Peer-to-Peer Lending – A New Digital Intermediary, New Legal Challenges

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ABSTRACT

In an increasingly digitalised world, this article deals with peer-to-peer (P2P) lending as a new online source of financing, which differs from e.g. financing in traditional banks. The article elaborates on the following questions: How should P2P lending be put in the context of the existing legislation? Is the existing legislation sufficient to meet the impact that P2P lending may have on modern society? Or is new special legislation necessary? Lenders can be both individuals and companies, but the main focus of this article is on individuals. It includes the European Commission's Proposal for a Regulation on European Crowdfunding Service Providers (ECSP) for Business (COM/2018/0113 final) and parallels are drawn to syndicated loans known from banking. How P2P lending fits into the existing legal framework in regard to banks, payment services, money laundering and terrorist financing, consumer credit, investor protection etc. is still veiled in some uncertainty. The most remarkable example of the legal implications is the *case of TrustBuddy AB*. On 23 June 2014, the Danish financial supervisory authority (FSA) decided that the P2P platform, TrustBuddy AB, needed to be licensed as a bank. The FSA concluded that TrustBuddy AB was not a credit intermediary and in reality, the lenders were investors. To create a sound business and to promote an EU market for P2P lending, a further clarification and adjustment of the existing legislation may yet be needed; especially since there are still several legal challenges in regard to private individuals being peers.

1. INTRODUCTION

Digital innovation has opened up new possibilities for non-traditional players and the growth of the online alternative finance market. One of the most important examples of how new business models based on financial technology (Fin-Tech) emerge, is the crowdfunding movement. As a major part of this movement, 'crowdlending' – known as peer-to-peer (P2P) lending – has spread throughout Europe, including the Nordic countries. The development has been fuelled by the global financial crisis, which both has eroded consumers' trust in banks and made consumer loans less attractive for banks by increased regulatory oversight and capital requirements, and historically low interest rates induce investors to look for alternative sources of profit.[1]

The first P2P lending emerged in 2005, but especially in the last five years the numbers have increased.[2] In Europe, P2P lending counts

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[1] Christoph Busch and Vanessa Mak, 'Peer-to-peer lending in the European Union' [2016] 4 EuCML 181, 181.

[2] The platform Zopa is known for being the world's first P2P lender, when it was launched in the United Kingdom (UK) in 2005, see AltFi Opinion, 'The world's

for more than 50% of the online alternative finance market, where the volume in 2016 reached €7,671m (2013: €1,127m; 2015: €5,431m).[3] Yet P2P lending still only constitutes a tiny fraction of the overall lending market; for example the German market for consumer lending alone has a volume of about €175,000m, and in the UK the percentage market share might be around 2-3%.[4] Thus, the potential for further growth seems considerable – especially taking the significant increase of P2P lending in recent years into account.

In 2016, *the European online alternative finance market* – excluding the UK – grew by 101% reaching €2,063m; the average annual growth was 85% in 2013-2015. The top three national EU markets for online alternative finance by market volume are France (€443.98m), Germany (€321.84m) and the Netherlands (€194.19m). However, the markets of Finland (€142.23m), Spain (€130.90m), Italy (€127.06m) and Georgia (€102.58m) experienced a boom in 2016. Also, the Nordics are exhibiting rapid regional growth. When reviewed together, they (Denmark (€88m), Finland (€142m), Iceland, (€1m), Norway (€4.9m) and Sweden (€86.5m)) account for over €322m.[5] The UK remains the largest individual market in Europe, even though the market share has declined from 81% in 2015 to 73% in 2016 (€5,608m).

As digital intermediaries, P2P lending platforms are online 'credit marketplaces' which promote the contact between borrowers and lenders. Though there is not a fixed definition of P2P lending, in this article the term is used for the matching of investors (lenders) and project owners (borrowers) through the use of an electronic information system (the platform) managed by a service provider, which as a legal person facilitates the granting of loans. In a limited interpretation, P2P lending only covers private individuals lending to one-another. However, the most common use also includes businesses as peers; for example 'private individual'-to-business. Since P2P platforms often have specialized in a certain type of borrower, they reflect this. However, the platforms' business models may be defined in other ways, as for example by loans secured against a property.

P2P business lending – understood as individuals or institutional funders that provide a loan to a business borrower – in 2016 represented

original P2P lender has announced a governance restructuring ahead of the hotly-anticipated launch of its bank': http://www.altfi.com/article/4284_zopa-creates-separate-board-for-neo-bank-hires-four-new-neds. All the web pages in this article are latest retrieved 31 May 2018.

[3] Tania Ziegler et al., *Expanding Horizons: The 3rd European Alternative Finance Industry Report* (University of Cambridge, 2018) 16 and 20-29. The report covers 14 different alternative finance models and by estimate 90% of the visible alternative finance market in Europe.

[4] Moritz Renner, 'Peer-to-peer lending in Germany' [2016] 5 EuCML 224 and Rainer Lenz, 'Peer-to-Peer Lending: Opportunities' and Risks' [2016] 4 EJRR 688, 690.

[5] Ziegler (n 3) 16, 20-29 and 75.

17.0% (€ 349.96m) of European alternative finance volume. In the Nordics, the P2P business lending sector grew from 2015 to 2016 by 97% to €55m representing 17% of regional volume. Finland has the largest share by 86% (€47m) and is only followed by Denmark 14% (€8m) and Sweden, where less than 1% (€0.1m) is reported.[6] The top three national EU markets are the Netherlands (€124m), France (€71m) and Finland (€48m).[7]

In P2P Business Lending the main focus is to promote credit to small and medium sized enterprises (SMEs). Examples of platforms are the Danish Flex Funding, Kreditmatch and Lendino (since 2013-14). The rationale is often that entrepreneurs may have difficulties raising loans in the banks. The European Commission's proposal for a Regulation on European Crowdfunding Service Providers (ECSP) for Business (hereafter the proposal) from 8 March 2018 especially focuses on the challenges that small and nascent firms have, particularly when they move from the start-up phase into the expansion phase where access to bank financing often is scarce, see the proposal Preamble 2.[8] P2P lending is thus found to represent one of the latest forms of financing that works towards so-called 'financial inclusion'.[9] It is part of the Commission's priority of establishing a Capital Market Union (CMU), which aims to broaden access to finance for innovative companies, start-ups and other unlisted firms.[10]

P2P consumer lending – understood as individuals or institutional funders who provide a loan to a consumer borrower – in 2016 represented 33.8% (€696.81m) of European alternative finance volume and thereby has the largest market share. In the Nordics, the P2P consumer lending market has been recovering from the bankruptcy of the major platform *TrustBuddy AB* in 2015 and therefore barely represents 21% of regional alternative finance volumes. In 2016 the volumes were approximately €67m and grew by 83% from 2015. Finland has the largest share by 93% (€62m) and is only followed by Sweden,

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6 Ziegler (n 3) 75-78.

7 Ibid 31.

8 COM/2018/0113 final – 2018/048 (COD). The proposal is included in a package of measures to deepen the Capital Markets Union (also) from 8 March 2018, together with the Communication 'Completing Capital Markets Union by 2019 – time to accelerate delivery'.

9 For a critical investigation of the ambiguous social outcomes, see Chris Rogers and Chris Clarke, 'Mainstreaming social finance: The regulation of the peer-to-peer lending marketplace in the United Kingdom' [2016] 18(4) BJPIR 930.

10 The 'CMU should create an appropriate regulatory environment that enhances cross-border access to information on the companies looking for credit, quasi-equity and equity structures, in order to promote growth of non-bank financing models, including crowdfunding and peer-to-peer lending'; see European Parliament resolution of 9 July 2015 on Building a Capital Markets Union (2015/2634(RSP)), par. 47.

where 7% (€5m) is reported.[11] The top three national EU markets are Germany (€181m), France (€179m) and Georgia (€103m).[12] Examples of P2P platforms that promote credits to consumers around the world are: Auxmoney (Germany; since 2007), Better Rates (Denmark; since 2015), Kokos.pl (Poland; since 2008), Lendico (Germany – also operates in Austria, Brazil, the Netherlands, Poland, South Africa, and Spain; since 2013), Lending Club (United States (US); since 2006), LendInvest (UK; since 2008), RateSetter (UK; since 2010), ViaInvest (Latvia – also operates in Czech, Poland, Romania, Spain and Sweden; since 2008), Smava (Germany; since 2007) and Zopa (UK; since 2005).

The proposal exempts among others in Art. 2(2)(a) crowdfunding services that are provided to project owners that are consumers, as defined in the Consumer Credit Directive Art. 3(a).[13] They are considered better protected in this directive, see 2.2.3 below. Furthermore, the proposal exempts in Art. 2(2)(d) crowdfunding offers with a consideration of more than €1m per crowdfunding offer, which shall be calculated over a period of 12 months in regard to a particular crowdfunding project. Eventhough the consumer terminology is not used in regard to investment, the proposal will apply to private individuals as investors (lenders).

P2P loans are mainly unsecured. However, *P2P property lending* – understood as individuals or institutional funders that provide a loan secured against a property to a consumer or business borrower – counts 4.6% (€ 95.15m) of European alternative finance volume. The top three national EU markets are Denmark (€55m), Estonia (€31m) and Latvia (€5m). It is seemingly absent in the Nordic countries, except from Denmark and Sweden (€1m).[14] An example of such a P2P platform is the Danish UdenomBanken via the company Reel Finans Pantebrevsselskab A/S (since 2014). Furthermore, there are other ways in which loans can be secured. For example Auxmoney has, since 2010, allowed a security assignment of cars in car loans.[15] There is no statistical material found in regard to other secured loans.

This article deals with P2P lending as a new source of financing compared to e.g. financing in traditional banks. It will elaborate on the following questions: How should P2P lending be put in the context of the existing legislation? Is the existing legislation sufficient to meet the impact that P2P lending may have on modern society? Or is new special

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[11] Ziegler (n 3) 75-78.

[12] Ibid 31.

[13] European Parliament and Council Directive 2008/48/EC of 26 June 2013 of 23 April 2008 on credit agreements for consumers and repealing Council Directive 87/102/EEC [2008] OJ L 133/66.

[14] Ziegler (n 3) 31.

[15] Renner (n 4) 224 and Christian Berger and Bernd Skiera, 'Elektronische Kreditmarktplätze: Funktionsweise, Gestaltung und Erkenntnisstand bei dieser Form des "Peer-to- Peer Lending"' [2012] 45 Kredit und Kapital, 289, 291.

legislation necessary? The peers can be both private individuals (natural persons as consumers) and businesses (legal persons), but the main focus of the article will be on individuals. Tax law is not included in this article, but also creates some challenges for the P2P platforms.

2. LEGAL CHALLENGES – A NEW DIGITAL INTERMEDIARY PLATFORM

How P2P lending fits into the existing legal framework in regard to banks, payment services, money laundering and terrorist financing, consumer credit, investor protection etc. is still veiled in some uncertainty. The answers are more clear in some legal areas than others, and mainly depend on how the platform is set up and in which country it operates in. Despite of the forthcoming EU regulation as set out in the proposal, which creates some clarification, legal challenges still surround P2P lending. The most remarkable example of the multifaceted legal implications is the *case of TrustBuddy AB*. On 23 June 2014, the Danish FSA decided that a) the P2P platform TrustBuddy AB needed to be licensed as a bank. The FSA concluded that it was not a credit intermediation, and the lenders were in reality investors. Among others, the FSA also b) found the validity of the contracts doubtful, where TrustBuddy AB got unrestricted rights and monitoring possibilities, but the credit risk still was the investors. The case furthermore underlines c) that it is important to make sure that the digital platform is set up in the correct manner to obtain the benefits of the new digital possibilities for financing. Litra a) above both relates to public law and the so-called outer layer of legislation that constitutes the conditions under which the platform and its users can operate, see 2.1 below. Litra b) above relates to private law and the layer of legislation that regulates the relations between the three parties (platform, lender and borrower), see 2.2 below. Litra c) above roughly relates to the inner layer of regulation that consists of the platforms' self-regulation; since this layer most often reflects the two other layers by compliance considerations, the inner layer is included in 2.1 and 2.2 below. The *case of TrustBuddy AB* will be elaborated on later.

2.1. PUBLIC LAW – THE PLATFORM

Since the way in which the platforms are set up varies, it has to be specifically assessed in each case to which extent the platform needs to comply with the legislation. Some activities may need an authorisation and others may not. Below are some of the major areas dealt with, where financial supervisory authorities are involved.

2.1.1. EU AUTHORISATION

As a first step for fostering cross border crowdfunding activities and thus enhance the operation of the Single Market, P2P platforms as crowdfunding service providers[16] will with the proposed regulation be given the option to apply for a single Union-wide authorisation and supervision by a single authority, *the European Securities and Markets Authority (ESMA)*. This provides a one-stop-shop access to the EU market, where the platforms can exercise their activities under uniform requirements as outlined in the proposal, see e.g. the proposal Preamble 7 and Explanatory Memorandum 5. The requirements focus on their ongoing supervision, operations, organisation, transparency and marketing communications as outlined in Art. 1.

A platform can choose to provide or continue providing services on a domestic basis under applicable national law and the proposed regulation does thereby not replace national rules on crowdfunding where they exist. The regulation will only apply to legal persons, who choose to seek authorisation/are authorised in accordance with Art. 10, see art. 2(1)(c) e.c. Such EU authorisation covers both the provision of services in a single member state and on a cross-border basis. Authorisation under the applicable national rules is then withdrawn. Crowdfunding services that are provided by natural or legal persons that have been authorised as an investment firm in accordance with the 2nd Markets in Financial Instruments Directive (MiFID II) Art. 7 will also be exempted from the regulation, see the proposal Art. 2(2)(b), and shall seek an authorisation under the directive to provide investment-based cross-border crowdfunding services.[17]

2.1.2. PAYMENT SERVICES

Most often, the platform transfers the loan amount from the lender(s) to the borrower and later on interest and repayments from the borrower to the lender(s). A platform's holding of clients' funds and the provision of payment services require an authorisation in accordance with the 2nd Directive on Payment Services.[18] These funds shall be safeguarded in accordance with the national provisions transposing the directive; in the proposal this is emphasised in Art. 9(3). The directive includes provisions on capital, supervision, good business practice,

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[16] The proposal regards the authorisation of *crowdfunding service providers* as defined in the proposal Art. 3(1)(a), which both includes investment-based and lending-based business models. In the following the word *platform* is used for crowdlending service providers that manage the P2P platforms.
[17] European Parliament and Council Directive 2014/65/EU of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU [2014] OJ L173/349.
[18] European Parliament and Council Directive 2015/2366/EU of 25 November 2015 on payment services in the internal market, amending Directives 2002/65/EC, 2009/110/EC and 2013/36/EU and Regulation (EU) No 1093/2010, and repealing Directive 2007/64/EC [2015] OJ L337/35.

transparency of conditions and information requirements and other obligations in relation to the use of payment services.

The mandatory authorisation requirement in the 2nd Directive on Payment Services cannot be satisfied by an authorisation as a crowdfunding service provider according to the proposal. In the proposal this is clarified in Art. 9, cf. Preamble 21. Therefore, platforms or third parties acting on their behalf shall in accordance with Art. 9(2) not hold clients' funds or provide payment services, unless those funds are intended for the provision of payment services related to (here) P2P lending, and the platform or the third party acting on its behalf is a payment service provider as defined in the 2nd Directive on Payment Services Art. 4(11). If this is not the case, the platform shall put in place and maintain arrangements to ensure that the project owners accept funding offers or any payment only by means of a payment service provider, see the proposal Art. 9(4).

In order to enable a proper supervision of such activities, platforms shall in accordance to the proposal Art. 9(1) inform their clients: whether, and on which terms and conditions they or a third party, provide asset safekeeping services, including references to applicable national law; and whether payment services and the holding and safeguarding of funds are provided by the platform or through a third party provider acting on their behalf.

National competent authorities shall according to the proposal Art. 13(2)(a) notify ESMA without delay the fact that a platform, or a third party provider acting on behalf of that platform, has lost its authorisation as a payment institution in accordance with the 2nd Directive on Payment Services Art. 13. ESMA shall then withdraw the platform's authorisation as a crowdfunding service provider, where ESMA is of the opinion that the facts affect the good repute of the management of the platform, or indicate a failure of the governance arrangements, internal control mechanisms or procedures referred to in Art. 5, see the proposal Art. 13(3). This wide discretion seems narrowed by the detailed 2nd Directive on Payment Services. The national competent authority of the member state is then notified of ESMA's decision to withdraw the authorisation of the platforms; see the proposal Art. 13(4).

2.1.3. ADDITIONAL LICENCES – BANKING

Since a P2P platform most often only transfers the payments, it does not need more than the mandatory authorisation requirement in the 2nd Directive on Payment Services. However, the platform operator may in some member states for example need a permit under the general industrial law, which is the case in the German Industrial Act, § 34 c Abs. 1 1. Satz Nr. 2 Gewerbeordnung, GewO. The platform may also be set up in ways that demand additional requirements. A platform may for example need to have a license as a mortgage trading company, if it deals with real estate loans. This is the case for the Danish *Udenombanken*, which therefore is more strictly regulated than other Danish platforms. Yet, the question that has got most attention is whether a platform engages in banking activities or not. For an investor, the question is of great importance, since the investment is only covered in accordance with the directives on deposit guarantee and investor-compensation schemes, if it is a licensed banking activity.[19]

P2P lending is traditionally defined in contrast to banking. Whereas a commercial bank accumulates risks by taking positions on its balance sheet, a platform does not take risks through its own contractual positions, but decentralises the risks by spreading them to its users.[20] As suggested, this is not the case if the platform engages in banking activities. A platform needs a license as a bank, if it takes deposits or other repayable funds from the public and grants credits for its own account, cf. the definition of a credit institution in the Credit Requirements Regulation Art. 4(1)(1), see the 4th Credit Requirements Directive Art. 3(1)(1).[21] According to the 4th Credit Requirements Directive Art. 9 member states shall prohibit persons or undertakings that are not credit institutions from carrying out the business of taking deposits or other repayable funds from the public.

Taking the interpretation of the Danish FSA, Finanstilsynet, into account, a P2P platform will normally not be covered by the rules, if separate accounts in banks are created, where it has no rights of disposal.[22] When the lender pays out the loan amount, the intention should also be to create a binding loan agreement and not to have the amount returned in its whole.[23]

In 2007, the former Belgian FSA, the Banking, Finance and Insurance Commission, Commission Bancaire, Financière et des Assurances, CBFA, concluded in a concrete project that the platform would only receive funds as an agent of the borrower and the lender and would not use these funds for its own account. The Belgian banking monopoly was not violated, since: 'The platform was prepared (i) to transfer the funds to the account of the beneficiary on the same bank working day they were received; (ii) to ask a recognized accountant to

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19 European Parliament and Council Directive 2014/49/EU of 16 April 2014 on deposit guarantee schemes [2014] OJ L 173/149, and European Parliament and Council Directive 97/9/EC of 3 March 1997 on investor-compensation schemes [1997] OJ L 84/22.

20 Lenz (n 4) 688.

21 European Parliament and Council Regulation (EU) No 575/2013 of 26 June 2013 on prudential requirements for credit institutions and investment firms (CRR) [2013] OJ L 179/1 and European Parliament and Council Directive 2013/36/EU of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms [2013] OJ L 179/338.

22 Finanstilsynet, note of 4 July 2012.

23 Søren Brinkmann and Allan Nielsen, 'Crowdfunding. En ny andelsbevægelse' [2014] 8 RR 56, 62.

certify the efficiency of this modus operandi and (iii) to send a copy of this certification to the CBFA'.[24]

To the best of the present author's knowledge, there have been two cases, where a platform has been sanctioned by a national FSA:

The Austrian FSA, Österreiche Finanzmarktaufsicht, instructed by administrative decision dated *22 December 2009* the club *Nick2Nick* to stop its platform *bankless-life.at*, since the platform did not possess any licence pursuant to the Austrian Banking Act, § 4 Abs. 7 1. Satz Bankwesengesetz (BWG), and did not cooperate with a licenced credit institute.[25] Members of the club used the platform for the procurement of private credits, and the club operated an illicit banking business by neither possessing a permit to accept deposits nor to grant credits or, respectively, procure credits.[26] Furthermore, it was not entitled to perform payment services pursuant to the Austrian Payment Act, § 64 Abs. 9 1. Satz Zahlungsdienstegesetz (ZaDiG) and lacked a permit under the industrial trade law to mediate private or mortgage credits.[27]

On *23 June 2014* the Danish FSA decided that *TrustBuddy AB* – which was established in 2009 as a listed company in Sweden with businesses among others in Denmark, Norway, Sweden, Finland, Spain and Poland – had to comply with the Danish Financial Business Act, lov om finansiel virksomhed § 7, stk. 1, and therefore needed to be licensed as a bank.[28] At TrustBuddy's webpage persons and companies could create profiles called accounts to use the services that TrustBuddy offered; among others it was explained to the lenders that their accounts were viewed as normal deposit accounts, but with higher interests. The amounts transferred to TrustBuddy by the lenders were actually put into an account in a bank in TrustBuddy's name in each country it operated within. TrustBuddy had unrestricted rights to the bank accounts. The lenders did not have any influence on how the money was managed, and who the borrowers were. They could only claim their deposit from TrustBuddy and not directly from the borrowers; it was emphasised by the fact that the lenders' names were not part of the credit agreements. The FSA found that this was not credit intermediation, and the lenders were in reality investors. Among others the FSA also found the validity

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24 CBFA, Verslag van het directiecomit [2007] 81, 82: https://www.nbb.be/doc/cp/nl/publications/ver/pdf/cbfa_dc_2007.pdf, as described by Veerle Colaert, 'On the absence of peer-to-peer lending in Belgium' [2016] 4 EuCML 182, 183.

25 www.fma.gv.at/fma-untersagt-den-betrieb-der-kreditvermittlungsplattform-bankless-life-at.

26 www.bankless-life.at.

27 www.fma.gv.at/verein-nick2nick. See also Nicolas Raschauer and Thomas Müller, 'Peer-to-peer lending in Austria' [2016] 5 EuCML 222, 223.

28 www.finanstilsynet.dk/~/media/Lovgivning/Regler-og-praksis/2014/20140625--Afgrelse-over-for-TrustBuddy-AB-version-til-offentliggrelse.pdf?la=da.

of the contracts doubtful, where TrustBuddy got unrestricted rights and monitoring possibilities, while the investors still bore the credit risk.

Afterwards, TrustBuddy put a stop to deposits from Danes, and Swedish depositors funded loans to the Danes. After an injunction from the Swedish FSA, Finansinspektionen, the platform was closed in October 2015. Partly without approval of the lenders, TrustBuddy had lend SEK 300m €31.92m) out. SEK 37m (€3,94m) had been lent out with no specification of which depositors the money came from. SEK 44m (€4.68m) were missing, which was the difference between the available balance on the customer accounts and the amount TrustBuddy owed to the depositors.[29]

The Danish *case of TrustBuddy* seems not only to have influenced the Danish market by lowering P2P consumer lending, but has also influenced other platforms. For example, the Danish platform Better Rates emphasises on its webpage that it is not a bank, but a payment service, and the wording seems to refer to the decision of the Danish FSA.[30]

In Germany – as in the US – the "peer-to-peer" loans are in practice always raised through the conduit of a licensed bank, because only licensed banks are entitled to originate loans.[31] The making of loans requires a license by the German FSA, Bundesanstalt für Finanzdienstleistungsaufsicht, BaFin, if the lender acts 'commercially' or 'on a scale which requires a commercially set-up business operation' according to the German Banking Act, § 32 Abs. 1 in connection with § 1 Abs. 1 2. Satz Nr. 2 Kreditwesengesetz, KWG. In practice, BaFin interprets the notion of commercial activity in a broad manner and holds it to be sufficient that the lender intends to be active over a certain period of time and has the intent to make profits; a single transaction may be enough, if only the lender envisages further transactions.[32] Also, the taking of deposits, which is whenever an individual or institution receives external funds from the public, constitutes a regulated banking activity according to KWG, see the same provisions above. The BaFin assumes that lending on P2P platforms is a regulated taking of deposits, if an individual or institution accepts funds from six or more investments and with a total volume of more than €12.500 or from more than 25 investments irrespective of the volume of the transaction. The BaFin will not treat funds as "external", if the loans are structured as subordinated debt; yet, a platform still would need a bank licence to originate loans.[33]

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[29] Tanja Jørgensen, 'Peer-to-peer lending in Denmark' [2016] 4 EuCML 185, 185-186, for elaboration of the case in a Danish context.

[30] www.betterrates.dk.

[31] Lenz (n 4) 692.

[32] BaFin, Merkblatt zum Tatbestand des Kreditgeschäfts, 8 January 2009, updated 2 May 2016, and Renner (n 4) 224-225.

[33] BaFin, Merkblatt zum Tatbestand des Einlagengeschäfts, 11 March 2014, sub V, and Renner (n 4) 225.

In Germany, licensed banks therefore both do the payment service and originate the loans, which means that they intermediate between both market sides by making the initial loan to individual borrowers and then passing on the credit risk to individual lenders.[34] The platform users are normally not aware of the involvement of banks, and the banks are called white-label banks, as their names do not appear. The use of banks makes it more expensive for platforms, as banks request a fee of 0.5% to 1.5% of the loan amount.[35] The German market may thereby imply legal challenges for the specific platform that wants to engage in cross boarder activities and in general be an obstacle for the growth of a European internal P2P lending market.

However, different implementations in the member states as well as interpretations by national FSAs may be an obstacle, too. For example, the absence of peer-to-peer lending in Belgium may be explained by the Belgian extensive implementation of the 4th Credit Requirements Directive Art. 9, which does not use the words 'carrying out the business of'. Any deposit-taking activity by persons other than credit institutions is therefore – irrespective of whether this is a business activity – prohibited in Belgium. A candidate-borrower on a P2P-platform would be considered to make an 'appeal to the public' in order to receive repayable funds and therefore to violate the banking monopoly. Only legal persons, as P2P borrowers may fall under an exemption in the Belgian Prospectus Act, 68bis, 6º, which uses a very wide definition of 'investment instrument', including any 'standardized loan document of which the content is identical for all lenders, except for the amount in principal, which may vary'.[36]

Other challenges that platforms may encounter in relation to banking monopoly are related to the platforms' competition against banks. When for example the Danish platforms are asked if they face any challenges, they reply that banks may in their basis capital include equity investments in data centres, which is not offered to payment institutions by the Danish FSA. Another challenge may be that, when banks lend to SMEs, they can achieve guarantee from the Danish Growth Fund, Vækstfonden, which is a state investment fund, but platforms cannot.[37] Being a licensed bank may therefore have certain benefits for a platform. Hence, in November 2016, the UK platform *Zopa* announced that it would apply for a banking license. Zopa's digital bank is scheduled to launch in 2018 and will use data accessed by introducing open banking.

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[34] Ibid 224 and Lenz (n 4) 692.

[35] Lenz (n 4) 692.

[36] Colaert (n 24) 183.

[37] Jørgensen, 'Peer-to-peer lending in Denmark' (n 29) 187.

It will offer customers a broader set of personal finance products including deposit accounts, credit cards and a money management app.[38]

2.1.4. MONEY LAUNDERING AND TERRORIST FINANCING

As any other financial service, P2P lending may be exposed to money laundering and terrorism financing practices. This is emphasized in the Commission's Report on the assessment of the risks of money laundering and terrorist financing affecting the internal market and relating to cross-border situations.[39] When funding transactions must take place via entities that are authorised under the 2nd Directive on Payment Services they are subject to the 4th Anti-Money Laundering Directive.[40] Such entity authorisation under the 2nd Directive on Payment Services is mandatory for platforms under the proposal, see the proposal Art. 9. As part of the Know Your Customer-principle in the 4th Anti-Money Laundering Directive, the platform shall obtain information about the costumer. Since P2P lending is web-based there is stricter requirements for documentation than attendance in person. When the platforms are asked, one of the challenges is that the national competent authorities may have slightly different demands when the 4th Anti-Money Laundering Directive is interpreted; for example the Danish FSA may have stricter demands to identification of the customer than the Swedish FSA, which accepts digital signature.[41]

For platforms under the proposal, the requirements for the 'good repute' of managers include in Art. 10 the absence of any criminal record under anti-money laundering legislation. According to the proposal Art. 13(2)(b) national competent authorities shall notify ESMA without delay about the fact that a platform, or its managers, employees or third parties acting on its behalf, have breached national provisions implementing the 4th Anti-Money Laundering Directive. This also applies to national competent authorities designated under the provisions of the directive. ESMA shall then withdraw the authorisation as persuant to the proposal Art. 13(3), see 2.2.1 above, where the details in regard of payment services also apply to money laundering or terrorism financing.

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[38] AltFi Opinion, 'Zopa boss Janardana details plans for customer-centric bank': http://www.altfi.com/article/3116_zopa_boss_janardana_sheds_light_on_customer_centric_bank. Retrieved 31 May 2018.

[39] COM(2017) 340 final, Report from the Commission to the European Parliament and the Council on the assessment of the risks of money laundering and terrorist financing affecting the internal market and relating to cross-border activities.

[40] European Parliament and Council Directive 2015/849/EU of 20 May 2015 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, amending Regulation (EU) No 648/2012 of the European Parliament and of the Council, and repealing Directive 2005/60/EC of the European Parliament and of the Council and Commission Directive 2006/70/EC [2015] OJ L 141/73.

[41] Jørgensen, 'Peer-to-peer lending in Denmark' (n 29) 187.

With a view to further ensuring financial stability by preventing risks of money laundering and terrorism financing, the Commission shall, after consulting ESMA, assess the necessity and proportionality of subjecting platforms to obligations for compliance with the national provisions implementing the 4th Anti-Money Laundering Directive and adding such platforms to the list of obliged entities for the purposes of the directive, see the proposal Art. 38(2)(g) and Preamble 24. This will – 24 months of entry into application of the proposed regulation – be presented in a report to the European Parliament and the Council on the application of this regulation, accompanied where appropriate by a legislative proposal.

2.2. Private law – The relationship between the parties

The relationship between the various parties structures the legal conflicts in a private law context. As in other types of crowdfunding, generally three types of parties are involved in P2P lending. The *intermediary* in the form of a service provider that brings together project owners and investors through an online platform, cf. the proposal Preamble 3. The *project owner* that seeks an activity or more activities (the project) to be funded, cf. the proposal Art. 3(1)(f). The *investors* who fund the proposed project, cf. the proposal Art. 3(1)(g) on investors and Art. 3(1)(h) on business projects. Dealing with P2P lending, the project owner and investors respectively are synonyms for the borrower and the lenders, who fund the project with loans, and the word used depends on the context.

Legal conflicts may arise from any stage of the (potential) project as from setting up and marketing the project to the completion of the project by the project owner's final repayment or to the events of default. A platform's disruptive business model can often be conceived of the following process:[42] 1) The potential borrower makes an inquiry to the platform indicating amount and maturity of the wished loan. 2) The platform assesses the underlying credit risk and sets a risk-appropriate interest rate, if the platform finds the risk acceptable. 3) The platform publishes the project to its users, if the borrower agrees with the platform's terms, including pricing. 4) Potential lenders have a predefined period, often two or four weeks, in which to place their offers to provide portions of the required loan amount. The remaining amount needed is visible for the platform users. The users have to sign a service contract with the platform and complete a due diligence process to comply with the 4th Anti-Money Laundering Directive to gain access to the platform. 5) The loan is originated, if the sum of investment offers matches the required loan amount. The platform collects the money from the lenders' bank accounts and transfers it to the borrower. The transfers of cash and credit claims are done concurrently as

[42] For the following process, see Lenz (n 4) 691-692.

counterclaims, after deduction of platform fees from the borrower and lenders for their matching. The lenders receive a credit claim documenting the borrower's legal commitment to pay interest and to redeem the principal. 6) Until the loan matures, the platform services the loan, collecting and distributing interest and redemption payments. The lenders carry the losses, if the borrower defaults. Even though the platform is not liable for losses, it is often obliged to manage missed payments.

During this process, the platforms most often charge fees for their services. For example, the platform Zopa charge an *origination fee* to help cover the cost of setting up the loan, a *loan servicing fee* to each loan contract, which is deducted directly from each borrower repayment before the principal and interest is passed on to investors, and a 1% fee, if an investor wants to sell their loans to access their money quickly.

2.2.1. SYNDICATED LOANS – A PARALLEL

Both P2P lending and syndicated loans are generally characterized by more lenders contributing to the total loan amount of a borrower, and an intermediary that sets up and manages the loan contracts. These similarities may contribute to how the legal conflicts in regard to P2P lending may be solved by a national court.

As an intermediary, the P2P platform shares the same coordinating function as the lead bank, which facilitates the establishment of the syndicated loan agreement, and the agent bank which often is the same bank as the lead bank and afterwards administers the loan and the repayment (interest, amortization, notifications etc.).[43] Even though the functions and structures are much the same, P2P-lending has a digital set-up and often has another focus than syndicated loans. In syndicated loans the lenders and the intermediary are traditionally banks, and the borrower – e.g. large enterprises – often uses the loan amount to large and/or risky projects, where capital requirements may hinder one bank from granting the whole amount. In P2P lending banks are traditionally not parties but instead considered an opposition to banking. Yet, this is not without exemptions as noted in point 2.1.3 above and underlined by the fact that banks may be institutional investors. The loan amounts are most often smaller than in syndicated loans and used for other purposes as the borrowers are e.g. SMEs or consumers. The most important difference is that all the platforms interfaces with borrowers, lenders and payment service providers have to be fully standardized and automated by using software.[44] Having this in mind, parallels to syndicated loans will be included in the following.

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[43] Lars Gorton and Tanja Jørgensen, 'Roles and functions of the lead bank and the agent bank in a syndicated loan agreement' [2009] 1 Euredia 33, 43, 51-52.

[44] Lenz (n 4) 693.

2.2.2. THE LEGISLATION

The relationship between the parties is regulated by the contracts. National rules and principles in contract law and agency will therefore as background law define the relationship between the platform and the borrower and the lenders. Further, consumers may enjoy specific protection in national law, which often is quite similar, since the member states have implemented the EU consumer directives such as the Consumer Credit Directive (2.2.3 below), the Unfair Commercial Practices Directive and the Unfair Terms in Consumer Contracts Directive. The Unfair Commercial Practices Directive protects amongst others consumers against aggressive marketing techniques. The Unfair Terms in Consumer Contracts Directive ensures among others that unfair terms in standard contracts are not binding in the member states and includes a non-exhaustive list of the terms which may be regarded as unfair.[45] When borrowers and lenders create a mandatory 'client account' at the platform, the platform's standard terms are accepted. In the member states there are not many cases in this regard, as P2P lending is still a quite new phenomenon. The Polish Court of Competition and Consumer Protection, Sąd Ochrony Konkurencji i Konsumentów, made decisions on unfair terms and conditions of the platform finansowo.pl. in three cases, which were brought forward by the consumer association Towarzystwo Lexus. The clauses concerned the unlimited possibility to amend the terms and conditions, the user exclusively carrying costs and risks connected with using the platform and the exclusion of the platform's liability in case of technical problems when using the platform. The clauses which were held to be unfair were: 'Finansowo.pl reserves the right to amend this regulation at any time' in the *judgment of 22 June 2010*, 'Use of the service finansowo.pl is possible only and exclusively at the User's own risk and expense' in the *judgment 22 June 2010* and 'Finansowo.pl shall not be liable for any damages resulting by service suspension, system or technical failures' in the *judgment 22 June 2010*.[46] In the *case of TrustBuddy*, the Danish FSA in its decision of 23 June 2014 (2.1.3 above) found the validity of the contracts doubtful, where TrustBuddy got unrestricted rights and monitoring possibilities, but the credit risk still was the investors; however, this is not a civil court judgement.

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[45] Council Directive 93/13/EEC of 5 April 1993 on unfair terms in consumer contracts [1993] OJ L 95/29 and European Parliament and Council Directive 2005/29/EC of 11 May 2005 concerning unfair business-to-consumer commercial practices in the internal market and amending Council Directive 84/450/EEC, Directives 97/7/EC, 98/27/EC and 2002/65/EC of the European Parliament and of the Council and Regulation (EC) No 2006/2004 of the European Parliament and of the Council [2005] L 149/22.

[46] Case XVII Amc 10/10, MSiG 2010/203/12669, case XVII Amc 9/10 MSiG 2010/203/12678 and case XVII Amc 8/10 MSiG 2010/203/12668. The cases are described by Joanna Rupa, 'Peer-to-peer lending in Poland' [2016] 5 EuCML 226, 227.

The emergence of P2P platforms has given private individuals a whole new possibility to lend to each other. It questions whether the traditional consumer protection in only business-to-consumer (b2c) relationships is sufficient. The question is dealt with below in 2.2.3, where the result also relates to other consumer directives.

2.2.3. CONSUMER CREDIT – THE BORROWER AND THE PLATFORM/INVESTORS

In the Consumer Credit Directive Art. 3(a), a *consumer* means 'a natural person who, in transactions covered by this Directive, is acting for purposes which are outside his trade, business or profession'. The regulation proposed will not apply to crowdfunding services that are provided to project owners that are such consumers, since the regulation aims to foster cross-border business funding, see the proposal Art. 2(2)(a) and Preamble 8. Instead, the protection in Consumer Credit Directive and the Mortgage Credit Directive are considered as more strict rules to safeguard consumers than the proposal, see the proposal Explanatory Memorandum 1.[47]

The Mortgage Credit Directive Art. 4(1) uses the Consumer Credit Directive Art. 3(a) consumer definition. The Mortgage Credit Directive applies according to its Art. 3(1) specifically for: (a) credit agreements which are secured either by a mortgage or by another comparable security commonly used in a member state on residential immovable property or secured by a right related to residential immovable property; and (b) credit agreements which purpose is to acquire or retain property rights in land or in an existing or projected building. These credit agreements are exempted from the Consumer Credit Directive, see this directive Art. 2(2)(a) and (b).

Even though the specific rules differ, the Consumer Credit Directive and the Mortgage Credit Directive seek to protect consumers with the aim to create an internal consumer credit market. However, as P2P borrowers, consumers may not always enjoy the demanded protection.

The Consumer Credit Directive only applies; when the *creditor* is 'a natural or legal person who grants or promises to grant credit in the course of his trade, business or profession', see Art. 3(b) cf. the scope in Art. 2(1) and the definition of a 'credit agreement' in Art. 3(c). The same is the case in the Mortgage Credit Directive Art. 4(2) for an agreement within the scope of the directive, see Art. 3.

This demand for a b2c relationship raises two main questions in regard to P2P lending:

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[47] European Parliament and Council Directive 2014/17/EU of 4 February 2014 on credit agreements for consumers relating to residential immovable property and amending Directives 2008/48/EC and 2013/36/EU and Regulation (EU) No 1093/2010 [2014] OJ L 60/34.

Is a private individual as a P2P lender granting 'credit in the course of his trade, business or profession' and thereby a 'creditor' as defined in the Consumer Credit Directive? It can be argued that a private individual as a P2P lender does not fit the directive Art. 3(b) definition of a creditor. According to the Belgian scholarly debate, the Belgian rules on consumer credit, which refers to the wording of the directive, will not apply to P2P lenders, nor to the platform, and therefore create great risks of over indebtedness and abuse for P2P borrowers.[48] Also in Poland such a loan agreement would be considered between two consumers, since the platform only offers the marketplace, where borrowers and lenders can find each other.

The answer to the question will depend on the specific situation and is not quite clear. However, even though a private individual as a lender aims to make profit, it seems awkward to view it in 'course of his trade, business or profession' as long as the profit cannot be considered a salary to make a living of. The raison d'être of the b2c demand is that private individuals as lenders shall not be subject to the strict obligations of business lenders. Instead a P2P lender's investment can be viewed as an alternative to having the means placed in a deposit account.

The consequence is that P2P lending, where the lender is a private individual cannot be qualified as consumer credit. This leads to significant risks of over indebtedness and abuse of inexperienced borrowers, as they do not necessarily enjoy the protection laid out in the EU consumer directives. Yet, national provisions may cover such lending anyway. According to the Danish Credit Agreement Act, kreditaftaleloven § 1, stk. 2, the Act also applies to credit agreements where the credit is granted by a not-professional person, if the agreement is concluded or disseminated on behalf of the lender by a professional person. It has another background than P2P lending and therefore has a wording that focuses on preventing circumvention of the Act.[49]

To conclude, the consumer borrower will only be covered by the higher consumer protection in (here) the Consumer Credit Directive and the Mortgage Credit Directive, when the lender grants 'credit in the course of his trade, business or profession'. In other situations, the general law such as on contracts and marketing will only cover the borrower.

To which extent shall the platform fulfil the obligations in the Consumer Credit Directive and the Mortgage Credit Directive? In other words: Is the platform a

[48] Cf. from a Belgian context Colaert (n 24) 182 with references to David Raes, 'Le peer to peer lending en droit belge – Espoir ou désespoir' in Cahiers AEDBF/EVBFR Belgium (ed), Digital Finance/La finance numérique (Anthemis/Intersentia 2015) 83, 100 and Sylvie Decoster and Clarisse Lewalle, 'Le crowdfunding: réglementation applicable, enjeux et perspectives' (2014) Revue Bancaire et Financière – Bank- en Financiewezen 455, 464 and 467.

[49] Tanja Jørgensen, 'Kreditformidlere – nu i dansk ret' [2011] ET 243, 244-245.

creditor or an intermediary regulated by the Consumer Credit Directive or the Mortgage Credit Directive?

In *Case C-311/15, TrustBuddy AB*, the Finnish Supreme Court, Korkien oikeus, asked the Court of Justice of the European Union (CJEU), the question of whether a P2P lending platform can be considered to be a 'creditor' under the Consumer Credit Directive, if it markets credit to consumers via the internet. However, the answer from the CJEU will remain unanswered. After TrustBuddy went into bankruptcy, the case was deleted from the court's register. As the Danish FSA found that TrustBuddy conducted banking activity, see 2.1.3 above, the platform was likely in the specific case a creditor. The referred request for a preliminary ruling was:

> Is [the Consumer Credit Directive Art. 3(b)] to be interpreted as meaning that a trade is to be regarded as a creditor if it markets credit to consumers via the internet in the form of so-called peer-to-peer lending and exercises, as regards the consumers, the decision-making power generally appertaining to creditors with respect to the terms and conditions, the granting of credit and debt recovery, even though the funds for credits come from anonymous private individuals and are kept separate from the trader's own funds?

Since a platform normally within its business just facilitates the interaction between the parties, the general answer seems to be that a platform hardly 'grants or promises to grant credit in the course of his trade, business or profession' and seems thereby *not to be a creditor* as defined in the Consumer Credit Directive Art. 3(b). If the lender is a private individual, there is furthermore hardly any credit agreement in the b2c sense of the Consumer Credit Directive Art. 3(c) and the Mortgage Credit Directive Art. 4(3), and the situation thereby falls outside the scope of the directives.

In case of a b2c relationship between the lender and the borrower, the Consumer Credit Directive or the Mortgage Credit Directive will apply, if the contract falls within the more detailed scope in the Consumer Credit Directive Art. 2 and the Mortgage Credit Directive Art. 3. In this situation a platform seems to fall within the definition of a *credit intermediary* in the Consumer Credit Directive Art. 3(f) meaning 'a natural or legal person who is not acting as a creditor and who, in the course of his trade, business or profession, for a fee, which may take a pecuniary form or any other agreed form of financial consideration: (i) presents or offers credit agreements to consumers; (ii) assists consumers by undertaking preparatory work in respect of credit agreements other than as referred to in (i); or (iii) concludes credit agreements with consumers on behalf of the creditor'. However, a platform that merely introduces a consumer to a creditor or credit intermediary will fall without the

Mortgage Credit Directive's definition of a credit intermediary. A credit intermediary in the directive's Art. 4(5) means:

> a natural or legal person who is not acting as a creditor or notary and not merely introducing, either directly or indirectly, a consumer to a creditor or credit intermediary, and who, in the course of his trade, business or profession, for remuneration, which may take a pecuniary form or any other agreed form of financial consideration: (a) presents or offers credit agreements to consumers; (b) assists consumers by undertaking preparatory work or other pre-contractual administration in respect of credit agreements other than as referred to in point (a); or (c) concludes credit agreements with consumers on behalf of the creditor.

A platform will as a credit intermediary have to fulfil *the specific obligations of credit intermediaries* in the Consumer Credit Directive or the Mortgage Credit Directive. According to the Consumer Credit Directive Art. 21, a credit intermediary shall indicate the extent of his powers in advertising and documentation intended for consumers and indicate the intermediary's service fee payable by the consumer and agreed between the consumer and the credit intermediary on paper or another durable medium before the conclusion of the credit agreement. In the Mortgage Credit Directive a credit intermediary shall fulfil the more extensive information requirements in Art. 15, and the requirement for establishment and supervision of credit intermediaries in chapter 11, including holding a professional indemnity insurance in Art. 29(2)(a) and entering into a register of admitted credit intermediaries led by a competent authority in their home member state in Art. 29(4).

In the two-fold contracting structure of German P2P lending, the licensed bank fulfils the lenders potential obligations under §§ 491 et seq. BGB, and the platform as a loan broker only has to comply with residual duties of information.[50] In other member states platforms will most often take on the obligations of the creditors, and many of the articles in the Consumer Credit Directive and the Mortgage Credit Directive also apply to credit intermediaries.[51] In the Consumer Credit Directive the obligations are mainly standard information to be included in advertising in Art. 4 and pre-contractual and contractual information, including the annual percentage rate of charge (APR), in Art. 5 and 10; the APR shall for example contain a platform's origination and loan servicing fees. In the Mortgage Credit Directive they are mainly the conduct of business obligations in Art. 7, the obligation to provide information free of charge to consumers in Art. 8, knowledge and competence requirements for

[50] Renner (n 4) 224.

[51] For elaboration, see Tanja Jørgensen, 'Kreditformidlere – fremtidige regler' [2011] ET 256-258.

staff in Art. 9, standard information to be included in advertising in Art. 11, general information in Art. 13, pre-contractual information in Art. 14, adequate explanations in Art. 16 and standards for advisory services in Art. 22.

The obligations raise legal challenges in at least two situations.

Often *unique users IDs* are used to keep the privacy of the borrower and lender. However, before a consumer is bound by a credit agreement, the consumer shall know the identity and the geographical address of the creditor as well as, if applicable, the identity and geographical address of the credit intermediary involved, see the Consumer Credit Directive Art. 5(1)(b) with reference to the Standard European Consumer Credit Information form set out in Annex II. This also applies to the credit agreement, see the directive Art. 10(2)(b). It is not in accordance with the pre-contractual information duty, when for example the platform Better Rates writes that it is first in the final loan agreement that the investors real names can be seen by the borrower according to the Danish Consumer Agreement Act, Kreditaftaleloven, as implements the directive.[52] P2P lending thereby includes knowledge of the borrower's need for finance to a wider audience than lending normally does.

It is the creditor – here the P2P lender – that is subject to assessing the consumer's *credit worthiness* both in the Consumer Credit Directive Art. 8 and the Mortgage Credit Directive Art. 18, which especially may prevent over indebtedness of the potential borrower. However, most platforms as intermediaries conduct their own assessment of the underlying credit risk and fit it in to the platform's risk categories. P2P platforms may though accept higher risks than banks, and borrowers who are rejected by banks may therefore end up being accepted by P2P platforms.[53] Reversely, this raises certain considerations in regard to the protection of the investor as creditor, see 2.2.4 below.

2.2.4. INVESTOR PROTECTION – THE INVESTORS AND THE PLATFORM

With the new digital platforms, private individuals have got an opportunity to lend money and make investments that they have not previously had. Both in P2P lending and syndicated loans, the lenders enjoy the advantages of severalty, including spreading of the risk, and there is thus some correlation between the loan amount and the number of lenders involved. For example, at the platform Auxmoney the minimum investment amount is €25. An investment of € 2,500 can therefore be split into 100 different loan projects to diversify the investment portfolio.

P2P lending often requires a great deal of trust from the investors, which needs to be met with corresponding responsibility from the platforms. For example, to save time and not have to study each loan

[52] www.BetterRates.dk.
[53] Lenz (n 4) 697.

project individually, Auxmoney has created a Portfolio Builder, which automatically invests in various loan projects. The investors thereby entrust their money to the platform's discretion without knowing precisely which projects they invest in.

There are significant risks for investors innate in P2P lending, and inexperienced investors do not necessarily know the consequences. The investor often receives limited information about the borrower as well as about the platforms' credit assessment methods, and furthermore, both platforms and borrowers have some incentive not to be too critical about the disclosure of risks. There is a natural conflict of interest between investor protection and the platform's business model, where the platform generates its income through a fee that usually corresponds to a certain percentage of the transaction volume, which thereby provides a steady incentive for the platform to stimulate the platform's transaction volume by exaggerating investment opportunities and profit chances, while playing down the risks of investment projects.[54] This makes P2P lending even more risky. It is illustrated by the striking *case of TrustBuddy* above, where the investors lacked insight in the credit assessment, the risk was played down and where the platform furthermore had all the powers until the money was returned to the lenders.

Despite of the risks, P2P lenders are to date not shielded by the EU directives on investor protection. Though, some member states require P2P platforms to get licensed and to operate under existing EU frameworks, such as the 2nd Markets in Financial Instruments Directive and the Alternative Investment Fund Managers Directive. Other member states have introduced national bespoke regimes on investor protection.

In the Netherlands six key regulatory changes were introduced in 2016: 1) investment limits so that lenders will be able to invest € 80.000 per platform, 2) a crowdfunding investment test for lenders, 3) an active confirmation and cancellation option whereby the platform will offer a period of reflection for lenders to either confirm or cancel their investment with two options: the 'active confirmation' option that requires platforms to send an email requesting lenders to confirm their investment within 24 hours, where the investment is cancelled in the absence of a response, and the 'active cancellation' option, which is the reverse of this, and the lender is sent an email offering cancellation of their investment, and the investment is finalised, if the lender takes no action, 4) asset segregation, where the assets of the platform should be kept separate from the assets of the lender/borrower at all times as the investment transitions through the platform, 5) monitoring of exemption holders, when considering the competence of directors, and assessing corporate credit risk, including determining the repayment capacity of

54 Lenz (n 4) 696.

companies and implementation of systems to allow payments between lenders and borrowers to continue in case the platform temporarily or permanently should stop functioning, and 6) a semi-annual reporting obligation with the main purpose to monitor the market developments.[55]

The proposal for a Regulation on European Crowdfunding Service Providers (ECSP) for Business, does not intend to interfere with national bespoke regimes or existing licenses, including those under the 2nd Markets in Financial Instruments Directive, the 2nd Directive on Payment Services or the Alternative Investment Fund Managers Directive. It rather seeks to provide platforms with the option to apply for a single Union-wide authorisation to scale up their operations throughout the EU. In this regard, it also seeks to empower investors with the necessary information, including the information on the underlying risks and to support investors' trust by requiring platforms to have the necessary safeguards in place to minimise risks materialising, see the proposal Explanatory Memorandum 1.

The proposal also covers private individuals as investors, since an 'investor' according to Art. 3(1)(g) means 'any person that, through a crowdfunding platform, grants loans or acquires transferable securities'. The provisions on investor protection and transparency set out in the proposal Chapter IV are quite extensive.

Pursuant to Art. 14, all *information*, including marketing communications, from the platform to clients about themselves, about the costs and charges, conditions, including project selection criteria, or about the nature of and risks associated with the services shall be clear, comprehensible, complete and correct. It shall be provided to potential clients, before they enter into a transaction and be available on a clearly identified section of the platform's website and in a non-discriminatory manner.

Art. 15 sets out an initial *assessment of appropriateness* of a prospective investor, which is quite similar to the test in the 2nd Markets in Financial Instruments Directive and to the crowdfunding investment test for lenders, which has been devised in the Netherlands in 2016.[56] For the purposes of the assessment, the platforms shall request information about the prospective investor's basic knowledge and understanding of risk in investing in general and in the types of investments offered on the crowdfunding platform, including specific information on past investments and any relevant knowledge or professional experience in relation to crowdfunding investments. Where a prospective investor

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[55] Matthew Williams, 'Peer-to-peer lending in the Netherlands' [2016] 4 EuCML 188, 190. The regulatory changes was introduced via the revised Decree on the Supervision of the Conduct of Financial Enterprises, Besluit Gedragstoezicht financiële ondernemingen Wft, and a change in supervisory policy on behalf of the FSA, Autoriteit Financiële Markten.

[56] id.

does not provide the information required, or where a platform on the basis of this information considers that the prospective investor has insufficient knowledge, the platform shall inform this prospective investor that the services offered on the platform may be inappropriate and give a *risk warning*. Platforms shall take the measures necessary to comply with the assessment of appropriateness for each investor every two years.

Furthermore, Art. 15(5) provides that platforms shall offer investors the possibility to *simulate their ability to bear losses*, calculated as 10% of their net worth, based on specific information dealing with income, assets and financial commitments.

A risk warning, the lack of requested information from the prospective investor or the results of the simulation will not prevent prospective investors and investors from investing in projects.

The platform shall according to Art. 16 provide prospective investors with *a key investment information sheet (KIIS)* drawn up by the project owner for each crowdfunding offer. It shall contain the detailed information set out in the Annex to the proposal and an explanatory statement, appearing directly underneath the title of the key investment information sheet:

> This crowdfunding offer has been neither verified nor approved by ESMA or national competent authorities.
>
> The appropriateness of your education and knowledge have not been assessed before you were granted access to this investment. By making this investment, you assume full risk of taking this investment, including the risk of partial or entire loss of the money invested.

It shall also contain this risk warning:

> Investment in this crowdfunding offer entails risks, including the risk of partial or entire loss of the money invested. Your investment is not covered by the deposit guarantee and investor compensation schemes established in accordance with [the directives on deposit guarantee and investor-compensation schemes]
>
> You may not receive any return on your investment.
>
> This is not a saving product and you should not invest more than 10% of your net wealth in crowdfunding projects.
>
> You may not be able to sell the investment instruments when you wish.

There are strict requirements to the form of the KIIS. According to Art. 16(3) it shall not only be 'clear, comprehensible, complete and correct' and not contain any footnotes other than law references, it shall also be presented in a stand-alone, durable medium which consists of maximum 6 sides of A4-sized paper format if printed and be 'clearly distinguishable from marketing communications'. On the other hand, all marketing communications to investors shall be clearly identifiable as such, and national competent authorities shall publish and keep updated on their websites national laws, regulations and administrative provisions applicable to marketing communications of platforms, see Art. 19(1) and Art. 20.

The platform shall keep KIIS updated for the whole period of validity of the offer, see Art. 16(4). When a platform identifies a material omission, a material mistake or a material inaccuracy, the project owner shall according to Art. 16(6) complement or amend that information in the KIIS. Where this is not possible, the platform must not make the crowdfunding offer or cancel the existing offer until the key investment information sheet complies with the requirements of this Article.

According to Art. 16(1) and (7) KIIS shall be drafted in at least one of the official languages of the member states concerned or in a language customary in the sphere of international finance and an investor may request a platform to arrange for a translation of KIIS into a language of the investor's choice. Where the platform does not provide the requested translation of KIIS, the platform shall clearly advise the investor to refrain from making the investment.

Art. 17 deals with *bulletin boards*. Platforms that allow their investors to interact directly with each other to buy and sell loan agreements or transferable securities which were originally crowdfunded on their platforms shall according to section 1 inform their clients that they do not operate a trading system and that such buying and selling activity on their platforms is at the client's own discretion and responsibility. If the platforms suggest a reference price for the buying and selling, they shall inform their clients that this price is non-binding and substantiate it, see section 2. An example of such a bulletin board, is the platform Zopa. Here it is possible for the investors to sell active loans to other investors in the market. There is a 1% fee and a market rate adjustment fee associated with this service, which is available while the loans are up to date with repayments and there are other investors looking to buy the loans.[57]

Art. 18 gives the right for the investor to *access the records* and demand that the platform for five years keeps all records related to their services and transactions on a durable medium and maintains all agreements between the platforms and their clients.

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[57] http://help.zopa.com/customer/en/portal/articles/2796228-are-there-any-fees-associated-with-peer-to-peer-investments-at-zopa-.

2.2.5. EXECUTION OF THE LOAN AGREEMENTS – THE INVESTORS AND THE BORROWER

A P2P loan is often structured as a monthly annuity loan. It is contracted in the lender's and borrower's names and at their expense. The platform normally services the loan until the loan matures by collecting and distributing interest and redemption payments. The *payment* transactions are safeguarded in accordance with the national provisions transposing the 2nd Directive on Payment Services, see 2.1.2 above. If the directives apply, a consumer borrower has a right to withdraw from a contract within 14 days according to the Consumer Credit Directive Art. 14 and a right to early repayment according to the Consumer Credit Directive Art. 16 or the Mortgage Credit Directive Art. 25.

The lenders carry the losses in the event of *default*. As a starting point, the platform is as not liable for losses, but may be held liable especially in cases of grossly behaviour, where for example the platform's negligence or malpractice has caused the lenders losses. A typical situation could be risk assessment, where a platform conceals a known high-risk project to the lenders by categorising it as a low-risk project or exaggerating profit chances while playing down the risks of the project.

In the event of default, more platforms manage missed payments. It could be a sale of non-performing loans on behalf of lenders to a debt collection agent for a fixed price to recover a minimum percentage of the credit claim or an automated litigation and recovery processes.[58] For example the platform Better Rates helps in the event of default to send out reminders and to enforce the claim by civil courts. At the platform Zopa, a loan is classed as defaulted, if a borrower reaches four months' worth of missed repayments. As a capital loss some of the original investment would be lost, and this amount would be deducted from the investor's client account at Zopa, while Zopa tries to make recoveries on the loans.

In case of the *borrower's bankruptcy,* the investments are not covered by the deposit guarantee and investor compensation schemes, and the lenders will suffer losses. Yet, the lenders will be covered in the case of licensed banking, see 2.1.3 above.

In the event of the *platform's bankruptcy,* the lenders will still have their residual claims on the repayments with interest. Yet, asset segregation is of great importance to identify the claims. At all times of the transitions, the assets of the platform ought to be kept separate from the assets of the lender/borrower for example via a partnership with a licensed payment service provider or by creating a separate legal entity to manage the users' assets. In the Netherlands there is a legal demand on platforms to secure asset segregation, see above.[59]

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[58] Lenz (n 4) 696.

[59] Williams (n 54) 190.

2.2.6. THE RELATIONSHIP BETWEEN THE INVESTORS

There is hardly any relationship between the individual investors to a project. Each investor provides separately the funds to the borrower, even though the loan agreements are contracted on the same terms. The principle of severalty will apply as in syndicated loans.[60] An investor is thus not responsible for the obligations of another by performing the loan amount to the borrower and the principle of joint and several liability in for example the Danish promissory note law, gældsbrevsloven § 2, will not apply. However, something else may in rare situations have been contracted.

The decision power when dealing with increased risks including upcoming default situations will as a starting point be the single investors, but unlikely syndicated loans investors have by contract entrusted the platform wide powers and there seems no need for joint decision as for example in a "peer-democracy" after drawdown.

3. IS THE EXISTING LEGISLATION SUFFICIENT?

P2P lending is a fairly new activity, but the intense growth in the last couple of years fuelled by new digital technologies indicates that it is only in its initial stage. As a starting point P2P platforms have to fit within the existing legislation. Yet, the existing legislation seems not quite sufficient to meet the impact that P2P lending may have on modern society.

On *the positive side*, P2P lending has brought a new dimension to the financial market by giving access to new types of investments and new investors, such as private investors. Furthermore, it has given borrowers such as consumers and SMEs access to finance that may be on better terms and at lower costs; finance that they may not have been able to obtain elsewhere. Even though P2P lending often is conceived as a competition to banks, it may fill in the gap, where traditional banking can be considered inapt, while it has become more difficult to obtain credit in banks as a result of the financial crises and stricter capital requirements.[61] On a European level, the platforms' use of technology (FinTech) can elude factors as geographical proximity which creates barriers to the internal market. P2P lending may bring investors greater accessibility and ability to diversify risk with a more resilient and effective financial infrastructure as a result. It may even deliver a more inclusive financial system both domestically and globally.[62]

Yet, also *negative consequences* of P2P lending are lurking in the form of new and different risks. The investor often receives limited information about the borrower as well as about the platforms' credit

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[60] Gorton (n 43) 48-49.
[61] Jørgensen, 'Peer-to-peer lending in Denmark' (n 29) 187.
[62] Lenz (n 4) 688, with reference to a speech by Bank of England Governor Mark Carney.

assessment methods, and furthermore both platforms and borrowers have some incentives not to be too critical concerning the disclosure of risks; a natural conflict of interest exists between investor protection and the platform's business model.[63] The borrowers' poor credit history or lack of access to bank loans may add to the risk of losses for investors and the risk of overindebtedness of borrowers. Due to a divergence in the credit risk assessment, there might be an adverse selection process operating in which low-risk customers borrow from banks and high-risk customers use P2P platforms. Since P2P platforms may accept higher risks than banks, borrowers who are rejected by banks may therefore end up being accepted by P2P platforms.[64]

While institutional investors may benefit from the new types of investments, the contrary may be the consequence for inexperienced private investors, which are unaware of the inherent risks. Yet, P2P lenders are to date not shielded by the EU directives on investor protection. The consumer borrower will likely only be covered by the higher consumer protection in especially the Consumer Credit Directive and the Mortgage Credit Directive, when the lender grants 'credit in the course of his trade, business or profession'. Taking up a loan in a mixed P2P and B2P platform, the consumer borrower may be protected in one situation but not in another.

From *the platforms' point of view*, P2P lending requires significant software investments, and they are today met with different requirements throughout the EU. The necessary involvement of a credit institution in for example Germany makes it more expensive for platforms.[65] However, in a national context the platform "just" needs to be set up in the correct manner to meet the public law requirements by for example having a licence to offer payment services and not engaging in bank activities on its own.

As a fairly new activity, only a small number of member states have introduced legislation on P2P lending, and most member states still seem to prefer a 'wait-and-see' approach.[66] However, P2P lending is rapidly developing with great risks to borrowers and investors, which will call for action. To avoid legislative fragmentation by uncoordinated regulatory activities at the member state level that create new barriers to the emerging EU crowdfunding market, a dedicated, *single European regulatory framework on crowdfunding*, including P2P lending, will be a suitable solution.[67] Expanding the European Commission's proposal for a Regulation on European Crowdfunding Service Providers (ECSP) for

63 Lenz (n 4) 696.
64 Lenz (n 4) 697.
65 Lenz (n 4) 692 and 2.1.3 above.
66 Busch (n 1) 181, and Christian Twigg-Flesner, 'Disruptive Technology – Disrupted Law? How the digital revolution affects (Contract) Law' in Alberto De Franceschi (ed), *European Contract Law and the Digital Single Market* (Intersentia 2016).
67 Busch (n 1) 181, and Lenz (n 4) 700.

Business to a mandatory framework, which also covers consumer borrowing, could do it. Yet, such a framework is not likely in the near future, when the Commission states '[g]iven the predominantly local nature of crowdfunding, there is no strong case for EU level policy intervention'.[68]

The most feasible way may therefore be to adjust today's legislation – at which level it is possible – to a new digital reality, where the existing market structures are changing. One likely, suitable solution could for example be to include both P2P lenders and borrowers in the existing frameworks. To illustrate, in the context of the Consumer Credit Directive and the Mortgage Credit Directive the protection of the consumer borrower could be clarified in situations, where the credit is granted by a private individual via an intermediary acting in the course of his trade, business or profession.

[68] Commission Staff Working Document of 3 May 2016, 'Crowdfunding in the EU Capital Markets Union', SWD(2016) 154 final, 31.