to borrowers. This is exemplified by the FCA which appears to recognise P2P lenders as consumers following the provisions of the Financial Services Act 2012 which define consumers broadly enough to include a range of retail customers and wholesale and professional investors.⁴¹ Under the Act, consumers are, "persons who use, have used or may use regulated financial services...have relevant rights or interests in relation to any of those services, have invested, or may invest, in financial instruments, or have relevant rights or interests in relation to financial instruments."⁴² The FCA, however, essentially treats P2P lenders as "retail investors" rather than "retail consumers". Retail consumers are defined as buyers of financial products or services for their own use or benefit

⁴⁰ Brill, "Peer-to-peer lending: innovative access to credit and the consequences of Dodd-Frank" (2010) 25 *Wash Leg Found Leg Backgrounder* 1at 3.

⁴¹ Joint Committee on the draft Financial Services Bill, Session 2010-12 at [105].

⁴² Financial Services Act 2012 s.1G(1).

either directly or through regulated firms, while retail investors are persons that purchase financial instruments such as shares, bonds and exchange-traded funds.⁴³

Classification as investor rather than consumer is significant because investor protection is completely different from consumer protection. Investor protection rules often assume a degree of expertise and are therefore less likely to be interventionist than ordinary consumer protection regulations. Typical investor protection rules including the segregation of client and financial intermediary's accounts⁴⁴ may be irrelevant in consumer protection. A non-interventionist approach may seem appropriate and proportionate to the circumstances of the traditional lending and investment framework where the investors are investing in the true sense of the expression. P2B lenders may even be so regarded as investors going by the available research evidence⁴⁵ suggesting a degree of financial awareness among such lenders. P2PL is, however, different because its lenders may well be ordinary people like its borrowers and share similar levels of investment/lending experience and knowledge, and, in fact, may face a greater risk of loss of money through borrowers' default. P2P lenders and borrowers are unlikely to be significantly different in demonstrating "lack of experience,

⁴³ Financial Services Authority, "The Financial Conduct Authority: approach to regulation" (June 2011) at 16.

⁴⁴ Staikouras, "A novel reasoning of the UK Supreme Court decision in Lehman Brothers: the MiFID segregation rule from the angle of financial intermediation and regulation theory" (2014) 2 *Journal of Business Law* 97.

⁴⁵ Pierrakis and Collins, "Banking on each other. Peer-to-peer lending to business: evidence from funding circle" http://www.nesta.org.uk/sites/default/files/banking_on_each_other.pdf, [Accessed April 10, 2014]; Pierrakis and Collins, "Banking on each other: the rise of peer-to-peer lending to businesses" <http://www.nesta.org.uk/publications/banking-each-other-rise-peer-peer-lending-businesses>, [Accessed April 10, 2014].

unfamiliarity with the subject matter of the contract, [and] weak bargaining position”⁴⁶ in their relationship and dealings with platforms.

Nonetheless, the consumer protection measures of the recent FCA regime for retail investors are largely informational and restricted to appropriate information.⁴⁷ This may seem right since the Financial Services Act 2012 adopts a differential approach to defining consumers and requires the FCA to take into consideration the varying degrees of risk involved in different investments or transactions consumers are involved in and their differing degrees of experience and expertise.⁴⁸ Different types of consumer are provided with different levels of consumer protection and different regulated activities are subject to varying levels of intervention depending on what category a consumer of that service falls into. This differential approach is, however, problematic for P2PL which involves two consumers with similar levels of knowledge and experience who may find themselves subject to different levels of protection simply because of their participation as lender and borrower. It is noteworthy that experience is a critical factor in whether consumer protection measures apply to particular individuals.⁴⁹

⁴⁶ *Director-General of Fair Trading v First National Bank plc* [2001] UKHL 52, [2002] 1 AC 481 at [17], per Lord Bingham.

⁴⁷ That the consumer simply needs to have sufficient information to give informed consent is certainly the basis for the most important EU consumer protection measure including Council Directive 93/13/EEC of 5 April 1993 on unfair terms in consumer contracts OJ L 095 0029-0034.

⁴⁸ Financial Services Act 2012 ss.1C(2)(a) and (b); Joint Committee on the draft Financial Services Bill, Session 2010-12 at [108].

⁴⁹ *Maple Leaf v Rouvroy* [2009] EWHC 257, [2009] 2 All ER (Comm) 287; *Patel v Patel* [2009] 3264 (QB), [2010] 1 All ER (Comm) 864; *Rahman v HSBC Bank plc* [2012] EWHC 11 (Ch).

The designation of P2P lenders merely as retail investors tends to imbibe the neo-classical/rational choice philosophy that aims to “responsibilise”⁵⁰ and empower⁵¹ consumers through information disclosure and education. This may not be suitable for P2P lenders who lack sufficient high levels of investment know-how and are not very different from individual customers/depositors in traditional banking, particularly in pure, person-to-person P2PL models. Such lenders are unlikely to have independent access to information about borrowers, including potential use of multiple platforms, and are faced with the problems of information asymmetry and behavioural bias in addition to directly bearing the risk of borrowers’ default. Compared to platforms, which may have independent verification and monitoring mechanisms, an individual P2P lender who has lent a fraction of a loan may not know the real financial situation of a borrower. The lender depends solely on what the borrower discloses and may not know whether the borrower has mounting financial difficulties from several sources.⁵²

It is instructive that similar issues of information asymmetry and behavioural bias trigger regulation in traditional bank lending. Banks are subject to regulation on deposit handling and how payments are made because they handle customers’ deposits, which are repayable on demand, and primarily bear the risk of borrowers’ default. Technically, banks simultaneously act as intermediaries between their customers and borrowers since loans are derived from customers’ deposits and borrowers are unknown to the customers. Borrowers do not know

⁵⁰ I. Ramsay, “Consumer law, regulatory capitalism and the ‘new learning’ in regulation” (2006) 28 *Sydney Law Review* 9.

⁵¹ A. Arora, “Unfair contract terms and unauthorised bank charges: a banking lawyer’s perspective” (2012) 1 *Journal of Business Law* 44 at 50.

⁵² Contrast the facts of the non-P2P social lending case of *Patel v Patel* [2009] EWHC 3264 (QB), [2010] 1 All ER (Comm) 864.

which proportion of borrowings comes from any particular customer and customers likewise are unaware of the destination of their money as loans. P2PL platforms similarly act as intermediaries between lenders and borrowers, although the degree of their involvement in the lending processes appears to be played down.

The second difficulty is that the philosophy of responsabilisation and empowerment is not well suited to P2PL lenders. Indeed, such a philosophy assumes the ability to exercise power. P2PL lenders are however in fact powerless. This is in the sense of behavioural research which regards powerlessness as the inability to achieve desired outcomes.⁵³ For instance, transactional parties respond to stressful situations in different ways and can cope by applying primary and secondary controls. Primary control uses active behaviours to change a situation to a preferred one while secondary control involves active and passive behaviours designed to alter oneself rather than a stressful situation.⁵⁴ Powerlessness, which occurs when a party is unable to exercise primary control, is more likely to be case with online P2PL participants, particularly the lenders. Lenders rely on the platforms to deliver key aspects of the P2P lending transaction, e.g. loan repayments, credit risk assessments and pursuit of defaulting borrowers; and can at best apply secondary control and may not be able to exercise primary control at all.

Rather than control, trust seems a key factor for lenders' participation in P2PL.⁵⁵ Trust makes a person vulnerable to another party even when that person is unable to monitor or control the

⁵³ M. Bunker and A.D. Ball, "Consequences of customer powerlessness: secondary control" (2009) 8 *Journal of Consumer Behaviour* 268 at 269.

⁵⁴ Bunker and Ball, "Consequences of customer powerlessness: secondary control" (2009) 8 *Journal of Consumer Behaviour* 268 at 270.

⁵⁵ R. Iyer, A.I. Khwaja, E.F.P. Luttmer and K. Shue, "Screening in new credit markets: Can individual lenders infer borrower creditworthiness in peer-to-peer lending?" (15 March 2010),

other party.⁵⁶ Trustworthiness can arise out of the personality of the one who trusts, the competence and reputation of the one who inspires trust, or governance provided by a third party that enforces trust.⁵⁷ Legal and economic theories emphasise the third party element of this tripartite typology which builds trust through the regulation of participants' exchange and ensuring that participants keep their promises.⁵⁸ Research demonstrates that individuals' reluctance to engage in internet-based transactions is overcome if they trust business counterparties in terms of security, privacy and reliability. Similarly, online P2PL transactions require strangers to trust and cooperate with each other via platforms that have an exclusive access to participants' personal recognisability factors. By analogy to a physical shop, a platform is arguably part of a consumer's transactional decision. The concept of transactional decision includes the decision to enter a shop and any other decision related to "any decision taken by a consumer concerning whether, how and on what terms to purchase."⁵⁹ One can argue, for example, that P2PL platforms are the online equivalents of prominent shopping brands/shop owners that allow multiple retailers and service providers to

http://www.hks.harvard.edu/fs/akhwaja/papers/PeerLending_09.pdf, [Accessed May 15, 2014]; M. Lin, N.R. Prabhala and S. Viswanathan, "Judging borrowers by the company they keep: friendship networks and information asymmetry in online peer-to-peer lending" (2013) 59(1) *Management Science* 17; J. Duarte, S. Siegel and L. Young, "Trust and credit: the role of appearance in peer-to-peer lending" [2012] 25(8) *Review of Financial Studies* 2455.

⁵⁶ R.C. Mayer, J.H. Davis and F.D. Schoorman, "An integrative model of organizational trust" (1995) 20 *Academy of Management Review* 709.

⁵⁷ A. Ashta and D. Assadi, "An analysis of European online micro-lending websites" (2010) 6(2) *Innovative Marketing* 7 at 10-11.

⁵⁸ Ashta and Assadi, "An analysis of European online micro-lending websites" (2010) 6(2) *Innovative Marketing* 7 at 10.

⁵⁹ *Trento Sviluppo srl and another v Autorità Garante della Concorrenza e del Mercato* (Case C-281/12) [2013] WLR (D) 507.

use their shop spaces, subject to a certain level of control from the owners. The need to clarify the status of platform intermediation is of paramount importance, a question to which we now turn.

Clarifying the status of platform

Like an internet service provider, a platform is therefore an “inevitable actor”⁶⁰ in the P2PL processes that direct the course of a transaction and conduct of participants. This suggests that P2PL platforms play both passive and active roles in bringing lenders and borrowers together and regulating their relationship, a point that extends beyond the consumer protection realm into other regulatory fields. Take, for example, the data protection rules which grant data subjects access rights to data held by data controllers.⁶¹ Almost certainly, lenders and borrowers are equally data subjects whose personal data are possessed by platforms as data controllers. A platform is likely to be a data controller and not a data processor for being able to determine the purposes of data obtained from lenders and borrowers. Although platforms can perform data processing tasks such as obtaining, recording and holding information, loan repayment monitoring and collection, loan default management and recovery, provision of statements and complaints resolution,⁶² they can be data processors only if they act on behalf of data controllers. Lenders and borrowers are not in a position to act as data controllers and direct platforms on how to process data. Platforms are also more likely than lenders and borrowers to possess the capability to own and exploit intellectual property rights over relevant data.

⁶⁰ *UPC Telekabel Wien GmbH v Constantin Film Verleih GmbH and another (Case C-314/12)* [2014] Bus LR 541 (ECJ).

⁶¹ Data Protection Act 1998, s.1(1); *Durant v Financial Services Authority* [2004] FSR 573.

⁶² *In re Southern Pacific Personal Loans Ltd* [2013] EWHC 2485 (Ch) at [7].

In their capacity as brokers, platforms have access to information which they can communicate in ways neither borrowers nor lenders can do. A platform is in a position to moderate information provided by borrowers and to ensure that it is correct. It goes without saying that, without the involvement of platforms, inter-party misleading or inaccurate information would not be distributed. It is then arguable that the financial naivety of lenders may theoretically lean in their favour should they wish to establish a platform's duty of care. However, platforms rarely, if ever, undertake to provide financial advice to lenders for each transaction. Quite the opposite, they make it clear to participants that they are not party to lending transactions. Although they connect lenders with borrowers, platforms' services apparently exclude providing advice to lenders on the suitability or risks involved in a particular borrower or vice versa. This suggests that online P2PL does not seem to fit within existing consumer investment regulatory regimes. For example, key to the application of the Financial Instruments Directive⁶³ to investment service and portfolio management is investment advice defined as "the provision of personal recommendation to a client."⁶⁴ Generally, P2PL platforms refrain from making personal recommendations to lenders in their business structures and therefore can avoid the suitability and appropriateness obligations imposed by article 19 of the Financial Instruments Directive and article 52 of Directive 2006/73/EC.⁶⁵

⁶³ Parliament and Council Directive 2004/39/EC of 21 April 2004 on markets and financial instruments OJ 2004 L145 1, article 4.

⁶⁴ *Genil 48 SL v Bankiter SA* (Case C-604/11) [2013] Bus LR 1132.

⁶⁵ Commission Directive 2006/73/EC of 10 August 2006 implementing Directive 2004/39 as regards organisational requirements and operating conditions for investment firms and defined terms of that Directive OJ 2006 L241 26.

The question then is how to define the role of platforms in P2PL. One could compare P2PL platforms, by analogy, to internet search engines. General search engines such as Google allow users to locate webpages even when they are unaware of specific internet addresses or to find a selection of webpages concerning chosen topics.⁶⁶ Google enables users to do this by entering terms in a search field and clicking the search button, while it constantly updates an index of billions of webpages that allows it to respond to users' search requests.⁶⁷ At some point, Google search results would display two types of results: "organic search results" that are ranked in order of relevance to the user's search terms; and "sponsored links" that are in the form of advertisements created by or at the direction of advertisers paying Google to display the links. However, Google has no control over users' search terms or the material available on various websites it indexes.

In *Google Inc v Australian Competition and Consumer Commission*,⁶⁸ the Australian Competition and Consumer Commission sought to establish that Google had contravened section 52 of the Australian Trade Practices Act 1974 which prohibits misleading and deceptive business conduct directly by producing or creating misleading sponsored links. Google sought to rely on section 85(3) which provides a defence for a person whose business it is to publish or arrange for publication of advertisements and who has received an advertisement for publication in the ordinary course of business not knowing and having no reason to suspect that its publication contravenes section 52. The Australian High Court held that Google does not author the sponsored links it displays or publishes.⁶⁹ Each aspect of sponsored links is determined by advertisers and the automated response of Google's search

⁶⁶ *Google Inc v Australian Competition and Consumer Commission* [2013] HCA 1 at [19].

⁶⁷ *Google* [2013] HCA 1 at [20].

⁶⁸ *Google* [2013] HCA 1.

⁶⁹ *Google* [2013] HCA 1 at [68].

engine is determined by users' search requests. The nature of the internet and the technology behind the display of sponsored links following consumers' search requests requires Google to "respond" to requests, but this merely amounts to the assembly of information provided by others for the purpose of displaying advertisements directed to Google's users. Consequently, the court saw Google as just a means of communication between advertisers and consumers.⁷⁰ The fact that Google staff had assisted advertisers in selecting keywords that would match websites to internet users' search terms did not demonstrate that Google's personnel, rather than advertisers, had chosen relevant keywords nor created, endorsed or adopted them.

Google's case therefore suggests that online intermediaries are not liable for third party information. A similar approach to P2PL will exclude platforms from liability to lenders for misleading, deceptive or inaccurate statements provided by borrowers. Lenders bear losses arising from such statements unless a basic duty to verify borrowers' information is imposed on platforms. Just as internet search engines match users' search terms to related websites, P2PL platforms match lenders' search for borrowers of particular ratings grades, particular borrowing purposes or other search criteria to borrowers that correspond with the search criteria. Platforms also match borrowers to lenders willing to lend at desired interest rates. As a facilitator, a platform has no control over the risk choices of lenders and, consequently, the list of borrowers drawn up by a search. Following *Google's* reasoning, platforms may not be liable for misleading and inaccurate borrowers' listings by merely communicating information the borrowers provided.

Platforms are arguably akin to meta-search engines because of the significant level of control they exercise in data translation, transfer and utilisation. Meta-search engines play a more

⁷⁰ *Google* [2013] HCA 1 at [69].

active role than Google and other general search engines by systematically reutilising the contents of other databases in translating end users' search terms.⁷¹ However, a more analogous intermediation to P2PL platforms seems to be a developer of an integrated set of computer programs that enables users to undertake data processing and statistical analysis tasks. The independent nature of users' tasks does not preclude the existence of the developer's ownership of intellectual property over such programs.⁷² P2PL platforms similarly display some "ownership" of the processes that enable lenders and borrowers to independently take transactional decisions. Platforms provide an asymmetrical environment where lenders and borrowers do not actually meet to discuss and agree on transactional terms, such as method and time of repayments, which are largely determined by platforms. P2P lenders cannot, for instance, provide the borrowers with an accurate percentage rate of charge (APR) since each lender lends a small fraction of the loan. The rules on APR⁷³ can apply to P2PL only if the actively coordinating role of the platforms is recognised. Platforms are also more likely than lenders to be able to impose credit limits on borrowers and fees for over limit, late payment, non-payment, underpayment, dishonoured payments and other penalties. It is instructive that in consumer credit terms such as repayment instalments are considered as essential contractual obligations.⁷⁴

A possible argument from this description of the P2PL processes is that if regulations do not deem platforms as parties to lender-borrower contracts or agents of either lenders or

⁷¹ *Innoweb BV v Wegener ICT Media BV and another* (Case C-202/12) [2013] WLR (D) 512.

⁷² See *SAS Institute Inc v World Programming Ltd* (Case C-406/10) [2013] Bus LR 941.

⁷³ See Consumer Credit (Agreements) Regulations 2010 Sch. 1, para.13; The Consumer Credit (Total Charge for Credit) Regulations 2010, reg.2; *Perenicova v SOS Financ Spol s ro* (C-453/10) [2012] 2 All ER (Comm) 907 (ECJ (1st Chamber)).

⁷⁴ See *Kásler and another v OTP Jelzálogbank Zrt* (Case C-26/13) [2014] WLR (D) 180, [2014] Bus LR 664.

borrowers, at the least platforms should be regarded as fiduciaries. The significance is that a fiduciary has good faith obligations and is required to disclose material facts to a lender even if the fiduciary is not the borrower.⁷⁵ It is recognised in market abuse regulation, for example, that a fiduciary has the duty to make full disclosure to market participants.⁷⁶ However, a party's position as an intermediary does not necessarily impose a disclosure obligation. This is confirmed by some recent cases involving the non-disclosure of substantial commissions by lenders/intermediary for an associated insurance company.⁷⁷ On the other hand, P2PL platforms often rely on credit ratings of borrowers provided either by third party credit ratings agencies, or by themselves, as a way to inspire the trust of lenders in the borrowers' ability to pay back, albeit the final decision on the risk level of borrowers lies with the lender. Theoretically, there are two ways P2PL platforms can be liable for losses suffered by lenders for relying on incorrect or misleading credit ratings. Firstly, platforms can be liable for communicating misleading or incorrect information originally provided by borrowers either through information gathered to produce credit ratings or through additional information posted on P2PL discussion boards. *Google's case* suggests that this is unlikely to be the legal position. Another possible barrier is the common law objection to damages award for pure

⁷⁵ *Niru Battery Manufacturing Co. v Milestone Trading Ltd (No. 1)* [2003] EWCA Civ 1446; *Horn v Commercial Acceptances Ltd* [2011] 1757 (Ch); *Yam Seng Pte Ltd v International Trade Corp Ltd* [2013] EWHC 111 (QB).

⁷⁶ *Chiarella v United States*, 445 US 222 (1980) at 240-243, Burger CJ dissenting; E. Avgouleas, *The mechanics and regulation of market abuse- a legal and economic analysis* (Oxford: Oxford University Press, 2000), 198.

⁷⁷ *Harrison v Black Horse Ltd* [2011] EWCA Civ 1128, [2012] Lloyd's Rep IR 521; *Plevin v Paragon Personal Finance Ltd, Conlon v Black Horse Ltd* [2013] EWCA Civ 1658, [2014] Bus LR 553. *Plevin* is presently on appeal before the Supreme Court.

economic loss in the absence of a contractual relationship between the platforms and the lenders.⁷⁸

Secondly, platforms can be liable for poor advice to lenders through credit ratings they supply by establishing a fiduciary duty of care towards lenders. However, the common law suggests that it is possible but unlikely for platforms to hold a fiduciary duty towards P2P lenders. By analogy to the traditional lender-borrower dichotomy, a long-standing general principle is that unless a bank clearly undertakes to advise a customer, it is under no duty to provide advice on the suitability or risks of a particular transaction from that customer's perspective.⁷⁹ There is no duty if a "bank did not cross the line which separates, on the one hand, the activity of giving information about and selling a product and, on the other hand, the activity of giving advice."⁸⁰ For example, in *Williams & Glyn's Bank v Barnes*⁸¹ an experienced businessman borrowed £1 million from a bank when his company was already heavily indebted to the same bank. When the company became insolvent and the bank called in the personal loan, the businessman argued that the bank breached its duty to him in providing the personal loan knowing that his company was experiencing difficulties. The court held that the bank had no duty to advise unless there was a clear assumption of responsibility.

⁷⁸ See P. Giliker, "Revisiting pure economic loss: lessons to be learnt from the Supreme Court of Canada?" (2005) 25 *Legal Studies* 49.

⁷⁹ See *Hedley Byrne & Co Ltd v Heller & Partners Ltd* [1964] AC 465.

⁸⁰ *Green and another v Royal Bank of Scotland plc (Financial Conduct Authority intervening)* [2013] EWCA Civ 1197, [2014] Bus LR 168 at [23].

⁸¹ *Williams and Glyn's Bank Ltd v Barnes* [1981] Com LR 205.

Williams may be contrasted with *Verity and Spindler v Lloyds Bank plc*.⁸² The claimants in *Verity* specifically sought the advice of a bank manager on the prudence of a transaction. The bank manager, who assumed the role of financial advisor, had been negligent in the advice provided. It was particularly significant that in establishing the request for financial advice the claimants were financially unsophisticated and the bank's brochure advertised free financial advice. In the more recent case of *Plevin v Paragon Finance*,⁸³ the critical factors for liability was a broker's advertisement of its readiness to find "the finance plan that's best for you" and its conduct of a demands, needs and suitability assessment for the borrower. *Verity* and *Plevin* are unlikely to apply to P2PL where platforms refrain from advertising and giving free or paid advice. Moreover, to regard credit ratings devised by external agencies as potentially misleading advice by platforms is unlikely to happen since platforms merely supply the credit ratings and communicate information borrowers provided to lenders.

Nevertheless, platforms' role in P2PL is not entirely passive. Platforms, for instance, provide supportive administrative processes for P2PL and grades and analyses potential borrowers.⁸⁴ Lenders are dependent on platforms and third party businesses to recuperate losses from defaulting borrowers.⁸⁵ In the worst case scenario where a platform collapses, lenders cannot independently pursue debt collection.⁸⁶ Independent identification of borrowers and their

⁸² *Verity and Spindler v Lloyds Bank plc* [1995] CLC 1557.

⁸³ *Plevin* [2013] EWCA Civ 1658 at [30-31], [43].

⁸⁴ Zeng, "Legal regulations in P2P financing in the U.S. and Europe" at 233.

⁸⁵ E.C. Chaffee and G.C. Rapp, "Regulating online peer-to-peer lending in the aftermath of Dodd-Frank: in search of an evolving regulatory regime for an evolving industry" (2012) 69 *Washington and Lee Law Rev* 485 at 506.

⁸⁶ Chaffee and Rapp, "Regulating online peer-to-peer lending in the aftermath of Dodd-Frank: in search of an evolving regulatory regime for an evolving industry" (2012) 69 *Washington and Lee Law Rev* 485.

location is difficult because of the anonymity of online P2PL users.⁸⁷ Although anonymity may be beneficial by preventing undue distribution of personal information and the use of intimidation to recuperate debt, it results in complete reliance on platforms which are in fact unreliable debt recovery agents.⁸⁸ For example, many lenders were left with minimal chance of recovering their money when Quakle, a UK P2PL platform, collapsed in 2011.⁸⁹

In the UK, unlike bank customers, lenders on P2PL platforms are not covered by the Financial Services Compensation Scheme (FSCS), a compensation fund of last resort for customers of financial services firms authorised by the FCA and the Prudential Regulation Authority.⁹⁰ The FSCS protects deposits, insurance policies and home finance and pays compensation to customers where firms have stopped trading or are in default.⁹¹ Bank depositors usually qualify for a guarantee of savings to a maximum of £85,000. However, lenders in loan-based P2PL have no recourse to the FSCS for the monies lent to borrowers should platforms fail or borrowers default on repayments although un-lent funds that platforms hold in bank accounts would be within the remit of the FSCS.⁹² Platforms may voluntarily choose but are not legally required to provide a similar safety net for lenders.

⁸⁷ C. Reed, *Making laws for cyberspace* (Oxford: Oxford University Press 2012), 50.

⁸⁸ Chaffee and Rapp, "Regulating online peer-to-peer lending in the aftermath of Dodd-Frank: in search of an evolving regulatory regime for an evolving industry" (2012) 69 *Washington and Lee Law Rev* 485 at 506

⁸⁹ R. Powell, "The Truth Behind Quakle's Collapse" (21 December 2011), <http://www.lovemoney.com/news/credit-cards-current-accounts-and-loans/loans/13799/the-truth-behind-quakles-collapse>, [Accessed January 11, 2014].

⁹⁰ Financial Services Compensation Scheme, "About us. What is FSCS" <http://www.fscs.org.uk/what-we-cover/about-us/> [Accessed April 18, 2014].

⁹¹ Financial Services Compensation Scheme, "About us. What is FSCS" <http://www.fscs.org.uk/what-we-cover/about-us/> [Accessed April 18, 2014].

⁹² Financial Conduct Authority, (Policy Statement, PS14/4) at 17.

Ratesetter's provision fund is an example.⁹³ Similarly, Zopa's "safeguard fund" introduced in April 2013 and held in trust by P2PS Limited would intervene to repay loans plus interest in the event that a borrower default on four loan repayments. Not all platforms have this type of fund and even if they do, there is no guarantee that such funds would not prematurely run out.

The above account demonstrates that the online P2PL system has not completely ridden its lending market of intermediaries. The fact is that platforms intermediate between lenders and borrowers that use their service, including the provision of auction mechanisms. Although platforms are not considered to be the direct lenders to borrowers, detailed examination of cash flow movements on such sites indicates that cash does not move directly from the lender to the borrower, and neither do repayments move directly from borrowers to lenders.⁹⁴ Rather, platforms tend to take on an intermediary role of exchange facilitation while taking commissions.⁹⁵ P2PL platforms are therefore not merely a communication post office-like or facilitative general search engine-like entity. Notwithstanding platforms' obvious attempts to avoid being labelled a party to contracts between lenders and borrowers, the reality is that neither the lender nor the borrower knows much about the other party and the complexities of the lending transaction. Platforms, in contrast, are likely to have the necessary information and expertise.

Strictly speaking, platforms are not parties to the borrower-lender contract and consequently there is no "business" counterparty in the traditional consumer protection approach since both

⁹³ A. Cortese, *Locavesting: The revolution in local investing and how to profit from it* (Hoboken, NJ: John Wiley, 2011).

⁹⁴ Ashta and Assadi, "An analysis of European online micro-lending websites" (2010) 6(2) *Innovative Marketing* 7 at 8.

⁹⁵ Ashta and Assadi, "An analysis of European online micro-lending websites" (2010) 6(2) *Innovative Marketing* 7 at 8, 16.

lenders and borrowers are the sole contractual parties and are not ordinarily acting in the normal course of business. Being that platforms play some active roles, the classical bilateral business-versus-consumer protection approach does not sit comfortably with the tripartite model largely practised in online P2PL. For instance the statutory obligation to provide statements of loans to borrowers under s.77A of the Consumer Credit Act 1974⁹⁶ assumes that the existence of a powerful duty-bearing lender acting in the normal course of business and playing an active role in the transaction. The idea of protecting one party against the other stronger party reflects the business-to-consumer understanding underpinning the UK and EU consumer policies. For example, in *Director General of Fair Trading v First National Bank plc*, Lord Steyn observed that consumer law “treats consumers as presumptively weaker parties and therefore fit for protection from abuses by the stronger contracting parties.”⁹⁷ In *Océano Grupo Editorial SA v Rocio Murciano Quintero* then, the ECJ stated that the EU consumer protection approach is based on the idea that the consumer is in a weaker position compared to the seller, particularly regarding bargaining power and knowledge.⁹⁸ Rather than be seen through the lens of the orthodox bilateral business-to-consumer relationship, online P2PL suggests the existence of an integrated organisation of three main parts- platform, lender and borrower.⁹⁹ As the systems theory demonstrates, a holistic view recognising the interplay of the parts of the P2PL entity is required because

⁹⁶ See *JP Morgan Chase Bank NA v Northern Rock (Asset Management) plc* [2014] EWHC 291 (Ch), [2014] 1 WLR 2197.

⁹⁷ *Director General of Fair Trading v First National Bank plc* [2001] UKHL 52, [2002] 1 AC 481 at [31], per Lord Steyn.

⁹⁸ *Océano Grupo Editorial SA v Rocio Murciano Quintero* [2000] ECR I-4941.

⁹⁹ This also follows from the Consumer Credit Act ss.56, 75.

problems in a part have consequences for the other parts.¹⁰⁰ This article will therefore proceed to discuss the implications of the orthodox consumer protection approach to P2PL.

Beyond pre-contract protection

Consumer protection regulation is traditionally regarded as a body of laws designed to prevent individuals from taking on excessive risks¹⁰¹ and to protect consumers' interests at the individual transaction levels.¹⁰² Relevant "harm" is considered a failure in individual transactions and usually occurs at the origination stage or in the substance of a transaction.¹⁰³ This explains why most consumer protection measures such as information disclosure focus on the pre-contractual stage of transactions and aim to prevent failures that inhibit consumers' ability to enhance their welfare.¹⁰⁴ For example, bargaining power and knowledge is often highlighted in the EU consumer policy and suggests an approach that leans heavily towards the pre-contractual stage of transactions. Although EU consumer law has introduced post-contractual withdrawal and cancellation rights in favour of consumers, it is only applicable in limited cases such as distance and doorstep selling to enable consumers

¹⁰⁰ P.M. Senge, *The fifth discipline: The art and practice of the learning organization* (New York: Doubleday, 1990).

¹⁰¹ E.F. Gerding "The subprime crisis and the link between consumer financial protection and systemic risk" (2009) 5 *Florida International University Law Review* 93 at 94; O. Bar-Gill and E. Warren, "Making credit safer" (2008) 157 *U. Pa. L. Rev.* 1.

¹⁰² M. Huffman, "Bridging the divide? Theories for integrating competition law and consumer protection" (2010) 6(1) *Euro C J 7*.

¹⁰³ Huffman, "Bridging the divide? Theories for integrating competition law and consumer protection" (2010) 6(1) *Euro C J 7* at 9.

¹⁰⁴ Huffman, "Bridging the divide? Theories for integrating competition law and consumer protection" (2010) 6(1) *Euro C J 7* at 9.

to reverse irrational decisions.¹⁰⁵ As confirmed in the new Consumer Rights Directive,¹⁰⁶ withdrawal/cancellation rights in such contracts protect consumers who are vulnerable because of the lack of opportunity to inspect goods and to meet, discuss and agree on contractual terms.¹⁰⁷

Limiting consumer protection to pre-contractual scenarios only seems too restrictive and inadequate for P2PL because of its peculiar nature. Although P2P lenders, for example, face information asymmetries before agreeing to lend, the main concern is the execution and performance of loan contracts, including prompt loan repayments and debt collection. Unlike banks, P2P lenders are largely incapable of establishing and operating their own debt recovery arrangements. The provision of appropriate amount of pre-contractual information may be necessary but it is an insufficient protection for such lenders. This suggests the need for a more interventionist approach to the post-contractual side of P2PL transactions rather than the traditional focus on pre-contract protection.

The new FCA regulations therefore seem right in attempting to protect lenders from adverse situations following the formation of P2P loan contracts. For example, a loan-based P2PL platform is required to take reasonable steps to have arrangements in place to ensure the continued management and administration of P2P loan agreements in the event that it fails or

¹⁰⁵ C. Twigg-Flesner and R. Schultze, “Protecting rational choice: Information and the right of withdrawal” in G. Howells, I. Ramsay, T. Wilhelmsson and D. Kraft (eds.), *Handbook of research on international consumer law* (Cheltenham: Edward Elgar, 2010), 130.

¹⁰⁶ Directive 2011/82/EU of the European Parliament and of the Council of 25 October 2011 on consumer rights OJ L 304, 22.11.2011, p.0064-0088 implemented in the UK by the Consumer Rights Act.

¹⁰⁷ J.A. Luzak, “To withdraw or not to withdraw? Evaluation of the mandatory right of withdrawal in consumer distance selling contracts taking into account its behavioural effects on consumers” (2014) 37 *Journal of Consumer Policy* 91 at 94.

ceases to carry on the business.¹⁰⁸ This provision protects lenders from the uncertainty and costs of recuperating loan payments from unidentifiable and anonymous borrowers, but it has a limited scope. There is no prescribed form of arrangements and platforms are free to design and introduce processes that suit their business model.¹⁰⁹ Although this lack of uniform standards is understandably in the interests of balancing regulatory costs and benefits,¹¹⁰ it still leaves the meaning of an appropriate arrangement open to debate between platforms and regulators. Whilst this allows a more tailored procedure, it could lead to more work for regulators in the long term. Should an arranged third party loan administrator fail, the appropriateness of the procedure would arise and be dealt with by regulators on a firm-by-firm basis. The FCA has not specified the consequences of the failure of arrangements, culpability for failures and, most importantly, lenders' alternative recourse. Platforms are only required to warn lenders of the risks involved and that safeguarding measures may not work as expected.¹¹¹ Potential lenders are expected to take these factors into consideration or at least be aware of them when deciding to lend on particular platforms and will ultimately bear the risk of failure. This approach therefore follows the rational choice model of consumer protection that emphasises limited pre-contractual disclosure and leaves little room for the outcomes of consumer decisions such as repayment default and inability to recuperate debt as well as post-contractual remedies such as reimbursement of money paid and provision of new services.

¹⁰⁸ Crowdfunding and the Promotion of Non-Readily Realisable Securities Instrument 2014, Annex B, 4.1.8A; Financial Conduct Authority, (Policy Statement, PS14/4) at 28.

¹⁰⁹ Crowdfunding and the Promotion of Non-Readily Realisable Securities Instrument 2014, Annex B, 4.1.8; Financial Conduct Authority, (Policy Statement, PS14/4) at 28.

¹¹⁰ Financial Conduct Authority, (Policy Statement, PS14/4) at 28.

¹¹¹ Financial Conduct Authority, (Policy Statement, PS14/4) at 28.

Rational choice, behaviouralism and information

Rational choice theory and behaviouralism are the main philosophical approaches to consumer protection and regulating consumer welfare. While efficiency is the main goal of rational choice theory, behaviouralism focuses on fairness. Rational choice is the idea that people are rational economic beings who, when faced with a number of choices, will choose the one that maximises their welfare.¹¹² Prices in the market reflect the choices of market participants and thus guarantee market efficiency.¹¹³ Rational choice theory supports the libertarian view that participants in lending transactions should be free to make decisions and assume risks arising from such decisions.¹¹⁴ Consequently, rational choice theorists favour a non-interventionist approach to consumer protection, use of limited regulatory tools such as information disclosure¹¹⁵ and promotion of competition between businesses to provide

¹¹² F. Akinbami, "Financial services and consumer protection after the crisis" (2011) 29(2) *International Journal of Bank Marketing* 134; J. Hanson and D. Yosifon, "The situational character: A critical realist perspective on the human animal" (2004) 93 *Georgetown Law Journal* 1 at 8-15, 138-152.

¹¹³ G. Sindler, "Behavioural finance and investor protection regulations" (2011) 34 *Journal of Consumer Policy* 315 at 317.

¹¹⁴ D. Baker and M. Breitenstein, "History repeats itself: Why interest rate caps pave the way for the return of the loan sharks" (2010) 127 *Banking Law Journal* 581; A. Labat and W. Block, "Money does not grow on trees: an argument for usury" (2012) 106 *Journal of Business Ethics* 383.

¹¹⁵ Howells, "The Potential and Limits of Consumer Empowerment by Information" (2005) 32 *Journal of Law and Society* 349; T. Wilson, N. Howell and G. Sheehan, "Protecting the most vulnerable in consumer credit transactions" (2009) 32 *Journal of Consumer Policy* 117 at 120-125.

consumers with an optimum number of choices.¹¹⁶ As the EU Consumer Protection Strategy 2007-2013 confirms, the aim is the responsabilisation of consumers towards promoting and protecting their interests.¹¹⁷

The implication is that information is essential for consumers to make efficient and rational choices on consumption and resource allocation.¹¹⁸ Rational choice is based on the assumptions that consumers will have enough information to base their preferences on and make clear and rational choices.¹¹⁹ It also assumes that consumers will, when making decisions, collect and evaluate the information available and base their decisions on this information alone.¹²⁰ In the context of online P2PL, this would imply that regulation should only ensure that platforms provide lenders and borrowers with as much accurate information as is necessary for them to enter into the right transactions. This non-interventionist approach is in fact imbibed by P2PL business models such as Zopa. In such cases, platforms as non-parties to lending contracts merely match consumers to one another and facilitate communication of both private information (credit scoring) and public information (from the P2PL discussion boards). Platforms provide lenders with credit reports and in some cases teach them how to use such reports but effectively leaves it to lenders to make a choice based on the reports and a number of investing heuristics.

¹¹⁶ L. Sylvan, “Activating competition: the consumer-competition interface” (2004) 12 *Competition and Consumer Law Journal* 191.

¹¹⁷ European Union Consumer Policy Strategy 2007-2013, at 4.

¹¹⁸ G.M. Ruiz, “Understanding the Pro-Plaintiff Bias in Consumer Protection Legal Processes” (2014) 37 *Journal of Consumer Policy* 113 at 119.

¹¹⁹ M. Bertrand and A. Morse, “Information disclosure, cognitive biases, and payday borrowing” (2011) 66 *Journal of Finance* 1865; Sindler, “Behavioural finance and investor protection regulations” at 317.

¹²⁰ Sindler, “Behavioural finance and investor protection regulations” (2011) 34 *Journal of Consumer Policy* 315 at 317.

However, this rational choice approach can be problematic for several reasons. Firstly, information asymmetry often exists in consumer transactions because consumers are significantly less able than traders to collect and process information.¹²¹ Consequently, regulators generally seem to select disclosure as the default consumer protection method.¹²² The idea is that market inefficiency arising from significant differences in information endowments between market participants can be resolved through accurate disclosures that can ensure an information balance and enable informed choices by market participants.¹²³ However, this rationale has doubtful application to P2PL. Platforms can and often do provide general information about how to lend and choose borrowers to lend to, but they do not provide further information to lenders about individual transactions which they are not party to. Platforms essentially present information borrowers provided for lenders and often refrain from doing more. Even if platforms owe a duty to ensure that borrowers' credit ratings are accurate and presented to lenders in a way they can understand and use it, it does little to balance the risk to lenders. Whilst disclosure might lead to improvements in the quality and extent of consumer information, it has little bearing on consumers' ability to comprehend the information provided.¹²⁴

Regulators often attempt to correct the information asymmetry by requiring increasing amounts of information. However, this may not always suit P2PL as the participants may not

¹²¹ Twigg-Flesner and Schultze, "Protecting rational choice: Information and the right of withdrawal" at 145.

¹²² S. Lumpkin, "Consumer protection and financial innovation" (2010) *OECD J Finance Mark Trends* 117 at 122.

¹²³ Lumpkin, "Consumer protection and financial innovation" (2010) *OECD J Finance Mark Trends* 117 at 122.

¹²⁴ Lumpkin, "Consumer protection and financial innovation" (2010) *OECD J Finance Mark Trends* 117 at 134

have much investment or lending knowledge and expertise.¹²⁵ It is also more likely the case that the lender's main risk of loss of money through borrowers' default¹²⁶ cannot be solved through more and more information or more and more appropriately presented information. Large amounts of information then become an internal transaction cost and consumers who engage in P2PL for personal reasons rather than business gain may disregard it as being too complex or too much.¹²⁷ Although rational choice theory assumes that individuals are willing to read the information provided, behavioural theory shows that too much information may not be a good thing. The mis-selling of payment protection insurance (PPI), a current controversial issue in the UK, demonstrates this type of consumer behaviour. In cases where PPI was sold to consumers on a non-advised basis- the financial firm only has a duty to provide information consumers need to make an informed choice and to present it in a clear, fair and not misleading manner¹²⁸ - it is likely that many consumers either did not read the terms and conditions of the agreement, understand the product literature, or seek further advice.

¹²⁵ Sindler, "Behavioural finance and investor protection regulations" (2011) 34 *Journal of Consumer Policy* 315 at 318.

¹²⁶ S.D. Strauss, *Get your business funded: Creative methods for getting the money you need* (Hoboken, NJ: John Wiley, 2011).

¹²⁷ Sindler, "Behavioural finance and investor protection regulations" (2011) 34 *Journal of Consumer Policy* 315 at 322.

¹²⁸ The Financial Ombudsman Service, "Payment protection insurance (PPI) case studies. Case studies three and five", http://www.financial-ombudsman.org.uk/publications/technical_notes/ppi/PPI-case-studies.html#cs3, [Accessed June 29, 2014].

Secondly, behavioural research demonstrates that consumer decisions are often irrational and influenced by emotion¹²⁹ and risk-underestimating and information-averse optimism.¹³⁰ People do not always make rational choices or act in ways that maximise their personal welfare. Rather, the simplification of complicated information through the use of heuristics combined with the natural tendency of people to copy each other's choices¹³¹ can lead to poor decisions. Herding, for example, is a typical distorted irrational behaviour often displayed by individuals.¹³²

Thirdly, the main source of risk information for P2P lenders is credit ratings provided by platforms or subcontracted credit ratings agencies. As third party sources of information, P2PL platforms and credit rating agencies may not always be what they appear to be. It is not unfeasible, for example, to conceive of shell companies set up as P2PL platforms being used as vehicles to commit fraud. The collapse of Enron and the recent global financial crisis indicated that in some cases information provided by ratings agencies lack credibility due to a conflict of interests between issuers paying for ratings services and the agencies' need to

¹²⁹ O. Ben-Shahar and E.A. Posner, "The right to withdraw in contract law" (2011) 40 *The Journal of Legal Studies* 115 at 119-120; H. Eidenmüller, "Why withdrawal rights?" (2011) 1 *European Review of Contract Law* 1 at 10.

¹³⁰ H. Luth, *Behavioural economics in consumer policy* (Antwerp: Intersentia, 2010), 148; Luzak, "To withdraw or not to withdraw? Evaluation of the mandatory right of withdrawal in consumer distance selling contracts taking into account its behavioural effects on consumers" at 96-98.

¹³¹ J. Hanson and D. Yosifon, "The situational character: A critical realist perspective on the human animal" (2004) 93 *Georgetown Law Journal* 1, 90-114; J.D. Hanson and D.A. Kysar, "Taking behaviouralism seriously: The problem of market manipulation" (1999) 74 *New York University Law Review* 630; Sindler, "Behavioural finance and investor protection regulations" at 324.

¹³² Sindler, "Behavioural finance and investor protection regulations" (2011) 34 *Journal of Consumer Policy* 315 at 324.

remain objective.¹³³ Arguably, this type of conflict of interests may not apply to online P2PL since borrowers may not be in a position to develop tainted relationships with credit ratings agencies in a way that affects transactions. However, it still provides an example of the fact that P2PL participants often base their decisions on risk assessments of information providers they may not have the tools or capabilities to verify or monitor. Even when lenders have access to borrowers' credit scores, they may not have access to comparison scores to be able to adjust minimum scores for loans and other requirements that reflect the state of the market. The lender and borrower are not in a contractual relationship with credit rating agencies and, therefore, cannot bring contractual claims against false and misleading information. A tortious claim for negligence is also unlikely because the requirement of assumption of responsibility¹³⁴ can be avoided by an appropriate disclaimer from credit rating agencies to platforms, which is commonplace in the credit rating industry.¹³⁵ Platforms, on the other hand, can prove a contractual relationship with credit rating agencies and bring contractual claims against inaccurate statements. A regulatory duty on platforms to provide fair and accurate information to lenders and borrowers may make it easier for platforms to prove damages against credit rating agencies.

Fourthly, there may be information asymmetries between contracting parties in any one transaction that create opportunities for fraud.¹³⁶ This is particularly important for the online

¹³³ See H. McVea, "Credit rating agencies, the subprime mortgage debacle and global governance: the EU strikes back" (2010) *I.C.L.Q.* 701.

¹³⁴ *Caparo Industries plc v Dickman* [1990] 2 AC 605.

¹³⁵ See P. Yeoh, "Self-regulation, regulation, co-regulation: the credit rating industry case" (2013) 2 *Journal of Business Law* 186.

¹³⁶ M.R. Darby and E. Karni, "Free competition and the optimal amount of fraud" (1973) 16 *Journal of Law and Economics* 67.

P2PL financial market because of its aim of encouraging and facilitating transactions between strangers.¹³⁷ A party may attempt to deceive the other through false information such as when borrowers commit credit score fraud or falsify documents to obtain loans. It is possible to legally require borrowers to provide more detailed information about their financial situation, including whether they are or have been involved in bankruptcies and financial difficulties, the amount of existing debts, borrowing history and other details. However, P2P borrowers may not be worthy civil claim defendants for lenders in comparison to platforms with greater financial means.

Being that the risk is not between a platform and a consumer, but between two different consumers who under some models may not know each other, a regulatory strategy that overcomes the strict legal structure of P2PL transactions may be necessary. With reference to the previous discussion about power in consumer relationships, this suggests that, in the interests of lender protection for example, regulations may consider in greater detail whether it is worth holding P2PL platforms liable as a connected party for the conduct of participants. The information paradigm can work in this context only if the law recognises the connected liability of platforms either as deemed principals or agents, after all platforms provide the critical link between lenders and borrowers. This recognition of a tripartite relationship is analogous to the connected creditor liability in consumer credit regulations, such as sections 56 and 75 of the Consumer Credit Act 1974.¹³⁸

¹³⁷ Ashta and Assadi, “An analysis of European online micro-lending websites” (2010) 6(2) *Innovative Marketing* 7 at 8.

¹³⁸ C.V. Hare, “Credit cards and connected lender liability” (2008) 3 *Lloyds Maritime and Commercial Law Quarterly* 333. See *Forthright Finance Ltd v Ingate (Carlyle Finance Ltd, Third Party)* [1997] 4 All ER 99; *Office of Fair Trading v Lloyds TSB Bank plc* [2007] UKHL 48; *Plevin* [2013] EWCA Civ 1658; *Scotland and another v British Credit Trust Ltd* [2014] WLR (D) 252.

FCA regulations: beyond non-interventionism in P2PL

This article has so far highlighted certain consumer protection issues that any regulatory regime needs to recognise to be able to limit the risks associated with online P2PL and provide adequate protection for both its lending and borrowing consumers. The potential and limitations of consumer protection regulation of P2PL will now be considered in the light of the recent regulatory intervention by the FCA. In view of the FCA's aim of ensuring proportionate regulation and the relatively embryonic condition of the P2PL market, it is highly unlikely that regulators will impose additional burdens on platforms in the near future. However, there is a degree of interventionism in the FCA's regulatory approach which rightly incorporates a number of consumer protection measures. The pre-contractual side of transactions are largely disclosure-based, whilst post-contractual measures include prudential requirements, client money rules and recourse to the Financial Ombudsman Service.

This is therefore a departure from the UK's non-interventionist "light-touch" regulation model linked by some to the uncontrolled systemic risks associated with consumer defaults in the recent financial crisis.¹³⁹ One could possibly argue that as the amounts lent by one P2P lender to a particular borrower constitutes a small fraction of the total loan facilitated by a platform and sourced from numerous lenders, the lender's risk and loss in the event of the borrower's default is too insignificant to warrant a more interventionist post-contract protection. However, P2P lenders and borrowers are part of wider society and can affect and be affected by it. It is not hard to assume that should the P2PL market continue to grow and matures into a major source of finance for individuals and businesses, the inability of a large number of borrowers to repay P2P loans can lead to a systemic financial crisis.

¹³⁹ Gerding "The subprime crisis and the link between consumer financial protection and systemic risk" (2009) 5 *Florida International University Law Review* 93 at 21.

One of the operational objectives of the FCA is, therefore, to strike a balance between the principles of consumer protection and consumer responsibility by adopting a differentiated approach that considers “appropriate” consumer protection in each situation.¹⁴⁰ The aim is to ensure that different consumers are dealt with in different ways, for example, by recognising that purchasers of pension policies and buyers of car insurance policies have different needs.¹⁴¹ Regulators are consequently expected to consider in each scenario what level of knowledge it is reasonable to expect from consumers, how complex are relevant financial products, the degrees of risk involved in different types of investment and transactions and differing levels of experience and expertise of different consumers.¹⁴² The Parliamentary Joint Committee argued that these factors are insufficient and need to be complemented by a corresponding responsibility on firms to act honestly, fairly and professionally in their customers’ best interests and, for example, by addressing consumers’ need for advice and information that is timely, accurate, intelligible and appropriately presented.¹⁴³ This argument, however, has a rational choice basis: information alone is not enough to improve consumers’ ability to make informed decisions if it is not easily understandable and accessible.¹⁴⁴

Consequently, the consumer protection regime of the FCA is chiefly based on disclosure as a means of ensuring that lenders have the fair and clear information they need to make

¹⁴⁰ Joint Committee on the draft Financial Services Bill, Session 2010-12 at [124], [125]; Financial Services Authority, “The Financial Conduct Authority: approach to regulation” (June 2011) at 17.

¹⁴¹ Joint Committee on the draft Financial Services Bill, Session 2010-12 at [124].

¹⁴² Joint Committee on the draft Financial Services Bill, Session 2010-12 at [124]. See Financial Services Act 2012 s.1C(2) (a), (b).

¹⁴³ Joint Committee on the draft Financial Services Bill, Session 2010-12 at [126].

¹⁴⁴ Joint Committee on the draft Financial Services Bill, Session 2010-12 at [127].

informed investment decisions.¹⁴⁵ A similar approach is followed in existing consumer credit rules as a “counterbalance” to the unequal bargaining relationship between commercial lenders and consumers.¹⁴⁶ The FCA has further adopted a principles-based regulatory approach that refrains from prescribing specific disclosures and their form and content. Rather, platforms are required to disclose appropriate and accurate information to their customers after identifying investment risks inherent in or relevant to their business models and the information their customers need to make informed decisions.¹⁴⁷ The underlying assumption is that P2PL business models vary¹⁴⁸ and each platform is in a better position than regulators to know the risks in their operations and their customers’ needs.

Another reason for essentially leaving platforms free to self-regulate disclosures to P2PL participants is in the interest of balancing regulatory costs and benefits.¹⁴⁹ This ensures that platforms are engaged in the regulatory process and allows consumer protection appropriately tailored to the operations of particular platforms. However, this method of business-oriented enforced self-regulation can lead to a lack of uniform information and disclosure standards amongst platforms. This can affect lenders’ ability to compare the risks of various platforms when choosing which platform to invest on and compound the information asymmetry faced by lenders and lead to confusion. A self-regulation approach does not take cognizance of the dominance of caveat emptor in the operation of online P2PL platforms and the great deal of

¹⁴⁵ Financial Conduct Authority, (Policy Statement, PS14/4) at 30.

¹⁴⁶ D.M. Collins, “Misleading APRs in consumer credit agreements: A new influence?” (2012) 7 *Journal of Business Law* 629.

¹⁴⁷ Financial Conduct Authority, (Policy Statement, PS14/4) at 31.

¹⁴⁸ Financial Conduct Authority, (Policy Statement, PS14/4) at 31.

¹⁴⁹ Financial Conduct Authority, (Policy Statement, PS14/4) at 15.

responsibility it places on inexperienced lenders. This arguably amounts to abandoning consumers to the risks of the market they operate in.¹⁵⁰ In the long run, this may not be good for the market if lenders build up too much negative experience from using P2PL platforms and lose confidence in the market and eventually abandon this investment method. Moreover, the prevalence of participants' anonymity and pseudonymity in the P2PL industry makes it difficult for effective consumer interactivity and information sharing. In other contexts, online consumer opinions and reviews constitute influential sources of information for consumers and the consumer-oriented self-regulation that may be necessary for the effectiveness of business-oriented enforced self-regulation.¹⁵¹

On the other hand, a purely interventionist approach is not totally satisfactory due to its regulatory burdens and costs. Moreover, the consumer-to-consumer nature of P2PL suggests the impracticality of a completely prescriptive regulation of platforms that normally act as bystanders to transactions. The structure of Zopa and other P2PL platforms indicate that a limited interventionist consumer protection approach fits most P2PL business models. Disclosure-based regulation is appropriate at the start of transactions when lenders make decisions on the basis of information collated by platforms from borrowers. A limited interventionist approach to disclosure requiring an element of financial education to improve consumer comprehension of relevant information may be useful. It is not out of place to require platforms to play a part in educating their customers about financial risks and

¹⁵⁰Akinbami, "Financial services and consumer protection after the crisis" (2011) 29(2) *International Journal of Bank Marketing* 13 at 15.

¹⁵¹ P. Repo, P. Timonen and K. Zilliacus, "Alternative regulatory cases challenging consumer policy" (2009) 32 *Journal of Consumer Policy* 289.

implications for their investments since disclosure actually imposes on consumers the responsibility of making sound choices based on the information provided.

Limiting the number of loans medium to high risk borrowers can take out at any one time on any P2PL platform is another possible regulatory measure. This limited interventionist measure would require communication between platforms and possibly the formulation of a borrower database of P2PL loans. The database could be managed through the P2P Association and governed by data protection laws. It may be accessible only to platform moderators and credit risk agencies, except where borrowers request copies of their personal information under the data protection law.

In any case, disclosure, financial education and other pre-contract measures may not be sufficient to protect lenders from potential problems that can occur during the lifespan of P2P loans. There are elements that cannot easily be predicted at the pre-contract stage such as the risk of a borrower's default, inflation risk and the possibility of the platform itself failing.¹⁵² This suggests that a more interventionist approach than pre-contractual requirement may be necessary to protect lenders and provide them with remedies for post-transaction events. For example, platforms' membership of a compensation scheme can tackle the problems of borrowers' bankruptcy and potential insolvency of platforms and resulting losses to P2P lenders. Compensation schemes provide lenders with the assurance that at least some of their money would be recoverable if all were to go wrong. It may be particularly useful for unsophisticated and financially illiterate lenders who lack the time, skill, information and resources required to monitor the financial health of borrowers and platforms ahead of default or insolvency. A compensation scheme goes some way in inspiring greater confidence in the P2PL market and possibly encouraging more investments and participation in the market.

¹⁵² Lumpkin, "Consumer protection and financial innovation" (2010) *OECD J Finance Mark Trends* 117 at 124.

However, there is the need to avoid a moral hazard from a regulated compensation scheme if P2P lenders rely heavily on regulators to prevent the fallout of insolvency or to bail them out if insolvency were to happen. Lenders can become careless, less prudent and free-riders of the state by passing the risk to regulators and tax-payers. Although this might not be an issue if borrowers' defaults are few and far between, there may be significant bailout costs where incidences are high or are coupled with either a platform's insolvency or inability and incompetence in debt collection. One way of addressing the moral hazard issue involves an element of consumer responsibility in the form of lender prudence by restricting lenders' recourse to a compensatory system. A compensation scheme could be limited to lenders that undertook reasonable steps to evaluate platforms and borrowers before committing funds for P2P loans. A possible candidate for protection is when lenders choose to lend to quasi-riskless borrowers like those rated grades A-B or previously classified as having a highly unlikely chance of default. In contrast, subprime loans and loans to grades C-D borrowers may be excluded from a compensation scheme as such loans imply the acceptance of responsibility for risky investments in the expectation of high returns.

In recognition of the tripartite nature of P2PL relationships, it may be useful to modify the existing scheme of the Financial Ombudsman Scheme (FOS).¹⁵³ The FOS determines disputes between consumer debtors and commercial lenders who hold Consumer Credit Act licences.¹⁵⁴ As it stands there is no room in the FOS scheme for P2P lender-platform disputes despite the fact that such lenders are essentially consumers in no position to bargain with platforms. Moreover, the lenders and borrowers have no remedial opportunity for direct

¹⁵³ Financial Services and Markets Act 2002 s.226A inserted by the Consumer Credit Act 2006 s.59.

¹⁵⁴ See E. Lomnicka, "Unfair credit relationships: five years on" (2012) 8 *Journal of Business Law* 713 at 716-717.

contact and dispute resolution since the inter-related P2PL contracts are initiated by and intricately linked to the platforms.

Entry authorisation and capital requirements are other methods of ensuring the efficiency of platforms and therefore inspiring confidence in the online P2PL market. A licensing system and capital requirements for platforms could help prevent future problems in the market and ensure that platforms are subject to similar standards, conduct of business rules and financial supervision.¹⁵⁵ This could potentially prevent poor business operations and inefficiencies and situations like Quakle's collapse from eroding confidence in the market. In this regard, compulsory schemes may be more effective than their voluntary counterparts. For example, the Operating Principles of the P2P Association require members to maintain funds calculated in accordance with Method A of the Payment Services Regulations 2009.¹⁵⁶ The benefit of the capital requirement in ensuring platform's liquidity is limited because the P2P Association is voluntary and at present has only three member platforms. It seems quite right that the FCA prudential regulations direct that all platforms must ensure that at all times their financial resources are not less than their financial requirements.¹⁵⁷

Conclusion

The internet has facilitated the relatively recent emergence of a growing P2PL industry as an online alternative to traditional bank and non-bank lending. P2PL presents both unrivalled opportunities for easy consumer-to-consumer lending and peculiar consumer protection challenges that confront its nascent regulation. An effective regulatory strategy has to

¹⁵⁵ P. Wood, *Law and Practice of International Finance* (London: Sweet & Maxwell, 2010), 328.

¹⁵⁶ Peer2Peer Finance Association, "Rules & Operating Principles", <http://www.p2pfinanceassociation.org.uk/rules-and-operating-principles>, [Accessed March 24, 2014].

¹⁵⁷ Crowdfunding and the Promotion of Non-Readily Realisable Securities Instrument 2014, Annex C, 12.2.

understand the overt and sometimes disguised factual and counterfactual contexts of the P2PL business model which demonstrate an active and controlling platforms' role. This article therefore situates the P2PL market in key consumer protection debates concerning the definition of a consumer, the degree and appropriateness of regulatory interventions, efficiency and fairness as consumer protection rationales, and disclosure and substantive intervention as regulatory strategies. By altering the characteristics of participants in a lending transaction, P2PL necessitates a reconsideration of what it means to be a consumer of financial services. Additionally, the bilateral business-versus-customer terminology of traditional consumer protection does not fit the P2PL consumer-to-consumer model that is in fact a tripartite relationship involving the intermediation of platforms that play more than passive, facilitative roles. These unique features of P2PL create the regulatory problem of the appropriate degree of consumer protection, particularly for lenders who are almost on all fours with borrowers as consumers.

The FCA has relied heavily on information regulation in its new P2PL regime and ruled out more interventionist approaches for the time being in the interest of proportionality. However, the inadequacies of the FCA regulatory regime include the classification of P2P lenders as retail investors, a term that disguises the lenders' true status as consumers of financial services. It is not even clear whether P2PL platforms are liable as intermediaries for any inaccurate or false financial information provided by borrowers. A more interventionist approach than business-oriented self-regulation and pre-contract information appears suitable for the P2PL industry. Protecting lenders from post-contractual risks such as borrower default and platform failure requires more than just clear and appropriate information. Possible substantive interventions include incorporating P2PL in the FOS scheme, licensing of platforms and compensation schemes for P2P lenders.

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