

Regulating Peer-to-Peer (P2P) Lending: A Comparative Study of the UK and China

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A Thesis Submitted for the Degree of Doctor of Philosophy

Kent Law School
University of Kent

October 2024

Word count 94,381 Number of pages 393

Abstract

P2P lending is a method of debt financing that connects individuals and/or SMEs (Small and Medium-sized Enterprises) for direct lending and borrowing through an online platform. As an alternative financial method, its significant growth enhances financial inclusion by lowering the threshold for accessing lending services. However, P2P lending users, as consumers, bear excessive risks associated with this tripartite trust-building lending service, necessitating tailored regulation to ensure sufficient protection for them.

This thesis examines the narrative of both unsecured and secured P2P lending from the perspective of consumer protection, identifying that P2P lenders are vulnerable and justifying the need for an interventionist regulatory approach to protect them. To understand P2P lending in the market and the regulation, and then to explore a tailored regulatory paradigm for protecting P2P consumers, this thesis compares two of the most important P2P lending markets, China and the UK. Drawing lessons from China's failure and the UK's regulatory experiences in this area, this thesis finds that P2P lending platforms are a unique form of digital lending intermediary, distinct not only from pure information intermediaries but also from traditional financial intermediaries. Therefore, the regulation cannot be simply mirrored to either.

This thesis argues that fault-based liability is insufficient to address regulatory difficulties and that holding platforms liable for certain wrongdoings on their platform is justified. It proposes a regulatory paradigm that includes enhancing the platform's liability by applying gatekeeper liability to P2P platforms, emphasising prudential regulation, and adopting a look-through approach to regulate emerging P2P loan securitisation.

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List of Abbreviations

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| ADB | Asian Development Bank Institute |
| B2C | Business-to-Consumer |
| C2C | Consumer-to-Consumer |
| CASS | Client Assets Sourcebook |
| CBILS | Coronavirus Business Interruption Loans Scheme |
| CBIRC | China Banking and Insurance Regulatory Commission |
| CBRC | China Banking Regulatory Commission |
| CCTV | China Central Television |
| CSRC | China Securities Regulatory Commission |
| DeFi | Decentralised Finance |
| DMA | Digital Market Act |
| DMD | Marketing Directive |
| DSA | Digital Services Act |
| EC | European Commission |
| EU | European Union |
| FCA | Financial Conduct Authority |
| FOS | Financial Ombudsman Service |
| FSCS | Financial Services Compensation Scheme |
| FSA | Financial Services Authority |
| ISAs | Individual Savings Accounts |
| IT | Internet Technology |
| MCOB | Mortgage and Home Finance Conduct of Business Sourcebook |
| P2P | Peer-to-Peer |
| P2PFA | Peer-to-Peer Finance Association |
| PPI | Payment Protection Insurance |
| SME | Small and Medium-sized Enterprise |
| SPV | Special Purpose Vehicle |
| SYSC | Senior Management Arrangements, Systems, and Controls |
| UK | United Kingdom |
| US | United States |

Acknowledgements

The journey over the past several years has been an amazing learning experience. I have been extremely fortunate to have Prof Toni Williams and Dr Asta Zokaityte as my supervisors. I am deeply indebted to them for their unwavering support, invaluable guidance and constant encouragement. Not only have they provided expert advice that helped me make progress, but they have also been immensely supportive of my personal well-being especially during the Covid-19 pandemic when I had just given birth and needed to intermit my study for baby care.

I am also grateful to Prof Donatella Alessandrini for her insightful suggestions and to Prof Amanda Perry-Kessarlis for her guidance in the research methods module. Moreover, my heartfelt thanks go to my dear friends, especially Dr Rebecca Gulbul and Dr Zi Yang, for making this journey so memorable. Additionally, I extend my gratitude to the administrative staff at Kent Law School, particularly Karen Finch, for their support in providing information and always addressing my inquiries promptly.

Finally, I am profoundly thankful to my parents, Wei Yang and Yaozhong Zhang, and my parents-in-law, Wanfang Lin and Jinfan Tang, for their constant support and care. I would also like to express my gratitude to my husband, Dr Zhuoqi Tang, for his love and encouragement and being a constant source of strength. Finally to my little girl, Alice Yimo Tang, thank you for making me stronger, better, and more fulfilled.

Chapter 1 Introduction

1.1 Research Background

As a form of fintech within the concept of a sharing economy¹, P2P lending has rapidly gained traction in markets across many countries, experiencing swift growth driven by advancements in Internet technology (IT) following the launch of the first P2P lending platform, *Zopa*, in the UK in 2005.² P2P lending has since become a significant alternative finance option for individuals and SMEs, addressing the lending gap left by traditional banks. Its inclusive approach to users has further contributed to the democratisation of finance.

However, practical cases have demonstrated that P2P lending carries significant risks. The primary risk inherent in the P2P business model stems largely from its "low-barrier, low-cost" approach. On one hand, P2P lending can be accessible to borrowers who are unable to secure funds from traditional financial institutions due to unsatisfactory credit scores, lack of collateral or other reasons. As a result, the overall creditworthiness of P2P borrowers is theoretically lower than that of borrowers in traditional financial institutions. On the other hand, due to lower operational costs compared to traditional financial institutions, P2P platforms have limitations in their ability to effectively manage risk. As a result of these factors, the default risk in P2P lending is higher.

Since the P2P lending platform functions as a facilitator rather than a direct lender and is not a party to the loan contract, the risk of loan default is borne by the lenders, not the platform.

¹ Molly Cohen and Arun Sundararajan, 'Self-Regulation and Innovation in the Peer-to-Peer Sharing Economy' (2015) 82 University of Chicago Law Review Online 116 <https://chicagounbound.uchicago.edu/uclrev_online/vol82/iss1/8/> accessed 19 September 2023.

² Zopa, 'Our Story' < <https://www.zopa.com/about/our-story> > accessed 3 February 2025.

However, as P2P lenders heavily rely on the platform to provide information, make lending decisions, monitor borrowers' repayments and even pursue defaulted loans, there is a moral hazard that platforms may be incentivised to maximise loan volumes without adequately assessing and disclosing associated risks, potentially leading lenders to underestimate the risks involved. This situation places P2P lenders in a uniquely vulnerable position, which differs from traditional personal lending where individual lenders typically possess greater bargaining power in negotiating interest rates, repayment terms, and debt recovery strategies.

In the credit market, consumer protection efforts have primarily focused on borrowers³, who are widely recognised as vulnerable parties at risk of experiencing unfair relationships within credit agreements.⁴ While P2P borrowers similarly require protection against unfair terms—such as excessive interest rates or abusive debt collection practices—the vulnerability of P2P lenders warrants distinct attention. This vulnerability sets them apart from participants in many other areas of the consumer credit market.

The inclusive and easily accessible nature of P2P platforms has attracted a wide range of individual lenders, many of whom lack professional investment experience or financial literacy.⁵ This increases their reliance on the platform's guidance, recommendations, or

³ Jodi Gardner, 'High-Cost Credit in the UK' in Jodi Gardner (ed), *The Future of High-Cost Credit: Rethinking Payday Lending* (Hart Publishing 2022) 15–40.

⁴ Jodi Gardner, 'The Challenges of Regulating High Cost Short Term Credit: A Comparison of UK and Australia' (2014) CHASM University of Birmingham <<https://www.birmingham.ac.uk/Documents/college-social-sciences/social-policy/CHASM/2014/the-challenges-of-regulating-high-cost-short-term-credit-UK-and-Australia.pdf>> accessed 21 February 2025.

⁵ Galit Klein, Zeev Shtudiner and Moti Zwillig, 'Why Do Peer-to-Peer (P2P) Lending Platforms Fail? The Gap Between P2P Lenders' Preferences and the Platforms' Intentions' (2023) 23 *Electronic Commerce Research* 709.

promotional materials when making lending decisions. As a result, they may be less equipped to identify misleading information or to recognise a lack of transparency in the risks presented.

Moreover, the inclusive nature of P2P lending means that many lenders also lack the financial resilience to absorb significant losses.⁶ Although P2P lending transactions often involve relatively small loan amounts⁷, the cumulative impact of losses can be devastating, particularly when individuals invest substantial portions of their life savings. If regulatory frameworks fail to engage meaningfully with the lived experiences of such lenders, they risk treating them as investors with surplus capital. In doing so, they overlook the lenders' potential vulnerability. This is not only unfair to lenders but also undermines the broader objectives of consumer protection, as it fails to acknowledge the power imbalances and informational asymmetries that may expose individuals to significant and unjust financial harm.

The vulnerabilities of the P2P lenders have been starkly illustrated by the numerous scandals that occurred within China's P2P lending market, which, before being shut down by the regulator, was the largest in the world by trading volume and number of platforms.⁸ Many P2P lenders in China faced unexpected and significant financial losses without fair remedies, largely due to the absence of regulation prior to 2015 and the subsequent failure of regulatory rectification to address emerging challenges effectively. This demonstrates the deficiency of a

⁶ *Ibid.*

⁷ *Ibid.*

⁸ Tania Ziegler and others, 'The Global Alternative Finance Market Benchmarking Report: Trends, Opportunities and Challenges for Lending, Equity and Non-Investment Alternative Finance Models' (Cambridge Centre for Alternative Finance 2020) < <https://www.jbs.cam.ac.uk/wp-content/uploads/2020/08/2020-04-22-ccaf-global-alternative-finance-market-benchmarking-report.pdf> > accessed 18 February 2024.

"free market" and "hands-off" approach to P2P lending and highlights the necessity of interventional regulation to ensure market stability and protect consumers.

To explore effective solutions for regulating P2P lending, it is crucial to examine a relatively stable P2P lending market where this type of lending functions as a key form of alternative finance for individuals and SMEs, and where there is no clear evidence of market unsustainability. For this purpose, this thesis selects the UK, the birthplace of P2P lending and the largest P2P lending market in the EU by trading volume⁹, as a representative example for a comparative study with China. Because the UK has managed to establish a more stable regulatory environment for P2P lending, comparing it with China's experience can provide valuable insights into the regulatory frameworks needed to foster safe and sustainable growth in this sector. References to regulations in other countries, such as the US, will be included when relevant to provide a broader context for the discussion.

1.2 Research Objectives and Research Questions

This thesis aims to offer a valuable understanding and comprehensive analysis of P2P lending regulation by first establishing a theoretical framework for understanding P2P lending, and then examining the regulatory experiences of both the UK and China. As legal research, this thesis does not aim to propose enhancements to the P2P lending business model itself. Rather, its primary objective is to investigate an effective regulatory framework for the regulation of P2P lending, with a particular focus on consumer protection, especially for lenders who are in a vulnerable position within this high-risk financial service. By addressing

⁹ Statista, 'Leading European Countries in Peer-to-Peer (P2P) Business Lending in 2020, by Market Volume' (21 February 2023) <<https://www.statista.com/statistics/625606/leading-european-countries-in-p2p-business-lending/>> accessed 4 February 2025.

the regulatory challenges specific to P2P lending, the thesis aims to contribute to the development of regulations that better safeguard consumers and ensure market stability. Additionally, this research aspires to provide valuable insights for future studies and practical applications in the evolving field of fintech. Based on the objectives, this thesis explores the following questions:

(1) What is the justification for regulating P2P lending?

Theoretical and practical justifications for financial regulation are multiple, such as market failure,¹⁰ consumer protection¹¹, systemic issues and so on.¹² As the justification for regulation determines the focus of regulation, it is important to explore why P2P lending should be regulated. Although almost all justifications for financial service regulation could also apply to the P2P lending industry, they vary in terms of importance. This thesis explores the justification by identifying the distinctive features of P2P lending as an innovative financial service arguing that consumer protection is the primary reason for regulating P2P lending. This emphasis on consumer protection arises from the vulnerable position of P2P lenders and the significant harm they have experienced in cases of failure, as demonstrated by practical examples within the industry. Therefore, this thesis focuses on consumer protection as the main perspective for developing tailored regulations.

¹⁰ Philip Mark Booth, 'Is "Market Failure" a Good Justification for Financial Regulation?' (2021) Institute for International Monetary Research <<https://research.stmarys.ac.uk/id/eprint/5209/1/IIMR%20paper.pdf>> accessed 20 September 2023.

¹¹ George J Benston, 'Consumer Protection as Justification for Regulating Financial-Services Firms and Products' (2000) 17 Journal of Financial Services Research 277.

¹² David Llewellyn, 'The Economic Rationale for Financial Regulation' (1999) Financial Service Authority Occasional Paper Series 1 <https://www.fep.up.pt/disciplinas/pgaf924/PGAF/Texto_2_David_Llewellyn.pdf> accessed 20 September 2023.

(2) What are the critical issues in evaluating and designing a P2P lending regulatory regime?

This question serves as the foundation for exploring the regulatory paradigm. The thesis analyses the risks and value that P2P lending presents to consumers and then explores the theoretical rationale for consumer protection within the context of P2P lending. It argues that the uneven playing field for P2P lenders necessitates an interventional regulation based on the theory of behavioural economics and soft paternalism. Additionally, it highlights the critical role and influential position of platforms in P2P lending transactions.

(3) To what extent have the UK and China addressed the regulatory challenges of P2P lending?

This question is explored in two parts. The first part reviews the development of P2P lending regulation in the UK and China, analysing the context of each country's regulatory framework to provide a critical evaluation. The second part involves a comparative study that assesses which regulatory rules are more effective in achieving the regulatory objectives.

Despite China's regulatory efforts, the P2P lending industry did not achieve sustainable and stable development, nor were adequate consumer protection measures effectively implemented. However, certain regulatory measures did succeed in achieving specific objectives, particularly in addressing conflicts of interest between platforms and users. The collapse of China's P2P lending market, while unfortunate, provides valuable insights into the regulation of P2P lending. Conversely, the UK's P2P market has demonstrated steady growth, but consumer harm still occurs, and regulatory gaps exist. Therefore, while both countries

have shown partial effectiveness in regulating the P2P lending sector, they have done so in different areas and to varying degrees.

(4) Is there any regulatory paradigm fit to solve regulatory difficulties by striking a balance between industry development and consumer protection?

This question represents the ultimate objective of this study. Drawing from both theoretical and practical perspectives, as well as a comparative analysis of the UK and China, this thesis contends that a fault-based liability framework is inadequate for addressing the excessive risks and ensuring transparency, clarity and fairness in the P2P lending industry. Instead, it proposes the adoption of a gatekeeper liability model as a more effective regulatory approach, emphasises the importance of prudential regulation and advocates for a look-through regulation in the context of P2P loan securitisation.

1.3 Significance of the Study

This thesis makes contributions to the literature on P2P lending regulation from three key perspectives. First, the thesis provides a theoretical framework for regulating P2P lending as a financial innovation, grounded in existing literature and integrating the latest features of P2P lending. Most research on P2P lending consists of empirical studies on business strategy, consumer behaviour, and the state of the industry, whereas legal studies are less common and typically focus on a single jurisdiction. Moreover, given the rapid evolution of the P2P industry, regulatory policies are constantly being updated to keep pace with new developments. While much of the existing literature focuses on the unsecured lending model that once dominated P2P platforms, this thesis takes a broader approach which includes both unsecured and secured models. It considers the dynamic nature of P2P lending and the ongoing changes in

regulatory frameworks, offering an integrated and comprehensive perspective on the subject. By doing so, it addresses the current gaps in the literature in the most updated view on P2P lending regulation beyond one jurisdiction's experience and provides a more holistic understanding of how regulation can effectively adapt to the evolving landscape of P2P lending.

The thesis identifies both P2P lenders and borrowers as consumers, with lenders being in a particularly vulnerable position. This vulnerability justifies the need for prioritising their protection as the primary focus of P2P lending regulation. By examining the theoretical background of P2P lending, the thesis concludes that free market theory is not suitable for this industry. Instead, behavioural economics provides a better framework for understanding P2P lending, necessitating a more interventionist regulatory approach. It suggests that soft paternalism should serve as the theoretical basis for exploring an appropriate regulatory paradigm.

Second, the thesis compares two distinct P2P lending markets—one that has failed and another that is relatively stable. This approach differs from existing comparative studies on P2P lending, which often focus on identifying similarities and differences between countries. Instead, this thesis aims to assess the effectiveness of regulatory rules for certain objectives in the two markets by assuming transparency, clarity and fairness to be the functions for regulating P2P lending. Through this comparison, the study offers insights into how various strategies can either foster or hinder the growth of P2P lending, highlighting best practices and potential pitfalls. The comparative study concludes that interventionist regulation is

necessary not only in theory but also in practice, and underscores the critical role of P2P platforms, suggesting that fault-based liability alone is insufficient.

Although China's P2P lending market has been formally phased out, the topic remains highly relevant. The regulatory failure in China offers important lessons for other jurisdictions, both in the context of P2P lending and the broader regulation of financial innovation. Despite setbacks in certain markets, P2P lending and other fintech-driven credit models continue to grow globally. The global P2P lending market is projected to expand at a compound annual growth rate (CAGR) of 25.52% between 2025 and 2034¹³. Similarly, global fintech revenues are expected to grow at a CAGR of approximately 15% from 2024 to 2030.¹⁴

In addition, the social value of P2P lending—particularly its potential to enhance financial inclusion and democratise access to finance—should not be overlooked. By lowering traditional barriers such as collateral requirements and rigid credit history checks, P2P platforms broaden access to capital and empower underserved or economically marginalised groups. A well-designed regulatory framework can support the responsible development of the industry while mitigating risks such as fraud, mismanagement, and overexposure. In doing so, it contributes to broader economic development goals, including inclusive growth and financial empowerment.

¹³ Precedence Research, 'Peer to Peer (P2P) Lending Market Size and Forecast 2025 to 2034' (31 January 2025) <<https://www.precedenceresearch.com/peer-to-peer-lending-market>> accessed 1 March 2025.

¹⁴ Boston Consulting Group, 'Global Fintech is a \$1.5 Trillion Opportunity' (3 May 2023) <<https://www.bcg.com/press/3may2023-fintech-1-5-trillion-industry-by-2030>> accessed 1 March 2025.

Third, the thesis introduces a new regulatory paradigm that strengthens the responsibilities of P2P lending platforms by implementing gatekeeper liability. Although this concept is rooted in the broader discussion of gatekeeper liability for financial intermediaries, it is specifically tailored to the unique dynamics of P2P lending. Unlike traditional financial intermediaries, where gatekeeper liability primarily focuses on public responsibilities like anti-money laundering, the emphasis here is on the P2P platforms' role in facilitating loan transactions. The thesis advocates for holding platforms accountable as gatekeepers or collaborative gatekeepers for activities conducted through their services, aiming to protect consumers and uphold the integrity of the P2P lending market. Additionally, as a framework, it highlights the importance of prudential regulation, complemented by civil liability, and incorporates a look-through approach for regulating P2P loan securitisation.

Overall, this study contributes to the literature by providing a theoretical framework for protecting consumers in the P2P lending industry, offering a unique comparative analysis, and proposing a new regulatory paradigm. These contributions not only enhance the understanding of P2P lending regulation but could also provide practical insights for policymakers, regulators, and industry stakeholders looking to develop more effective and responsive regulatory frameworks for this rapidly evolving sector.

1.4 Methodology

1.4.1 Literature-based study

This study is conducted through literature-based research, utilising a combination of both primary and secondary sources including legislation, regulatory documents, government

publications, industry and organisational reports, academic journal articles, conference papers, websites, blogs, News, and reviews of relevant cases. The primary focus is on legal, socio-economic, and empirical studies related to P2P lending.

To answer research questions 1 and 2, the thesis justifies regulating P2P lending from the perspective of consumer protection and establishes a theoretical framework for the rationale of protecting P2P consumers based on legal and economic theories, industry data/information and empirical studies of the P2P lending sector. This framework forms the basis for proposing tailored regulations for P2P lending. Questions 3 and 4 are also addressed through a literature study, with doctrinal research and comparative analysis applied as well.

1.4.2 Doctrinal Research

The study examines the markets and regulations of China and the UK on two approaches to achieve its research objectives. First, it uses these two countries as typical cases of P2P lending markets to understand the development of the P2P lending industry and to analyse how regulatory frameworks operate within this sector. This includes a review of the development of P2P lending markets and a doctrinal analysis of the respective regulatory framework. Doctrinal research is an analytical process that offers a systematic presentation of the rules governing a specific legal area, it examines the relationships between these rules and helps clarify complex issues within them.¹⁵ This thesis employs doctrinal research to explain the regulatory rules of P2P lending in the UK and China, not only to understand the underlying ideologies on which they are based but also to contextualise them within the background of

¹⁵ Terry Hutchinson and Nigel Duncan, 'Defining and Describing What We Do: Doctrinal Legal Research' (2012) 17 Deakin Law Review 83.

each P2P lending market. The regulatory rules compared in this thesis include, for China, the “1+3” regulatory framework, along with the No. 83 Notice and three local government policy statements issued by the Shenzhen municipality and the provinces of Hainan and Hunan, which provide guidance on the orderly exit of P2P lending platforms. For the UK, the analysis focuses on three key policy statements issued by the FCA governing the regulation of P2P lending. In addition, Article 36H of the Financial Services and Markets Act 2000, which defines P2P agreements as regulated activities, is also examined. This approach aims to explore answers to questions 2 and 3, while also laying the foundation for question 4.

1.4.3 Functional Comparative Study

The second approach to investigating P2P lending regulation in China and the UK is to conduct a comparative study using a functional method. The functional comparison allows for the examination of issues independently from the doctrinal frameworks of each legal system being compared.¹⁶ This approach provides an unbiased basis for identifying and evaluating legal materials across jurisdictions, making them suitable for mutual comparison.¹⁷ Despite China and the UK having different legal systems, the practical purposes of P2P lending regulation converge more closely than their respective legal traditions suggest.

¹⁶ Jaakko Husa, ‘Comparative Law, Legal Linguistics and Methodology of Legal Doctrine’ in Mark Van Hoecke (ed), *Methodologies of Legal Research. Which Kind of Method for What Kind of Discipline?* (Hart Publishing 2011) 221-222.

¹⁷ Catherine Valcke and Matthew Grellette, ‘Three Functions of Function in Comparative Legal Studies’ in Maurice Adams and Dirk Heirbaut (eds) *The Method and Culture of Comparative Law: Essays in Honour of Mark Van Hoecke* (Hart Publishing 2014) 99-112.

For adopting a functional approach, the thesis assumes that P2P lending regulations across jurisdictions share common overarching objectives, namely: protecting consumers, enhancing the integrity of the financial system, and promoting effective competition. Within the context of this study, which focuses on consumer protection, the functions of P2P lending regulations are identified as ensuring transparency, clarity, and fairness. The comparative analysis examines the effectiveness of regulatory rules in China and the UK, assessing the extent to which they have fulfilled these intended functions and addressing the specific regulatory challenges associated with P2P lending. The comparative study aims to address question 3 and provide a basis for question 4.

The functional method is one of several approaches to comparative law, centred around identifying and analysing the functions that legal rules and regulatory bodies serve in different contexts.¹⁸ It seeks to determine the underlying principles that guide these functions and evaluates their effectiveness in achieving regulatory goals. This approach is based on the premise that every legal system faces similar fundamental problems and that these problems are often resolved through different means, albeit sometimes with comparable outcomes. This concept of functional equivalence enables meaningful comparisons across diverse legal systems.¹⁹ The functional method emphasises the effects of laws rather than doctrinal structures, focusing on providing practical legal responses to real-life situations by comparing

¹⁸ Other main approaches to comparative law include comparative legal history, the study of legal transplants, and the comparative study of legal cultures. Ralf Michaels, 'The Functional Method of Comparative Law' in Mathias Reimann and Reinhard Zimmermann (eds) *The Oxford Handbook of Comparative Law* (online edn, Oxford Academic 2012) 341.

¹⁹ Konrad Zweigert and Hein Kötz, *An Introduction to Comparative Law* (Tony Weir tr, 3rd edn, OUP 1998).

how different laws address similar issues and identifying which legal framework is more effective in fulfilling its function.²⁰

The functional method is particularly well-suited for this study because the regulatory challenges of P2P lending primarily arise from the business model itself. These challenges include: 1) non-professional individual lenders being in a vulnerable position due to difficulties in accessing accurate information and making informed decisions; 2) lenders bearing the credit risk while relying on platforms for information and loan repayment, which further exacerbates their vulnerability; and 3) platforms having limited resources for thorough credit assessments and facing moral hazards to aggressively pursue transaction volumes.

These issues are inherent to any country with a P2P lending market, regardless of differences in their legal systems, financial markets, or economic conditions. Therefore, while there are variations in legal systems, socio-economic backgrounds, and the state of financial markets and regulation between China and the UK, using the functional method allows this study to focus solely on whether the regulations address the specific issues mentioned above and effectively fulfil their intended functions. This approach helps achieve the aim of the study, which is to gain insights into resolving the regulatory challenges of P2P lending.

A careful functionalist approach must remain sensitive to whether the intended regulatory function is genuinely fulfilled by the legal framework in practice.²¹ In the context of P2P lending, this involves examining whether consumer protection regulations effectively mitigate

²⁰ Michaels (n 18) 341-378.

²¹ *Ibid.*

the risks of borrower overindebtedness and lender financial harm, or whether they merely serve to formalise platform operations without adequately addressing these underlying vulnerabilities.

However, it should be acknowledged that the functional method of comparative law has been a subject of controversy.²² One of the main criticisms is that it disregards legal families and traditions, potentially oversimplifying complex legal systems.²³ Nonetheless, in the context of P2P lending regulation, which is an emerging area within Fintech, the influence of legal tradition appears to be comparatively less pronounced. As a relatively recent development, P2P lending has prompted regulators in various jurisdictions to create novel and adaptive regulatory frameworks, rather than relying exclusively on established legal doctrines.

Another common critique of the functionalist approach is its limited engagement with cultural factors, which may render it overly reductionist.²⁴ The assumption that legal systems “solve” financial vulnerabilities in comparable ways can obscure the nuanced socio-economic roles that law plays in different contexts.²⁵ In this study, however, such limitations are expected to have minimal impact. The regulatory challenges examined are largely tied to the business model of P2P lending itself, rather than to deeply rooted moral or cultural values. The underlying normative goal—protecting lenders from default risk while preventing unjust harm

²² *Ibid* 378-380.

²³ *Ibid*.

²⁴ *Ibid*.

²⁵ Iain D C Ramsay, ‘Functionalism and Political Economy in the Comparative Study of Consumer Insolvency: An Unfinished Story from England and Wales’ (2006) 7 *Theoretical Inquiries in Law* 625.

to borrowers—is relatively straightforward and broadly shared. Although ethical concerns such as fairness in lending terms and information transparency are relevant, the core regulatory focus remains on economic efficiency, risk mitigation, and consumer protection. As such, divergent moral or cultural perspectives are unlikely to significantly influence the regulatory approach, increasing the potential for convergence or, at the very least, meaningful comparison across jurisdictions.

1.5 Structure of the thesis

The thesis comprises eight chapters and is organised as follows:

While Chapter 1 serves as an introduction, Chapter 2 lays the foundation for the examination of regulatory interventions by clarifying the distinctive characteristics of P2P lending. It argues that P2P lending requires tailored regulation to fit its innovative aspects and promote its positive social value in enhancing financial inclusion.

Chapter 3 identifies P2P users as financial consumers and explores the risks they face in the P2P lending market. It argues that behavioural economics and soft paternalism are well-suited for protecting these consumers, given that they sometimes make irrational decisions. The chapter also emphasises the importance of disclosure during the pre-contractual stage to mitigate information asymmetry.

Chapter 4 analyses the characteristics of the P2P lending industry and its regulation in China. The regulatory responses to the P2P lending scandals are critically evaluated, followed by an exploration of the reasons behind the failure of P2P lending in China. To understand this failure, the chapter illustrates the development of the P2P lending market in China and highlights the

significant issues that arose. Additionally, the chapter examines the regulatory framework and the interaction between regulation and the collapse of P2P lending in China, with a particular focus on the harsh and ambiguous central-local regulatory regime.

Chapter 5 examines the development and regulation of P2P lending in the UK. It analyses the resilience of the market, demonstrating its steady growth despite the negative impacts of the COVID-19 pandemic. The chapter also explores how the FCA's adaptive regulatory approach has contributed to this sustained expansion, while highlighting areas where regulation has been insufficient.

Chapter 6 provides a comparative analysis of P2P lending regulations in the UK and China, focusing specifically on consumer protection through a functional approach. This chapter identifies transparency, clarity, and fairness as key functions of consumer protection regulations within the P2P lending industry. By examining the regulatory frameworks of both countries, the chapter underscores the importance of enhancing platform liability to better protect consumers.

Chapter 7 reconsiders the nature of P2P platforms, identifying them as unique digital lending entities that do not fit neatly into the categories of pure information intermediaries or financial intermediaries. The chapter emphasises the proactive role and central position these platforms hold in P2P loan transactions. To enhance consumer protection more effectively, it proposes the adoption of gatekeeper liability, which aims to balance industry innovation with robust consumer safeguards. Additionally, this chapter discusses prudential regulation, civil

liability, and look-through regulation, providing a comprehensive framework for addressing the complexities of the P2P lending market and enhancing consumer protection.

Chapter 8 summarises the key findings and answers the research questions. It also discusses the limitations of this study and offers suggestions for future research on the evolving P2P lending market and its regulation.

Chapter 2 P2P lending as a financial service

2.1 Introduction

P2P lending represents a notable financial innovation characterised by distinct features deviating from conventional institutional lending practices. This thesis argues that these distinctive features necessitate tailored regulatory frameworks to address pertinent legal, economic and social characteristics of P2P lending transactions. This chapter endeavours to elucidate the fundamental concepts, business modalities, and distinctive attributes of P2P lending, thereby establishing a comprehensive groundwork for the subsequent examination of regulatory interventions. As such the chapter is primarily concerned with aspects of the second research question of this thesis: What are the critical issues in designing and evaluating a P2P lending regulatory regime? Additionally, the chapter lays the groundwork for addressing the first research question: What is the justification for regulating P2P lending? It responds to these questions by describing the characteristics of P2P lending and exploring aspects of this complex innovation that are significant to the design of effective regulation to protect P2P consumers.

The primary research methodology employed in this chapter involves the examination of these questions through a literature-based study and the analysis of relevant data gathered from publications and reports. Section 2.2 draws on this literature and data to offer a comprehensive account of P2P lending. This account outlines the emergence of this financial development, showing its relationship with other innovative types of non-bank lending, such as microfinance, and gives a sense of its contemporary scale. Section 2.2 also offers an overview of the terminology used within the literature, discusses key characteristics of P2P lending and describes how these transactions are organised.

Section 2.3 examines the analytical distinctiveness of P2P lending to identify those characteristics that are significant to decisions about the regulation of P2P lending markets. This section of the chapter focuses in particular on the informational dimensions of P2P markets, the characteristic role of the platform in P2P transactions, key aspects of building and sustaining trust in P2P lending and claims about the distinctive societal value that P2P lending provides. The section also considers whether P2P lending has the features of a “disruptive innovation”, a finding that potentially could have implications for thinking about regulation.

The chapter finds, first, that P2P lending inherits certain elements from microfinance while broadening the potential user base, and second that the emergence of P2P lending is intricately linked with the advancement and widespread adoption of IT. A third finding is that P2P lending has a low threshold for borrowers to enter the market and a cost-saving business model, which enables favourable interest rates to be offered to a broader spectrum of

individuals and SMEs. Consequently, P2P lending potentially may foster financial inclusion and financial democratisation. The chapter's fourth finding is that despite the low access barriers and its cost-saving models, which engender a limited level of competition with traditional financial institutions, P2P lending primarily aims to address gaps within the traditional lending landscape instead of positioning itself as a direct competitor to the traditional lending market. As such, P2P is not a disruptive innovation and is unlikely to challenge the dominant position of banks. A fifth finding is that P2P lending is not a form of financial disintermediation. Although it eliminates traditional financial intermediaries, it does not entirely eradicate intermediaries, as the platforms play a significant role in the lending process, which the thesis will subsequently show has implications for regulatory design. Finally, the chapter finds that trust-building in P2P lending operates on two levels: the user's trust in the platform and the lender's trust in the borrower. The "wisdom of the crowd" phenomenon plays a pivotal role in both levels of trust-building and concludes that regulatory bodies should take note of the negative aspects brought about by herd behaviour.

2.2 The development and characteristics of P2P lending

2.2.1 The emergence of P2P lending

Lending directly between individuals has existed in the physical world since 3,500 BC when people utilised consumer loans for agricultural purposes in ancient Sumer.²⁶ Throughout history, diverse forms of money lending have emerged, with legal and economic scholars tracing the origins of P2P lending and commonly viewing it as a type of microfinance. This is because microfinance refers to financial services designed for individuals and small businesses

²⁶ Jeff Desjardins, 'The History of Consumer Credit in One Giant Infographic' (*Visual Capitalist*, 29 August 2017) <<https://www.visualcapitalist.com/history-consumer-credit-one-infographic/>> accessed 10 February 2025.

that do not have access to traditional banking and its associated services.²⁷ In this sense it displays similar concepts that underpinned P2P lending.

The literature, for example, Hulme and Wright, in their study of P2P lending as a business model, states that P2P lending can be traced back to friendly societies that first emerged in Britain in the 17th Century.²⁸ Moreover, Brill's legal study argues that the roots of P2P lending can be traced back to the principles of microcredit, a practice that has been employed for centuries in nations such as Ghana and India.²⁹ Similarly, in an industry news article, Jan mentioned German credit cooperatives and Irish loan funds when introducing the pre-history of P2P lending.³⁰ In addition, in Wang and others' book on China's P2P lending market, they trace the origins of China's P2P lending to the Rotating Savings and Credit Association, which is a personal cooperative lending model.³¹ Although there is no consensus on the specific type of microfinance from which P2P lending originates, it is obvious that P2P lending demonstrates similar social values to microfinance in the aspect of providing alternative access for the financially disadvantaged group. However, it cannot be overlooked that P2P lending also incorporates distinctive features, particularly in terms of its innovative fintech business model, which will be discussed in 2.2.4.

²⁷ Jonathan Morduch, 'The Microfinance Promise', *Journal of Economic Literature* 37 (1999) 1569.

²⁸ Michael K Hulme and Collteet Wright, 'Internet Based Social Lending: Past, Present and Future' (2006) 11 *Social Futures Observatory* 19.

²⁹ Alex Brill, 'Peer-to-Peer Lending: Innovative Access to Credit and the Consequences of Dodd-Frank' (2010) 25 *Wash L Found L Backgrounder* 1.

³⁰ Jan Bednorz, 'The History of Peer-to-Peer Lending' (*P2Pmarketdata*, 6 June 2023) <<https://p2pmarketdata.com/articles/p2p-lending-history/>> accessed 10 February 2025.

³¹ Jiazhuo G. Wang and others, *Financing the Underfinanced Online Lending in China* (Springer 2015) 4.

Modern P2P lending emerged with the establishment of the first platform, *Zopa*, in 2006.³² As explained by one of the co-founders, David Nicholson, widely acknowledged as the father of P2P lending, the idea of P2P lending was inspired by the pre-banking past and the fundamental relationship between lenders and borrowers.³³ In addition, he highlights that the development of IT made the new form of lending intermediary possible:

*"I was building a deeper understanding of what's really going on here, and what's really going on in a bank and sort of reading a little bit about where banks came from and how banking has moved over the years and actually understanding that really, although a lot of stuff looks very complex, there are actually some pretty simple basic building blocks underneath. Then, if you go back and look at those building blocks, you understand why banks have been the institutions that have been capable of doing those because if you wind back 100 or 200 years, you didn't have any of the information, or the systems, or the technology, that would enable anybody else to do that intermediary function."*³⁴

The rise of Web 2.0 technologies, which promote user and customer participation, has made it possible to surpass geographic barriers in peer-to-peer lending.³⁵ One of the primary

³² Zopa (n 2).

³³ Ulrich Atz and David Bholat, 'Peer-to-Peer Lending and Financial Innovation in the United Kingdom' Bank of England Working Paper No.598 (2016) <<https://www.bankofengland.co.uk/working-paper/2016/peer-to-peer-lending-and-financial-innovation-in-the-uk>> accessed 10 February 2025.

³⁴ Bednorz (n 30).

³⁵ Tim O'Reilly, 'What is Web 2.0: Design Patterns and Business Models for the Next Generation of Software' (2007) 1 Communications & Strategies 17.

objectives of the Web 2.0 paradigm is to foster collaboration, coordination, and interactive communication.³⁶ As such, the emergence of P2P lending is closely intertwined with these technological advancements, enabling the feasibility of online lending through digital platforms.

Another crucial factor is the number of individuals using the internet, providing a sufficient user base that can access P2P lending platforms. *Table 1* displays the first P2P lending platforms of 20 selected countries and demonstrates a necessary (but not sufficient) condition for the emergence of P2P lending platforms: either a higher internet penetration rate, a lower internet penetration rate but with a higher population, or both higher internet penetration rate and higher population.

Table 1: Initial P2P Platforms in Selected Countries³⁷

| Country | First P2P lending platform | Founding year | Internet Penetration in the founding year (%) | Population in the founding year (million) | Population using internet in the founding year (million) |
|---------|----------------------------|---------------|---|---|--|
| UK | Zopa | 2005 | 70 | 60.2 | 42.1 |
| US | Prosper | 2006 | 68.9 | 298.4 | 205.6 |

³⁶ Getaneh Alemu and Brett Stevens, *An Emergent Theory of Digital Library Metadata* (Elsevier 2015).

³⁷ The names of the platforms, their founding years and the corresponding population are sourced from Google searches in Eastleigh, UK <<https://www.google.com>> accessed 9 March 2024. Data on internet penetration is cited from Statista <<https://www.statista.com>> accessed 9 March 2024.

| | | | | | |
|--------------|----------------------------|------|------|-------|-------|
| Japan | Maneo | 2006 | 68.7 | 127.9 | 87.9 |
| China | PPdai | 2007 | 16 | 1,320 | 211.2 |
| Germany | Auxmoney | 2007 | 60.2 | 82.3 | 49.5 |
| France | Prêt d'Union ³⁸ | 2009 | 70 | 64.7 | 45.3 |
| Russia | Zaimer | 2010 | 43 | 142.8 | 61.4 |
| Australia | SocietyOne | 2011 | 79.5 | 22.3 | 17.7 |
| Brazil | Biva | 2012 | 48.6 | 200 | 97.2 |
| Mexico | Kubo.financiero | 2012 | 39.8 | 115.8 | 46.1 |
| South Africa | RainFin | 2012 | 41 | 53.2 | 21.8 |
| Italy | BorsadelCredito | 2013 | 58.5 | 60.2 | 35.2 |
| India | Faircent | 2014 | 13.5 | 1,291 | 174.3 |
| New Zealand | Harmony | 2014 | 84 | 4.5 | 3.8 |
| Singapore | MoolahSense | 2014 | 82.1 | 5.5 | 4.5 |
| South Korea | Lendit | 2014 | 87.6 | 50.8 | 44.5 |
| Denmark | Flex Funding | 2014 | 96 | 5.6 | 5.4 |
| Pakistan | UBL SME | 2015 | 11 | 211 | 23.2 |
| Indonesia | Modalku | 2015 | 22.1 | 280 | 61.9 |
| Switzerland | CreditGate24 | 2015 | 87.5 | 8.3 | 7.3 |

³⁸ It became Younited Credit. See RumeurPublique, 'Prêt d'Union becomes Younited Credit' (*RumeurPublique*, 24 May 2016) <<https://www.rumeurpublique.fr/en/2016/05/24/pret-dunion-becomes-younited-credit/>> accessed 10 February 2025.

2.2.2 Characteristics of P2P lending

While P2P lending can be succinctly described as a digital platform matching borrowers and lenders to transact loans directly, various sources do not always provide identical delineations of it. This could be due to a lack of consensus, or due to the evolving understanding of P2P lending over time as authors have gained more insights into the industry's development. To illustrate this progression, the following is a list of definitions drawn from the literature, presented in chronological order:

“P2P lending is a breed of financial transactions that occur directly between individuals without the intermediation of a traditional financial institution.”

-----Lee and Lee (2012)³⁹

“Online peer-to-peer lending is ...by enabling individuals to borrow and lend to one another principally through unsecured loan transactions brokered by an online platform.”

-----Osuji and Amajuoyi (2015)⁴⁰

“P2P platform technology allows direct matching of borrowers and lenders diversification over a large number of borrowers without the loans having to be held on an intermediary balance sheet.”

³⁹ Eunkyong Lee and Byungtae Lea, 'Herding Behavior in Online P2P lending: An Empirical Investigation.' (2012) 11 Electronic Commerce Research and Applications 495.

⁴⁰ Onyeka K. Osuji and Ugochi C.Amajuoyi, 'Online Peer-to-Peer Lending: Challenging Consumer Protection Rationales, Orthodoxies and Models?' (2015) 6 Journal of Business Law 485.

-----Milne and Parboteeah (2016)⁴¹

“P2P platforms epitomise the idea of disintermediated “middle-man-free” access to finance, especially insofar as platforms are conceived as technological means that allow borrowers to directly access available funding on the one hand, and lenders to invest in specific loans on the other.”

-----Bavoso (2020)⁴²

“The arrival of Web 2.0 has brought us the incoming of online peer-to-peer (P2P) lending, which serves as a virtual place for individual lenders and borrowers to borrow from and lend to each other directly without involving financial intermediaries.”

-----Rong and others (2023)⁴³

Based on these definitions, three main differences can be observed:

- a. Who are the lenders and borrowers?
- b. Is P2P lending a form of disintermediation?
- c. Is a P2P lending platform solely facilitating unsecured loans?

⁴¹ Alistair Milne and Paul Parboteeah, ‘The Business Models and Economics of Peer-to-Peer Lending’ (2016) ECRI Research Report No 17 <<https://ssrn.com/abstract=2763682>> accessed 28 September 2023.

⁴² Vincenzo Bavoso, ‘The Promise and Peril of Alternative Market-based Finance: The Case of P2P Lending in the UK (2020) 21 Journal of Banking Regulation 395.

⁴³ Yuting Rong and others, ‘Proposing a New Loan Recommendation Framework for Loan Allocation Strategy in Online P2P Lending’ (2023) 123 Industrial Management & Data System 910.

a. Regarding the first question of the identity of lenders and borrowers, one critical issue is whether users of P2P lending are categorised as “individuals”, exclusively referring to natural persons, or if the term is non-specific, encompassing users who are natural persons, SMEs, and perhaps even other legal entities.

While the concept of P2P lending originally emphasises transactions between natural persons, virtually no P2P platforms prohibit legal entities, such as SMEs, from accessing their services. Indeed, based on the type of borrowers, P2P lending can be categorised into P2P consumer lending and P2P business lending.⁴⁴ Consumer lending entails providing small loans to individuals, commonly utilised for daily consumption and debt consolidation from various credit sources.⁴⁵ Business lending extends financial support to SMEs for purposes such as asset finance, business expansion, or working capital.⁴⁶

As P2P lending has also played a significant role in financing SMEs in many countries,⁴⁷ delineating users of P2P lending as individuals does not fully encompass the diverse spectrum of borrowers and lenders within this business model. One possible reason why certain literature uses the term “individuals” in its definitions could be to align with its dedicated focus on the individual-centric dimensions of P2P lending. This includes research on P2P consumer lending, individual consumer behaviours, and risks associated with P2P lending for

⁴⁴ Bryan Zhang and others, ‘The 5th UK Alternative Finance Industry Report’ (Cambridge Centre for Alternative Finance, 2016) <<https://www.jbs.cam.ac.uk/wp-content/uploads/2020/08/2018-5th-uk-alternative-finance-industry-report.pdf>> accessed 10 January 2024.

⁴⁵ *Ibid.*

⁴⁶ *Ibid.*

⁴⁷ Reza-Gharehbagh Raziye and others, ‘Peer-to-peer Financing Choice of SME Entrepreneurs in the Re-emergence of Supply Chain Localisation’ *International Transactions in Operational Research* 27 (2020) 2534.

individual consumers. However, for a comprehensive definition, borrowers and lenders of P2P lending cannot be described as solely “individuals”.

b. The question of whether P2P lending is an example of disintermediation arises from the existence of three distinct descriptions regarding the role of the platforms: 1) they are portrayed as non-intermediaries; 2) they are depicted as non-traditional intermediaries (though clarification regarding their intermediary status is lacking); 3) they are characterised as financial intermediaries. This pertains to the contentious perspective regarding whether P2P lending constitutes a form of financial disintermediation.

Financial disintermediation, as described by Hester, signifies a departure from relying on intermediary services toward a basic system where financial transactions may either be non-existent or exclusively bilateral between the ultimate saver and investor.⁴⁸ Disintermediation always refers to the consumer-to-consumer (C2C) business model, notable examples include *eBay*, *Etsy*, *Uber* and *Airbnb*. These platforms replace the previous business-to-consumer (B2C) model by allowing consumers to directly link to each other.

As the P2P loan contract is established directly between lenders and borrowers without the platforms being involved as contractual parties, P2P lending has been categorised as a type of C2C business. In the initial emergence of P2P lending, it was called “the eBay for loan”.⁴⁹ Also,

⁴⁸ Donald D. Hester, ‘Financial Disintermediation and Policy’ (1969) 1 *Journal of Money, Credit and Banking* 600.

⁴⁹ Robert Holf, ‘Prosper: The eBay of Loans?’ (*Bloomberg UK*, 13 February 2006) <<https://www.bloomberg.com/news/articles/2006-02-12/prosper-the-ebay-of-loans?embedded-checkout=true>> accessed 10 February 2025.

P2P lending has been perceived as “cutting out the middleman” in the loan transaction.⁵⁰ Consequently, some perspectives categorise P2P lending as a form of financial disintermediation. For example, a February 2014 article by the Financial Times views P2P lending as a form of disintermediation when discussing the banks’ apprehension about the threat posed by P2P lending.⁵¹ Also, Teplý and others use the example of disintermediation in P2P lending as a case in their financial study.⁵² Moreover, Kaja and others state in a legal study that P2P lending is a type of technologically enabled financial disintermediation.⁵³ Similar conceptualisations can be found in much other academic literature and news articles related to P2P lending.

However, while P2P lending may superficially appear to align with certain aspects of the disintermediation concept, it is fundamentally distinct from it. This distinction arises from the essential function performed by the P2P platform in facilitating transactions between the involved parties, which cannot be easily substituted or disregarded. This means that P2P lending loans are not exclusively bilateral arrangements between lenders and borrowers.

⁵⁰ Mingfeng Lin, 'Out of the Shadow? Promises and Challenges of Peer-to-Peer Lending' in Iris H-Y Chiu and Iain G. MacNeil (eds) *Research Handbook on Shadow Banking* (Edward Elgar Publishing 2018) 297-313.

⁵¹ Tracy Alloway and Arash Massoudi, 'Wells Fargo Bans Staff from Investing in P2P Loans' (*Financial Times*, 20 January 2014) <<https://www.ft.com/content/f3135594-7f82-11e3-b6a7-00144feabdc0>> accessed 10 February 2025.

⁵² Petr Teplý, Yael Roshwalb and Michal Polena, 'Financial Disintermediation: The Case of Peer-to-Peer Lending' in Maurizio Pompella and Roman Matousek (eds) *The Palgrave Handbook of FinTech and Blockchain* (Palgrave Macmillan 2021) 375-401.

⁵³ Fatjon Kaja, Edoardo D. Martino and Alessio M. Paces, 'Fintech and the Law&Economics of Disintermediation' (2021) European Corporate Governance Institute Law Working Paper No.540/2020 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3683427 > accessed 29 October 2023.

The influence of the platform on lending permeates every stage of the lending process, from inception to completion. First, during the platform selection stage, consumers' decision to choose a specific platform is closely linked to the reputation of the platform. For example, Shi and others conducted an empirical study of China's P2P lending platforms and found that the reputations of P2P lending platforms have influenced lenders' decisions both directly and indirectly.⁵⁴ This impact is more critical for the lender than for the borrower, as borrowers have the potential necessity to seek loans from any available source if they cannot secure one elsewhere. Moreover, the number of lenders choosing to use a platform directly affects its capacity to act as a reliable funding source for borrowers, which, in turn, drives up transaction volumes and increases profitability for the platform.

Additionally, the quality of service provided by platforms also influences consumers' choices. Lee demonstrates that the adoption of mobile P2P lending applications by users is greatly affected by their perceived ease of use, the perceived usefulness of the application, and their overall satisfaction with it.⁵⁵ This is reaffirmed by Dharmastuti and Laurentxius' empirical study on factors affecting lenders' interest in providing P2P loans.⁵⁶

Second, during the lenders' decision-making stage, they heavily rely on the platform that provides comprehensive information and assesses the creditworthiness of borrowers. This

⁵⁴ Xiaokun Shi, Junjie Wu and Jane Hollingsworth 'How Does P2P Lending Platform Reputation Affect Lenders' Decision in China' (2019) 37 *International Journal of Bank Marketing* 1566.

⁵⁵ Sangmin Lee, 'Evaluation of Mobile Application in User's Perspective: Case of P2P Lending Apps in FinTech Industry.' (2017) 2 *KSII Transactions on Internet and Information Systems (TIIS)*1105.

⁵⁶ Christiana Fara Dharmastuti and Jonathan Laurentxius, 'Factors and Benefits that Affect Lender's Interest in Giving Loans in Peer to Peer (P2P) Lending Platform' (2021) 12 *Binus Business Review* 121.

reliance underscores the pivotal role of platforms in shaping lenders' investment strategies. If platforms deliberately inflate credit ratings to borrowers in a bid to maximise profitability, lenders may inadvertently surpass their risk tolerance thresholds, diverging from their original investment objectives. Consequently, the integrity and reliability of the platform's information emerge as indispensable factors influencing lenders' investment decisions, fostering overall confidence in the P2P lending process, and ultimately impacting the lending outcomes.⁵⁷

Third, during the loan transaction stage, transaction funds are managed by P2P lending platforms, which place such funds in a client account. Despite the client account being segregated from the platform's own account, the platform retains significant control over them. Therefore, if the platform harbours intentions to misappropriate these funds for any motive, it poses a considerable challenge for P2P users to discern and prevent such actions in advance. This difficulty is exacerbated by the absence of robust regulatory mechanisms to mitigate such risks effectively. For example, this phenomenon occurred with notable frequency in China's P2P lending, especially before 2016 when regulatory measures were lacking.⁵⁸

Fourth, following the loan transaction, in instances where the borrower defaults, the lender becomes heavily reliant on the platform for loan recovery. This dependency arises from two pivotal factors: 1) the platform typically possesses more extensive information about the borrower compared to individual lenders; 2) in cases where a loan defaults, the platform is

⁵⁷ Osuji and Amajouyi (n 40).

⁵⁸ 零壹财经 [lingyicaijing], '网贷简史 (事件篇) : 33 个大事件细数行业沧桑' [A Brief History of Online Lending (Events Edition): 33 Major Events Detailing the Industry's Changes] (2019) <https://www.sohu.com/a/343344880_104992> accessed 10 February 2025.

better positioned than individual lenders to facilitate debt recovery. This is because it is highly likely that a defaulted loan involves multiple lenders, with each lender having a small amount of funds. Even if they possess all the necessary information about borrowers, it remains challenging for a lender to pursue loan repayment independently, as the associated costs would likely exceed the funds they initially lent.

In addition, while initially centred on the facilitation of transactions by connecting borrowers with lenders, the P2P lending industry has progressively expanded its scope to incorporate a myriad of financial services.⁵⁹ These services include enhanced rating mechanisms, the adoption of secured lending models by certain platforms, the establishment of lending pools, and even the provision of investment guidance. Such shifts can be attributed to an increasingly competitive market environment and more stringent regulatory measures. These services substantially amplify the influence and significance of P2P platforms in facilitating transactions between borrowers and lenders. Their role extends far beyond merely “matching” borrowers and lenders.

Given the substantial influence and role of P2P platforms in the lending and borrowing process, they do not fit into the category of disintermediation. Instead, they represent an innovative intermediary distinct from traditional lending intermediaries that act as parties to the contract. Therefore, it can be concluded that while P2P lending removes traditional intermediation from the lending process, it does not eliminate intermediation altogether. This can also be observed in the statements made by the founder regarding the establishment of the P2P lending

⁵⁹ *Ibid.*

concept: *“What if there are other places that could act as that intermediary? Why does it have to be a bank that sits in-between depositors and people who are borrowing money?”*⁶⁰

Hence, both the conceptual foundation laid out by the founders and the practical function of the platform indicate that it does not constitute a form of financial disintermediation. From a regulatory standpoint, it should not only be classified as a traditional intermediary without acknowledging its distinctive attributes but also the pivotal role performed by the platform in transactions should not be disregarded.

It is also worth pointing out that, in recent years, a disintermediated type of lending has emerged, which may sometimes be confused with P2P lending, known as Decentralised finance (DeFi) for lending and borrowing cryptocurrency directly and anonymously.⁶¹ Despite cryptocurrency being facilitated rather than the fiat currency by DeFi platforms (though it can be exchanged for fiat currency), the primary difference between DeFi and P2P lending is the platform’s influence over the loan transaction.⁶² DeFi operates on blockchain technology and employs smart contracts, which are self-executing agreements with the terms and conditions directly encoded into software. Users interact with these smart contracts directly through decentralised applications without the need for intermediaries.⁶³ In contrast to DeFi, which operates as a form of disintermediated finance where the platform serves solely as an online

⁶⁰ Atz and Bholat (n 33) 7.

⁶¹ Sirio Aramonte, Wenqian Huang and Andreas Schrimpf, 'DeFi Risks and the Decentralisation Illusion' (2021) 6 BIS Quarterly Review 21.

⁶² Sean Kwon, 'Regulation of Defi Lending: Agency Supervision on Decentralisation' (2023) 24 The Columbia Science & Technology Law Review 379.

⁶³ Campbell R. Harvey, Ashwin Ramachandran and Joey Santoro, *DeFi and the Future of Finance* (John Wiley & Sons 2021).

trading venue and provides technical assistance to facilitate transactions between parties, P2P lending transactions rely heavily on the platform's provision of various services and information, which are integral to the transaction process. Therefore, it is clear that the distinction between P2P lending and DeFi highlights how P2P lending differs from disintermediated finance.

In addition, it should be emphasised that C2C business does not necessarily equal disintermediation. C2C platforms can play an intermediary or non-intermediary role. There is nothing inherently incorrect about using C2C to characterise P2P lending relationships, as both P2P borrowers and lenders can be considered consumers (which will be elaborated upon in Chapter 3). However, such labelling offers limited meaningful insights for understanding or regulating the consumer market. Although P2P lending was initially likened to *eBay* in the lending industry, the difference in what they facilitate determines differing roles for platforms, as well as potential implications and regulatory requirements, in comparison to most other C2C platforms. Users in P2P lending platforms transact money as loans, fundamentally setting it apart from platforms facilitating products or services. For instance, in transactions between *eBay* buyers and sellers, items and payments are directly exchanged between consumers, whereas in P2P lending, money must pass through the customer account overseen by the platform. While some C2C platforms may briefly hold money paid by customers, such as *Uber*,⁶⁴ the duration is typically short, and the individual amounts involved are typically much smaller. Therefore, P2P lending diverges considerably from other platforms within the C2C notion proposed in e-commerce and the sharing economy.

⁶⁴ Uber, 'Why Is There a Pending Charge on My Account?' <<https://help.uber.com/en-GB/riders/article/why-is-there-a-pending-charge-on-my-account-?nodeId=320f2eca-45b7-4b80-ae15-df7edc6d87b1>> accessed 10 February 2025.

c. The answer to the third question of whether a P2P lending platform solely facilitates unsecured loans is quite straightforward. Although the initial concept of *Zopa* revolves around unsecured lending,⁶⁵ which is also one of the social values of P2P lending, namely filling the lending gap left by stringent bank lending practices for unsecured personal or SME loans, there has been an increasing number of secured P2P lending platforms emerging (this will be discussed in Chapters 4 and 5). This trend aims to mitigate the inherent risks for P2P lenders and also serves as a strategic business move to attract more potential lenders. There are various forms of collateral for the secured model. For example, in the UK, three P2P lending platforms focus on loans secured against properties generating rental income.⁶⁶

However, it cannot be denied that the unsecured loan model has predominantly characterised P2P lending and remains mainstream in this area. Unsecured P2P lending refers to a loan that relies only on the borrower's creditworthiness without any collateral supporting it. In the event of a borrower default, the lender lacks any collateral to recover the funds. The dominance of unsecured lending also explains why P2P lending serves to fill the lending gap left by traditional bank lending which tends to impose stricter criteria in the realm of unsecured personal and SME loans.

Overall, it can be observed that the different answers to the first and third questions lie in the non-identical operational models of P2P lending. In its inception, P2P lending emerged as a novel concept aimed at facilitating unsecured personal loans among individuals within the

⁶⁵ Martin Kupp and Jamie Anderson, 'Zopa: Web 2.0 Meets Retail Banking' (2007) 18 *Business Strategy Review* 1.

⁶⁶ Matthew Howard, '24 Peer-to-Peer Property Lending Websites' (*4thway*, 1 January 2024) <<https://www.4thway.co.uk/candid-opinion/peer-to-peer-property-lending/>> accessed 10 February 2025.

context of the burgeoning digital era. In contrast to the conventional trust model prevalent in traditional financial institutions, which typically necessitates collateral or a good credit score, P2P lending resembled lending practices akin to lending among acquaintances or family members, characterised by a heightened sense of interpersonal trust. Despite the presence of credit ratings on certain platforms, individuals with suboptimal scores still have a chance of securing loans, provided there is a willing lender to match their request.

Additionally, some platforms aim to leverage alternative methods for assessing borrowers' creditworthiness, such as evaluating social media information and activity.⁶⁷ However, this approach has proven to undermine the sustainability of platforms due to inaccurately high ratings, which led to unexpectedly excessive default rates. A notable example is the collapse of the English P2P lending platform *Quakle* in 2011, which was attributed to a nearly 100% default rate.⁶⁸ Consequently, to enhance control over default rates and mitigate associated risks, most platforms resort to employing more dependable sources of credit rating information. This involves using data sourced from reputable professional rating agencies, imposing limitations on high-risk loans, embracing a collateral-based lending framework, and so forth. Nevertheless, these adaptations present regulatory bodies with challenges, necessitating their ongoing monitoring of industry advancements and proactive anticipation of future trends to effectively address emerging regulatory imperatives. Section 2.2.4 will provide an overview of P2P lending models, aiming to deliver a comprehensive introduction

⁶⁷ Yuejin Zhang and others, 'Research on Credit Scoring by Fusing Social Media Information in Online Peer-to-Peer Lending' (2016) 91 *Procedia Computer Science* 168.

⁶⁸ Elaine Moore and Jonathan Moules, 'Peer-to-Peer Loans Company Closes: Group "Incurred near-100 Percent Default Rate"' (*Financial Times*, 7 December 2011) <<https://www.ft.com/content/2db417a6-20c1-11e1-816d-00144feabdc0>> accessed 10 February 2025.

to and understanding of P2P lending. This serves as a foundation for comprehending the regulation of P2P lending.

2.2.3 Nomenclature of P2P lending: more than a linguistic matter

P2P lending is not a unique name for this kind of lending service. Especially, in the initial stage, various names can be found in either academic outputs or industry news. Commonly known names include loan-based crowdfunding, social lending, marketplace lending, online lending and so on.

When naming any business model, the primary consideration is typically that the name should directly reflect the main features of the business model. The various names for this form of financial service implied by P2P lending (which is the name chosen by the thesis) reflect how the business model is understood in different regions, as well as the regulatory expectations. This section will briefly introduce the commonly used names for this form of financial service and explain why they cannot be precisely equivalent to the term “peer-to-peer” lending.

- **Loan-based crowdfunding**

The name is primarily used by the UK regulator, the FCA, in its regulation rules. Crowdfunding means *“one way that individuals, charities, and businesses (including start-ups) can raise money from the public to support a project, campaign or person”*.⁶⁹ Despite there being four

⁶⁹ FCA, ‘Crowdfunding’ (FCA, 19 August 2021) <<https://www.fca.org.uk/consumers/crowdfunding>> accessed 20 December 2021.

types of crowdfunding existing in the UK, loan-based crowdfunding is regulated together with investment-based crowdfunding, both recognised as non-readily realisable securities.⁷⁰

The name loan-based crowdfunding clearly illustrates the core element of the P2P lending business model in that money is raised through crowdlending as a loan which means the purpose for the fund suppliers is to supply money in exchange for future repayment with an interest return. However, the term “loan-based crowdfunding” emphasises a collective or “crowd” contributing to the funding of a particular project. This can be seen from the general definition of “crowdfunding”, which is *“the practice of getting a large number of people to each give small amounts of money in order to provide the finance for a project, typically using the internet.”*⁷¹ Similarly, the European commission defines crowdfunding as *“a way of raising money to finance projects and businesses. It enables fundraisers to collect money from a large number of people via online platforms.”*⁷²

While it is accurate that many individual P2P loans involve contributions from multiple lenders, this is not universally true, as some loans may be provided by a single lender. Additionally, the term emphasises P2P business lending but may neglect consumer lending, which does not necessarily entail borrowing for a specific project. While consumer lending may have specific

⁷⁰ FCA, *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, 6 March 2014)

⁷¹ Cambridge Dictionary, ‘crowdfunding’ <<https://dictionary.cambridge.org/dictionary/english/crowdfunding>> accessed 23 August 2024.

⁷² European Commission, ‘Crowdfunding Explained’ (*European Commission*, 3 December 2020) <https://single-market-economy.ec.europa.eu/access-finance/guide-crowdfunding/what-crowdfunding/crowdfunding-explained_en> accessed 24 August 2024.

purposes, such as household consumption, it fundamentally differs from the concept of a “financial project” in crowdfunding.

The FCA's regulatory rules for P2P lending, as outlined in the 2019 rules, incorporate the term “loan-based crowdfunding”, with “P2P lending” provided in parentheses.⁷³ However, in the most recent Letter, it uses the term “loan-based P2P lending” solely.⁷⁴ This shows that the FCA tends to use “P2P lending” rather than “loan-based crowdfunding” as the preferred term recently.

- **Online Lending**

The term “online lending” was predominantly used in China. Generally, it refers to any loan process completed entirely online, encompassing various types like online payday loans and online banking services. Because P2P lending emerged in China in 2007 as the sole loan model conducting transactions exclusively via the Internet at that time, “online lending” became synonymous with P2P lending, although the term “P2P lending” is also used in China. Furthermore, China's regulatory authorities adopted the term “online lending information intermediary” in regulatory guidelines; the term is commonly referred to as online lending for brevity.⁷⁵

⁷³ FCA, *Loan-based ('peer-to-peer') and investment-based crowdfunding platforms: Feedback to CP18/20 and final rules* (Policy Statement, PS19/14, June 2019)

⁷⁴ FCA, ‘Portfolio Letter: FCA expectations for Loan-based Peer-to-Peer Lending platforms’ (FCA, 15 January 2024) <<https://www.fca.org.uk/publication/correspondence/expectations-loan-based-peer-to-peer-lending-portfolio-letter.pdf>> accessed 11 March 2024.

⁷⁵ 中国银行业监督管理委员会、工业和信息化部、公安部、国家互联网信息办公室令 2016 年第 1 号, [Order No.1 (2016) of the China Banking Regulatory Commission, Ministry of Industry and Information Technology, Ministry of Public Security, and Cyberspace Administration of China] 网络借贷信息中介机构活动管理暂行办法[Interim Measures for the Administration of the Business Activities of Online Lending Information Intermediary Intermediaries] (Interim Measures 2016).

It is obvious that the term “online lending” is too broad. With the evolved landscape of financial services, where a multitude of loans can be conducted entirely online, its usage lacks precision and may lead to confusion or misinterpretation of the underlying business model.

- **Social lending**

Within the articles employing the term “social lending”, a relatively large proportion of them pertain to the P2P lending market in the US, although it does not represent an overwhelming majority.⁷⁶ Social lending emphasises its social impact by intending to address societal issues. The name “social lending” has emerged as a response to the financial challenges faced by social enterprises and charitable organisations.⁷⁷ Thus, this name is always related to businesses and initiatives that generate broader community benefits or charitable social impact.⁷⁸ The term “social lending” frequently denotes non-profit P2P lending platforms such as *Kiva* and *LendAHand*. Broadly speaking, they can be classified within the expansive concept of P2P lending; nevertheless, owing to the nature of their funding as charitable donations, their regulatory requirements fundamentally differ from those applicable to for-profit P2P lending platforms (as discussed in section 2.2.4). Therefore, it is necessary to distinguish between non-profit and charitable P2P platforms and those that are oriented towards investment and business purposes in their naming.

⁷⁶ Google Scholar search for the term “social lending” shows that 12 out of the first 20 results are related to the US <https://scholar.google.com/scholar?q=social+lending&hl=en&as_sdt=0%2C5&as_ylo=2016&as_yhi=>> assessed 10 August 2024, Eastleigh, UK.

⁷⁷ Jonas Schmidt, ‘What is Social Impact Lending and How Does it Support Borrowers’ (*P2Pmarketdata*, 21 February 2020) <<https://p2pmarketdata.com/articles/social-impact-lending/>> accessed 8 March 2024.

⁷⁸ *Ibid.*

- **Marketplace lending**

While the term “marketplace lending” is often used interchangeably with P2P lending in some articles, distinctions between the two can still be observed in certain contexts. *Folk2Folk*, a platform that identifies itself as a marketplace lending platform, delineates the distinction between P2P lending as follows: “*Peer-to-peer lending platforms are typically utilised by individuals, while marketplace lenders connect borrowers with both individual and institutional investors*”.⁷⁹ In this context, the term “marketplace lending” cannot be used interchangeably with “P2P lending” when the platform is primarily focused on facilitating loans between individuals.

In fact, P2P platforms primarily designed to facilitate loans between individuals generally do not exclude institutional investors, though there may be certain restrictions on non-individuals acting as P2P lenders. For instance, in the UK, non-individual lenders can qualify as P2P lenders only if the credit amount does not exceed £25,000 or if the P2P agreement is not entered into by the borrower primarily to conduct a current or future business.⁸⁰ Therefore, the distinction between “marketplace lending” and “P2P lending” is not always clear-cut but does exist in certain contexts.

Based on the preceding explanation, it becomes apparent that none of these terms is entirely synonymous with “P2P lending” when describing this form of business. Despite their interchangeability in some literature and news articles, as well as their substantial similarities,

⁷⁹ Folk2Folk, 'Peer-to-Peer vs. Marketplace Lending: What's the Difference?' <<https://folk2folk.com/peer-to-peer-lending-vs-marketplace-lending/>> accessed 9 March 2024.

⁸⁰ FCA, 'P2P agreement' <<https://www.handbook.fca.org.uk/handbook/glossary/G3218.html>> accessed 23 November 2023.

they either inadequately encapsulate the comprehensive scope of P2P lending, or their focal points diverge from those of P2P lending. Therefore, the naming is not simply a linguistic issue but rather relates to understanding the scope of the P2P lending model. For the sake of clarity, it is preferable to use a consistent and unified name when referring to a specific business model. The financial innovation market is constantly evolving, with many new niche business models emerging regularly. Having too many different names for similar concepts can create confusion and hinder consumer protection, as it may make it more difficult for consumers to understand the nuances between different models and identify the services that best meet their needs.

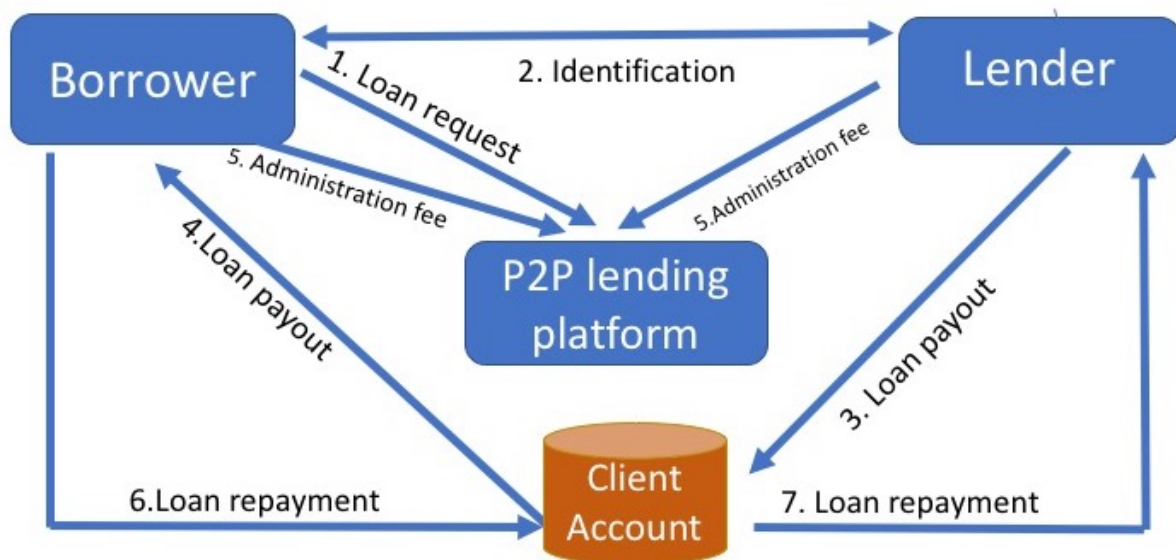
2.2.4 P2P Lending business models

When referring to the business models of P2P lending, the primary one is the basic model, in which the platform facilitates direct unsecured loans between borrowers and lenders. This model, pioneered by *Zopa*, was the predominant one during the initial emergence of P2P lending across various countries, serving as the bedrock for the industry. Subsequent to its establishment, other models have been developed based on this foundational framework.

In any P2P lending business, three parties are involved in the lending process: the lender, the borrower, and the platform (though the platform is typically not a party to the loan contracts). Prospective users, both borrowers and lenders, create an account/register and grant the platform permission to access their data.

Figure 1 depicts a schematic of the lending process based on the basic model, which represents an unsecured P2P loan transaction. As illustrated, there are approximately seven steps involved in completing a P2P lending transaction.

Figure1: Transaction process of P2P lending



Step 1: The prospective borrower initiates a loan application on the platform, providing personal information (such as credit history and loan purpose) and devising a repayment plan, which may involve monthly instalments or full repayment after a specified period. Following an assessment of the borrowers' information, platforms evaluate/rate their creditworthiness. Subsequently, eligible borrowers' loan requests are presented to potential lenders through the platform website.

Step 2: Matching the borrower with the right lender might be the most crucial process in P2P lending. Most P2P platforms provide flexible options for users. Lenders can divide their investment amount into individual portions and select from available loans that match their

risk tolerance and return expectations. They can then place offers for a portion or the entirety of the requested amount.

There are two methods for lenders to choose loans to fund. The first approach is the active option model, in which lenders directly bid on loan applications based on details shared by the platform. This involves lenders evaluating the provided information and selecting which loan requests to fund according to their personal risk preferences.

In this model, loan rates are primarily determined through auctions. Borrowers specify the highest interest rate they are willing to pay, while lenders determine the lowest rate they are looking to earn for a particular risk category. The platform then utilises any auction model, such as reverse auctions, the Vickrey-Clarke-Groves auction, unit-demand auctions, multi-item ascending-price auctions and so on, to match lenders with loan requests. Each of these auction models has its own advantages and disadvantages, but they share a common feature: complexity in determining pricing rules when there are multiple winners.⁸¹ Due to the low barrier to entry for P2P lending, most lenders are not professional investors who can easily navigate complex auction models. Consequently, they may be less inclined to participate in P2P lending when they find it very challenging to comprehend or complete the auction process accurately. Therefore, in order to attract more individual lenders, the auction model has gradually been replaced by the fixed interest rate model (set by the platform).⁸²

⁸¹ Ning Chen, Arpita Ghosh and Nicolas S. Lambert, 'Auctions for Social Lending: A Theoretic Analysis' (2014) 86 *Games and Economic Behavior* 367.

⁸² Milne and Parboteeah (n 41).

The other method is the passive option, where lenders rely on platforms to allocate their funds. This method has become more popular among lenders.⁸³ In the passive option, the platform decides whether to approve or deny a loan request and assigns each approved request to a specific risk category. The platform also sets a predetermined fixed interest rate for each risk category and employs auto-bid tools (such as machine learning algorithms) to select risk categories and allocate funds based on each lender's risk-return preferences.

When a loan is established, a contract is drawn up between the lender and the borrower, with the platform not being a party to the loan contract. Although platforms conduct various forms of risk assessment, the credit risk is borne by the lender rather than the platform (this will be discussed in Chapter 3).

Steps 3 and 4: lenders transfer money to the platform, which subsequently transfers it to borrowers' accounts. These funds are collected and administered within a segregated client account established with a bank or other financial institution, separate from the platform's own account and balance sheet.

Step 5: The platform generates revenue by charging various fees, which may include:

⁸³ Moran Ofir and Ido Sadeh, 'A Revolution in Progress: Regulating P2P Lending Platforms' (2020) 16 New York University Journal of Law & Business 683.

- Origination fees, typically calculated as a percentage of the loan amount and deducted from the loan disbursement. This fee typically ranges from 1% to 6% of the loan amount.⁸⁴
- Prepayment fees or late payment penalties, charged in cases where borrowers choose to repay their loans before the scheduled maturity date or fail to make payments on time.⁸⁵
- Servicing fees, primarily charged to lenders as a percentage of the interest earned.⁸⁶
- Listing fees, charged mainly to borrowers to create a loan listing.⁸⁷
- Currency conversion fees, applicable to borrowers or lenders operating in different countries or currencies.⁸⁸

Additionally, some platforms may charge fees for additional services. For example, *Capital Stackers*, a UK-based P2P platform, offers advisory and ongoing monitoring services for a fee.⁸⁹ Moreover, certain platforms allow lenders to sell their loans, and the platform charges a fee. For example, *Blend*, another platform in the UK, imposes a secondary market fee of 0.6%.⁹⁰

⁸⁴ FasterCapital, 'What Are the Fees Associated with Peer to Peer Lending Platforms' <<https://fastercapital.com/questions/what-are-the-fees-associated-with-peer-to-peer-lending-platforms.html>> accessed 11 March 2024.

⁸⁵ *Ibid.*

⁸⁶ *Ibid.*

⁸⁷ *Ibid.*

⁸⁸ *Ibid.*

⁸⁹ CapitalStack, 'Fees and Interest' < <https://www.capitalstackers.com/borrow/fees-and-interest/>> accessed 10 March 2024.

⁹⁰ Blend, 'FAQ' <https://www.blendnetwork.com/faq/investors?gclid=CjwKCAjw7-SvBhB6EiwAwYdCAbqH0rtKoFr9-n1ziNnDrPiPtHki7zqgklJynS9pEOI49eVrRkRUKhoC-JMQAvD_BwE#5> assessed 11 March 2024.

These represent the more common types of fees, although not all platforms impose all of them. Regardless of the variety of fees charged by platforms, it is evident that excessive costs of borrowing and lending could render the industry unsustainable, thus the total fees normally remain reasonable.

Steps 6 and 7: The repayment process mirrors the borrowing process, with the borrower initially transferring funds to the platform's client account, which then transfers them to the lender.

The actual process may be more complex depending on the operating procedures of the platforms and the type of loan involved. Additionally, there may be additional steps required when the process does not run smoothly, such as default payments. Although platforms do not guarantee the pursuit of repayment from borrowers in default, many platforms undertake efforts to pursue repayment.

Another point to note is that although P2P platforms are not directly involved in the lending contract, they, like any other financial service provider, require users to agree to their “terms and conditions” before using their services. This means that there is a service-based contractual relationship between the platform and the user. This contractual relationship pertains not to lending, but rather to the provision of facilitation services.

To mitigate the risk of borrower default and bolster lenders' confidence in the P2P lending market, some platforms have embraced a secured P2P lending model. Property-related assets and automobiles are among the most common types of collateral. Typically, if the borrower

fails to repay their loan, the platform sells the collateral to cover any shortfall. The secured model entails additional steps related to collateral and variations in fee structures due to collateral valuation and enforcement procedures in the event of borrower default. However, it should be noted that the secured model does not imply absolute security for the lender, and simultaneously, it can introduce additional risks for the borrower. This point will be discussed in Chapter 3.

Additionally, some platforms, whether operating under the unsecured model or the secured one, have been engaged in P2P loan securitisation. Securitisation is a financial process designed to bundle together multiple assets, specifically selling illiquid loans by converting them into marketable securities by bundling many small loans into a single security. Investors in these securities earn returns when borrowers repay their loans.⁹¹ In P2P lending, loans are sold by either lenders or platforms to a special purpose vehicle (SPV), which subsequently issues securities similar to bonds to investors in the capital markets. These securitised bonds are backed by the P2P loans owned by the SPV. The primary benefit and purpose of securitisation is to generate liquidity from otherwise illiquid assets.⁹²

P2P loan securitisation strengthens the connections between P2P lending and the broader financial system but brings a second layer of risk. For example, all forms of securitisation carry a risk of moral hazard, as the originator might attempt to offload low-quality assets onto

⁹¹ Thierry Balzacq, 'Securitisation Theory: Past, Present, and Future' (2019) 51 *Polity* 331.

⁹² Bavoso (n 42).

investors in the capital markets.⁹³ From a regulatory standpoint, there are questions concerning permission, origination standards and so on. These issues will be discussed in Chapter 7.

In addition to the aforementioned platforms in which both platforms and lenders engage for financial returns, there exists a category of non-profit P2P lending aimed at alleviating poverty.⁹⁴ A notable example is *Kiva*, a US-based international platform established to broaden financial access and support underserved communities. Under *Kiva*'s model, lenders do not gain any interest from the borrowers.⁹⁵

Most literature about non-profit loan platforms is found within the field of business studies, examining market strategies or empirical finance. As stated in section 2.2.2, these studies sometimes characterise non-profit loan platforms as P2P lending platforms. For instance, Dorfleitner and Oswald selected *Kiva* as a case study for their empirical investigation to identify the influencing factors of default probability in P2P lending.⁹⁶ However, from a legal study standpoint, non-profit lending is substantively distinct from for-profit P2P lending, as it entails charitable giving, and thus, the regulatory requirements differ significantly. This is exemplified by the fact that *Kiva* is not subject to the same regulations as other P2P lending

⁹³ Hongbo Fan and Jing Zhang, 'Research on the Application of Block Chain Technology in Asset Backed Securitisation' (2018) 35 *Journal of Intelligent & Fuzzy Systems* 2847.

⁹⁴ Domen Bajde, 'Kiva's Staging of "Peer-to-Peer" Charitable Lending' in Milford Bateman and Kate Maclean (eds) *Seduced and Betrayed: Exposing the Contemporary Microfinance Phenomenon* (University of New Mexico Press 2017) 87-100.

⁹⁵ *Ibid.*

⁹⁶ Gregor Dorfleitner and Eva-Maria Oswald, 'Repayment Behavior in Peer-to-peer Microfinancing: Empirical Evidence from Kiva' (2016) 30 *Review of Financial Economics* 45.

platforms in the US.⁹⁷ Additionally, in the UK, non-profit lending does not align with the FCA definition of P2P lending, as customers do not lend money with the expectation of interest return. Therefore, the discussion in this thesis does not encompass non-profit P2P lending.⁹⁸

2.3 Some implications of the nature of P2P lending for the design of regulation

2.3.1 The question of “disruptive innovation”

Data reflects that P2P lending has experienced substantial growth since its inception. For example, in the UK, the P2P lending market expanded from £1.5 million in 2005 to £6.1 billion in annual investments by 2018.⁹⁹ Globally, the value of P2P lending grew from approximately \$1.2 billion in 2012 to \$9 billion by 2014.¹⁰⁰

Since P2P lending began to show signs of rapid growth, there has been discussion about the competition and potential threats it poses to bank lending. For example, Tang’s financial study finds that P2P lending is “*a substitute for bank lending in terms of serving infra-marginal bank borrowers*”¹⁰¹ Basha, Elgammal and Abuzayed’s literature review of P2P lending show that P2P lending “*can outperform the conventional lending in the retail sector*”¹⁰² Rourke, Pelizzon and

⁹⁷ Pierre Ly, Geri Mason, ‘Competition Between Microfinance NGOs: Evidence from Kiva’ (2012) 40 World Development 643.

⁹⁸ FCA (n 69).

⁹⁹ AltFi, ‘Peer-to-Peer Lending: State of the Market Annual Report 2019’ (Workinvoice, 2019) <https://www.workinvoice.it/wp-content/uploads/2019/07/StateOfTheMarket19-1.pdf?utm_source=chatgpt.com> accessed 20 February 2025.

¹⁰⁰ Statista, ‘Value of Peer-to-Peer Lending Worldwide from 2012 to 2014’ (Statista, 2024) <<https://www.statista.com/statistics/325902/global-p2p-lending/>> accessed 1 March 2025.

¹⁰¹ Huan Tang, ‘Peer-to-Peer Lenders Versus Banks: Substitutes or Complements?’ (2019) 32 The Review of Financial Studies 1900.

¹⁰² Shabeen A Basha, Mohammed M Elgammal and Bana M Abuzayed, ‘Online Peer-to-Peer Lending: A Review of the Literature’ (2021) 48 Electronic Commerce Research and Applications 101069.

Thakor's empirical study indicate that P2P lenders "create a competitive disadvantage for some banks."¹⁰³ Thus, a question that arises with the emergence and development of P2P lending is whether it can be recognised – and therefore should be regulated -- as a disruptive innovation.

Disruptive Innovation is introduced by Christensen, Raynor and McDonald, describing a new technology or business model that fundamentally changes an industry by providing more accessible, cost-effective, or convenient options compared to current offerings.¹⁰⁴ It has been considered a potent approach to understanding growth driven by innovation.¹⁰⁵ Disruptive innovations necessitate specific regulatory frameworks.¹⁰⁶ They should steer clear of traditional methods of rulemaking and adjudication.¹⁰⁷

Therefore, there are two reasons why it is necessary to clarify whether P2P lending constitutes a disruptive innovation. First, some business studies assert that P2P lending represents a disruptive innovation which poses a significant threat to traditional financial institutions, particularly in regions where P2P lending has experienced notable growth. For example,

¹⁰³ Calebe de Roure, Loriana Pelizzon and Anjan Thakor, 'P2P Lenders versus Banks: Cream Skimming or Bottom Fishing?' (2022) 11 *The Review of Corporate Finance Studies* 213.

¹⁰⁴ Chris Larson, '4 Keys to Understanding Clayton Christensen's Theory of Disruptive Innovation' (*Harvard Business School Online*, 15 November 2016) <<https://online.hbs.edu/blog/post/4-keys-to-understanding-clayton-christensens-theory-of-disruptive-innovation>> accessed 24 August 2024.

¹⁰⁵ Clayton M. Christensen, Michael E. Raynor and Rory McDonald, 'What is Disruptive Innovation', (*Harvard Business Review*, December 2015) <<https://hbr.org/2015/12/what-is-disruptive-innovatin>> accessed 10 February 2025.

¹⁰⁶ Nathan Cortez, 'Regulating Disruptive Innovation', *Berkeley Technology Law Journal* 29 (2014) 137.

¹⁰⁷ Tim Wu, 'Taking Innovation Seriously: Antitrust Enforcement if Innovation Mattered Most' (2012) 78 *Antitrust LJ* 313.

Kohardinata, Noorlailie and Bambang examine that P2P lending is an entrant's disruptive trajectory in Indonesia;¹⁰⁸ Arnold and Jeffery state that P2P lending "*meet(s) multiple conditions of disruption theory*".¹⁰⁹ If P2P lending is deemed a disruptive innovation, it implies a restructuring of the lending segment within the financial system, thereby carrying significant implications for the financial market.

Second, if P2P lending is indeed deemed a disruptive innovation, then from a regulatory standpoint, it becomes imperative not only to consider its disruptive characteristics but also to anticipate potential implications as it further penetrates the traditional lending market. One possible consideration is that due to its higher risk profile compared to conventional banking lending, P2P lending has a greater potential to trigger systemic risks upon gaining dominance in the market.

The concept of disruption refers to a process in which a smaller company with limited resources is able to effectively challenge well-established incumbent businesses.¹¹⁰ Because of focusing on service or product improvement for their most profitable and demanding customers, incumbents always ignore the needs of other sections.¹¹¹ That gives space for the beginning of disruptive innovation which targets those overlooked sections and customers.¹¹²

¹⁰⁸ Cliff Kohardinata, Soewarno Noorlailie and Tjahjadi Bambang, 'Indonesian Peer to Peer Lending (P2P) at Entrant's Disruptive Trajectory' (2020) 21 *Business: Theory and Practice* 104.

¹⁰⁹ David Arnold and Paul Jeffery, 'The Digital Disruption of Banking and Payment Services' in F.Xavier Olleros and Majlinda Zhegu (eds) *Research Handbook on Digital Transformations* (Edward Elgar Publishing 2016) 103-120.

¹¹⁰ *Ibid.*

¹¹¹ *Ibid.*

¹¹² *Ibid.*

New entrants then move upmarket, offering the performance that mainstream customers demand, leveraging the advantages gained from their initial success. Disruption takes place when a significant number of mainstream consumers begin adopting the newcomers' products or services.¹¹³

While P2P lending has undoubtedly played a crucial role in the lending market, particularly in serving individuals and SMEs, it would be unreasonable to recognise it as a disruptive innovation. This is mainly because P2P lending has been positioned as a complementary role to the mainstream (bank) lending market. Even in the realm of SME financing, where P2P lending holds significant value, P2P platforms have less market share in lending compared to traditional banking channels. Taking the UK as an example, *Table 2* illustrates the annual lending volumes of P2P business lending and bank business lending from 2012 to 2020. The data reveals that P2P business lending volumes remained substantially lower than those of banks from 2012 to 2019. Despite the notable surge in P2P business lending in 2020, attributed to factors of the Covid-19 pandemic and related government policies (as elaborated in Chapter 6), it still falls short of challenging or surpassing the dominance of banks.

Table 2: Annual volume of P2P business lending and Bank business lending in the UK (in billion GBP)¹¹⁴

| Categorisation | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 |
|----------------|------|------|------|------|------|------|------|------|------|
| | | | | | | | | | |

¹¹³ Christensen, Raynor and McDonald (n 105).

¹¹⁴ Statista, 'Annual Volume of Different Business Lending in the United Kingdom (UK) from 2012 to 2020, by Lender' <<https://www.statista.com/statistics/797749/peer-to-peer-vs-bank-lending-uk/>> accessed 1 March 2024.

| | | | | | | | | | |
|-----------------------|------|-----|------|------|-----|----|------|------|-------|
| P2P Business Lending | 0.06 | 0.2 | 0.75 | 0.88 | 1.2 | 2 | 2.55 | 8.1 | 48.6 |
| Bank Business Lending | 38 | 43 | 54 | 58 | 59 | 57 | 57.7 | 56.7 | 103.8 |

In fact, since its inception, the main social function of P2P lending has been to provide alternative finance access to individuals and SMEs who may be excluded from conventional banking services, as it presents a lower barrier to entry compared to traditional bank lending. Consequently, P2P lending does not command the same customer base or market penetration as traditional banks. Despite witnessing growth, whereby individuals who could otherwise access banking services opt for P2P lending due to potentially favourable interest rates, it is important to note that P2P lending is not primarily aimed at challenging traditional bank lending. This is different from disruptive innovation in that it attempts to replace mainstream market products after success in a niche market. Moreover, several factors impede its competitiveness and prevent it from posing a disruptive threat to bank lending.

For borrowers who may be eligible for bank or institutional lending, even if P2P lending platforms offer lower interest rates than those provided by banks or financial institutions (for borrowers with similar levels of creditworthiness), they would still carefully consider various factors such as potential additional charges, procedures for debt collection in case of default, the platform's client account management practices, and contingency plans for unforeseen events such as platform bankruptcy during the lending process and others.

From a lender's perspective, while bank deposits yield significantly lower interest rates compared to P2P lending, the key disparity lies in the protection provided by financial authorities for bank deposits. Although there is usually a ceiling on deposit protection, it

generally covers a substantial amount of savers' deposits. In contrast, P2P lending entails higher risks, which can stem not only from borrowers' default risk but also from platform bankruptcy and even illegal operations, compared to banks. Importantly, there is no government or financial authority protection scheme for P2P lenders.

When contrasting P2P lending with other forms of risky financial investments, it is noteworthy that many financial instruments require a relatively high amount of investment, making them inaccessible to small investors. P2P lending bridges this gap by providing opportunities for individuals with smaller funds to invest, to participate in the financial investment market. Furthermore, for those already engaged in the financial investment market, P2P lending offers an additional avenue for investment diversification, serving as part of a comprehensive risk management strategy.

Consequently, P2P lending fills a gap left by the traditional financial market, catering to a wide range of investment needs that might not be fully addressed by conventional banks or financial institutions. It provides a unique value proposition by offering investment opportunities that are distinct from those provided by banks and other financial entities. Instead of competing directly with these institutions for the same customer base, P2P lending mainly serves niche markets and caters to lenders and borrowers seeking alternatives outside the conventional banking system. This positioning allows P2P platforms to complement rather than compete with traditional financial services, providing additional options for both lenders and borrowers. By addressing specific needs and gaps within the market, P2P lending operates alongside traditional financial institutions without significantly threatening their core business models. It serves primarily as a supplementary option rather than a direct competitor,

attracting users who might not otherwise engage with the conventional banking sector. Thus, P2P lending cannot be considered a disruptive innovation in the traditional sense because it does not seek to overturn or replace the existing financial infrastructure. Instead, it enhances the financial ecosystem by broadening access and providing more diverse financial options, making it an important yet non-disruptive component of the modern financial landscape.

2.3.2 Trust-building in P2P lending

Trust is fundamental in lending relationships and is a key determinant in P2P loan transactions. As P2P lending represents a high-stakes financial service characterised by significant user engagement in transactions with unfamiliar counterparts, trust emerges as a fundamental necessity for establishing lending relationships. Understanding trust-building in P2P lending is essential for exploring regulatory strategies aimed at fostering a climate of trust.

What is trust? It appears to be a vast topic, with numerous disciplines studying and defining it. Essential components of these definitions encompass perceived advantages and drawbacks, unpredictability, reliability, and susceptibility. For example, Chang, Cheung and Tang define trust as a psychological state that enables an individual to accept vulnerability based on positive expectations of the intentions or behaviour of others.¹¹⁵ Moreover, Mayer Davis and Schoorman describe trust as the *“willingness of a party to be vulnerable to the actions of another party based on the expectation that the other will perform a particular*

¹¹⁵ Man Kit Chang, Waiman Cheung and Mincong Tang, ‘Building Trust Online: Interactions among Trust Building Mechanisms’ (2013) 50 Information & Management 439.

*action important to the trustor, irrespective of the ability to monitor or control that other party”.*¹¹⁶

These two examples of definitions of trust pertain to psychological processes, yet trust can also extend to encompass behavioural dimensions. For example, Tyler and Stanley delineate two integral components inherent in definitions of trust: a belief component and a behavioural component. These components collectively shape individuals' perceptions and interactions within trust dynamics.¹¹⁷

In terms of P2P lending, its operation relies on two dimensions of trust among the three participants. First, a loan between lenders and borrowers necessitates a relationship grounded in trust, based on the borrower's creditworthiness, that the borrowed money will be repaid on time and in the agreed-upon amount.¹¹⁸ Trust in the borrower refers to the belief that the borrower will act in good faith and meet the lender's expectations without exploiting any vulnerabilities the lender may have. Some empirical studies have found that trust in the borrower is the most significant factor for lending success. For instance, Lin and Chen's research, using data from 785 lenders on *PPDai*, China's first and largest P2P platform, showed that trust in borrowers is crucial in shaping a lender's decision to lend.¹¹⁹

¹¹⁶ Roger C. Mayer, James H. Davis and F. David Schoorman, 'An Integrative Model of Organizational Trust' (1995) 20 *Academy of Management Review* 709.

¹¹⁷ Katherine Tyler and Edmund Stanley, 'The Role of Trust in Financial Services Business Relationship' (2007) 21 *Journal of Services Marketing* 334.

¹¹⁸ Tom C.W Lin, 'Infinite Financial Intermediation' (2015) 100 *Minnesota Law Review* 1377.

¹¹⁹ Dongyu Chen and Zhangxi Lin, 'A Trust Model for Online Peer-to-Peer Lending, a Lender's Perspective' (2014) 15 *Information Technology and Management* 239.

Different from offline personal lending between acquaintances, where borrowers and lenders often have kinship or friendship connections and know each other personally, P2P lenders lack familiarity with borrowers and cannot directly demand repayment in case of default. Additionally, trust-building in P2P lending differs from that in other C2C retail marketplaces like *eBay*, where sellers and buyers engage in frequent transactions. P2P loans can span many months or even several years and involve numerous monthly payments. Therefore, reputation systems and institution-based trust, which rely on high transaction frequency, are less effective in P2P lending.¹²⁰

Building trust in online lending is inherently more complex than in traditional institutional lending due to the increased potential for fraud and misrepresentation.¹²¹ Unlike traditional lenders, who often have access to extensive information and personal interactions with borrowers, online lenders typically rely on limited and sometimes incomplete data to establish trust.¹²² Relying on incomplete information increases the uncertainty and risk that lenders face when making lending decisions, as they must evaluate the borrower's creditworthiness without the benefit of comprehensive background checks or face-to-face meetings.¹²³ Consequently, it is essential for online lending platforms to implement thorough assessment processes for borrowers to mitigate these risks and build a reliable system of trust.

¹²⁰ *Ibid.*

¹²¹ Jefferson Duarte, Stephan Siegel and Lance Young, 'Trust and Credit: The Role of Appearance in Peer-to-Peer Lending' (2012) 25 *The Review of Financial Studies* 2455.

¹²² *Ibid.*

¹²³ David Gefen, Elena Karahanna, Detmar W. Straub, 'Trust and TAM in Online Shopping: An Integrated Model' (2003) 27 *MIS Quarterly* 51.

There are two primary methods for assessing borrowers by the platform. The first is a direct evaluation of the loan requests, including the reliability and adequacy of the provided information. The completeness and accuracy of the borrower's requested information may directly indicate their creditworthiness. The second method is an indirect assessment. Even if a particular lender and borrower have not engaged in repeated transactions, the borrower might have made multiple requests on the platform and interacted with other lenders in the past.¹²⁴ These previous requests and interactions build the borrower's social capital, which can serve as an indicator of their trustworthiness and integrity.¹²⁵ However, lenders cannot obtain this information unless the borrower requests the platform to list it, or the platform has the borrower's permission to provide it to the lender. Thus, trust in P2P platforms by both lenders and borrowers is also crucial, which is the second dimension of trust.

Trust in a platform denotes a subjective conviction that the intermediary will adeptly establish and uphold equitable rules, procedures, and outcomes within its marketplace.¹²⁶ This trust is founded on the expectation that the platform will operate competently, reliably, and with integrity. If necessary, the platform will provide a means for users to address any opportunistic behaviours exhibited by their counterparties.¹²⁷

¹²⁴ *Ibid.*

¹²⁵ *Ibid.*

¹²⁶ *Ibid.*

¹²⁷ Paul A. Pavlou and David Gefen, 'Building Effective Online Marketplaces with Institution-Based Trust' (2004) 15 *Information Systems Research* 37.

Zhang and others state that the platform's service quality and protection are two essential factors determining lenders' trust in the platform.¹²⁸ Given that lenders face higher risks than borrowers, they rely heavily on platforms to safeguard their funds. Thus, trust in the platforms is primarily based on the safety measures they offer, including escrow services, fraud protection, authentication, and verification. In addition to these core safety features, lenders also anticipate that the platform will offer reliable services to support transactions.¹²⁹

Indeed, service quality and protection are also factors influencing borrowers' trust in a platform, although borrowers may not have the same degree of choice as lenders. Given the variations in thresholds, interest rates, and fees among P2P platforms, borrowers' primary consideration in selecting a platform is often not trust, but rather accessibility and affordability. However, for borrowers who possess some freedom in selecting their lending platform, trust in the platform is important. They also prefer to select a platform in which they have trust in the provision of high-quality services. High-quality services for borrowers include, for instance, ensuring that in the event of default, the debt collection method is fair and causes minimal disruption to their lives; proper handling of collateral is imperative in the case of secured loans; equally critical is safeguarding, which involves securely storing funds in the platform's client account before disbursing them to the borrower.

The trust also encompasses borrowers' belief in the platform's ability to safeguard against the potential for unexpected bankruptcy or illicit activities. Given that the lending contract is

¹²⁸ Tengwen Zhang and others, 'Trust Building in Online Peer-to-Peer Lending', *Journal of Global Information Technology Management* 17 (2014) 250.

¹²⁹ *Ibid.*

established between the lender and the borrower, if funds have been disbursed to the platform's client account but have not yet been received by the borrower, the scenario wherein the owner of the platform absconds with the funds does not absolve the borrower of their debt obligation.

In contrast to lenders' trust in borrowers, it is more probable that users have interacted with the platform repetitively. Past experience has a significant impact on trust.¹³⁰ For P2P users, past experiences can serve as an indirect assessment of the platform. For instance, users who have frequently and consistently used a platform over time may exhibit greater trust in it.

In the two dimensions of trust, information plays the most significant role in its construction. Under certain conditions, the P2P lending market can resemble the "lemons market" described by Akerlof, where transactions are characterised by uncertainty and even opportunism.¹³¹ In cases where lenders cannot differentiate between good and bad loans, this may lead to the displacement of good loans, potentially resulting in market failure.¹³² Therefore, it is worthwhile to explore how lenders gather and assess information through the platform to build trust.

In the realm of motivations driving individuals to participate in P2P lending, Lin and others have discerned that individuals are more inclined to lend funds to peers who possess credible

¹³⁰ Robin Meize-Grochowski, 'An Analysis of the Concept of Trust' (1984) 9 *Journal of Advanced Nursing* 563.

¹³¹ George A. Akerlof, 'The Market for "Lemons": Quality Uncertainty and the Market Mechanism' (1970) 84 *Quarterly Journal of Economics* 488.

¹³² *Ibid.*

hard information within their extended network, particularly those endowed with a favourable credit score.¹³³ Conversely, borrowers with subpar credit ratings face diminished prospects of success. Moreover, heightened interest rates coincide with elevated default rates.¹³⁴

However, soft information should not be overlooked. Duarte and others have underscored the significance of soft information, such as personal details, in fostering a positive perception of the borrower.¹³⁵ They also explain that borrowers who demonstrate greater trustworthiness have a better chance of securing loan funding and are offered lower interest rates compared to those who are less trustworthy.¹³⁶

Thus, P2P lending platforms possess access to extensive private hard and soft data concerning the credit history and current financial standings of their borrowers.¹³⁷ With the advancement of the online credit market, these platforms have progressively developed their proprietary scoring models, leveraging digital data sources. Additionally, in jurisdictions where credit information-sharing mechanisms are in place, P2P lending platforms typically enjoy access to

¹³³ Mingfeng Lin, Nagpurnanand Prabhala and Siva Viswanathan 'Judging borrowers by the company they keep: friendship networks and information asymmetry in online peer-to-peer lending.' (2013) 59 Management science 17.

¹³⁴ *Ibid.*

¹³⁵ Jefferson Duarte, Stephan Siegel and Lance Young, 'Trust and Credit: The Role of Appearance in Peer-to Peer Lending', *The Review of Financial Studies* 25 (2012) 2455.

¹³⁶ *Ibid.*

¹³⁷ Lars Norden and Martin Weber, 'Credit Line Usage, Checking Account Activity, and Default Risk of Bank Borrowers,' (2010) 23 *Review of Financial Studies* 3665.

the credit histories of their borrowers.¹³⁸ Nonetheless, such datasets often suffer from being incomplete and may not match the quality of private data held by banks. Consequently, it is necessary for P2P platforms to deploy distinct information screening processes compared to banks to mitigate these informational asymmetries.

P2P platforms and lenders also harness the "wisdom of crowds" to collect and interpret information that informs lenders' decision-making.¹³⁹ Yum and others' study highlights lenders' ability to anticipate the private information of fellow lenders, harness collective wisdom, and enhance decision-making by observing others' actions.¹⁴⁰ Likewise, Freedman and Jin demonstrate that loans endorsed or bid on by friends experience fewer instances of missed payments.¹⁴¹ This collective wisdom may encompass soft information that lenders possess about borrowers, stemming from personal connections, geographic proximity, and similar factors.¹⁴² For example, to reduce uncertainty and address information asymmetry, borrowers' social networks have been taken into account.¹⁴³ Several studies underscore the influence of lenders' social networks and other decision-making factors on loan behaviour. Lin, Viswanathan and Prabhala discovered that Information from borrowers' social networks helps

¹³⁸ Ryan M. Nash and Eric Beardsley, 'The future of finance. The rise of the new Shadow Bank' (2015) 3 Goldman Sachs Investment Research 1.

¹³⁹ Haewon Yum and Myungsin Chea, 'From the Wisdom of Crowds to My Own Judgment in Microfinance Through Online peer-to-peer Lending Platforms' (2012) 11 Electronic Commerce Research and Applications 469.

¹⁴⁰ *Ibid.*

¹⁴¹ Seth Freedman and Ginger Zhe Jin, 'The Information Value of Online Social Networks: Lesson from Peer-to-Peer Lending', NBER Working Paper No.19820 (2018)
<https://www.nber.org/system/files/working_papers/w19820/w19820.pdf> accessed 29 October 2023.

¹⁴² Olena Havrylchuk and Marianne Verdier, 'The Financial Intermediation Role of the P2P Lending Platforms' (2018) 60 Association for Comparative Economic Studies 115.

¹⁴³ Freedman and Jin (n 141).

reduce information asymmetry in transactions, increases the chances of successful borrowing, and lowers both interest rates and the likelihood of loan defaults.¹⁴⁴ Everett's findings suggest a notable reduction in loan default rates only when membership in social networks entails genuine personal connections.

Those studies indicate that the “wisdom of crowds” is essential for lenders' decision-making; however, it is worth mentioning that it can sometimes be irrational, exacerbating information asymmetry and its associated consequences. The main concern is herd behaviour, which can entail irrational trust, as lenders may blindly follow the actions of others without engaging in rational decision-making processes.¹⁴⁵ Many empirical studies have identified herding behaviour in the P2P lending market. For example, Lee and Lee observed a significant impact of others' decisions on lenders' behaviour, leading to a phenomenon of herd behaviour.¹⁴⁶ Zhang and Chen employed a panel data model to test and concluded that both rational and irrational herding exist in the P2P lending market. While irrational herd behaviour is not uncommon in various retail investments¹⁴⁷, its adverse effects may be magnified within the P2P lending area due to the vulnerable position of P2P lenders, which will be discussed in Chapter 3.

¹⁴⁴ Lin, Viswanathan and Prabhala (n 133).

¹⁴⁵ Ke Zhang and Xiaoxue Chen, ‘Herding in a P2P lending Market: Rational Inference or Irrational Trust?’ (2017) 23 *Electronic Commerce Research and Applications* 45.

¹⁴⁶ Eunkyong Lee and Byungtae Lee, ‘Herding Behaviour in Online P2P lending: An Empirical Investigation’ (2012) 11 *Electronic commerce research and applications* 495.

¹⁴⁷ Puput Tri Komalasari and others, ‘Herding Behaviour in the Capital Market: What do We Know and What is Next?’ (2022) 72 *Management Review Quarterly* 745.

2.3.3 Advantages and Social value in P2P lending

P2P lending has inherent advantages that are vital not only to the competitiveness of P2P platforms in the lending market but also to enabling access to financial services for individuals and SMEs. This promotes financial inclusion and financial democracy, which can be seen as the social value of P2P lending. Therefore, the regulation of P2P lending should consider whether regulatory measures can enhance or at least reduce barriers to the societal value offered by P2P platforms. These advantages include:

a. low entry thresholds

P2P lending offers a low barrier to entry for both borrowers and lenders, thus enhancing access to financial resources. For borrowers, economic challenges such as income fluctuations or insufficient cash flow for specific projects may compel them to seek external financing. This is especially true for the poorest groups, who face significant difficulty in finding simple solutions to their economic hardships within the consumer credit market.¹⁴⁸ P2P lending platforms provide them with an opportunity to secure funding when internal financial resources are insufficient. This accessibility empowers a broader spectrum of borrowers, including those traditionally underserved by conventional financial institutions, to access capital for various purposes, ranging from personal expenses to entrepreneurial endeavours. In other words, borrowers who are rejected by banks may successfully obtain a loan through P2P lending platforms.

¹⁴⁸ Iain Ramsay and Toni Williams, 'The Crash that Launched a Thousand Fixes: Regulation of Consumer Credit after the Lending Revolution and the Credit Crunch' (2009) <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1474036> accessed 11 August 2024.

While the loan market context may vary from country to country, it is a common occurrence that many small borrowers encounter challenges in obtaining credit from financial institutions.¹⁴⁹ ¹⁵⁰ For example, in the UK, the tightened lending criteria imposed by banks following the 2008 global financial crisis resulted in increased difficulty for small borrowers to obtain credit, thereby limiting their ability to secure funds from traditional banking sources.¹⁵¹ ¹⁵² Consequently, a significant number of individuals and SMEs encountered challenges in accessing credit or obtaining credit at reasonable interest rates.¹⁵³ This circumstance compelled small fundraisers to seek alternative avenues for financing, leading them to explore P2P lending as a viable solution.

In China, the traditional financial system has historically struggled to effectively meet the diverse financing needs of various economic entities.¹⁵⁴ Large state-owned companies have remained the preferred clientele of major commercial banks, leaving low to middle-income individuals and small-scale private businesses with inadequate access to funding.

¹⁴⁹ Facundo Abraham and Sergio L Schumkler, 'Addressing the SME finance problem.'(2017) World Bank Research and Policy Briefs 120333 <<https://documents1.worldbank.org/curated/ar/809191507620842321/pdf/Addressing-the-SME-finance-problem.pdf>> accessed 24 October 2023.

¹⁵⁰ Genevieve Sheehan and Scutella Rosanna, 'To Their Credit: Evaluating an Experiment with Personal Loans for People on Low incomes' (2006) Brotherhood of St Laurence <<https://library.bsl.org.au/jspui/handle/1/6038>> accessed 12 March 2024.

¹⁵¹ Havrylchuk and Verdier (n 142).

¹⁵² Simon H. Kwan, 'Financial Crisis and Bank Lending' 11 (2010) Federal Reserve Bank of San Francisco Working Paper 2010-11 < <https://www.frbsf.org/wp-content/uploads/wp10-11bk.pdf>> accessed 1 November 2023.

¹⁵³ Richard Swedberg, 'The structure of confidence and the collapse of Lehman Brothers', in Michael Lounsbury, Paul M. Hirsch (ed.) *Markets on Trial: The Economic Sociology of the U.S. Financial Crisis* (Research in the Sociology of Organizations, Vol. 30 Part A, Emerald Group Publishing 2010) 71-114.

¹⁵⁴ Lingyu Kong and Florian Ploeckl, 'Modern Chinese Banking Networks during the Republican Era' (2022) 64 *Business History* 655.

Furthermore, state-owned commercial banks have widely implemented a locally centralised management strategy aimed at enhancing the oversight of financial services. This strategy involves delegating approval authority to upper-level management, consolidating local offices, and tightening credit issuance.¹⁵⁵ Consequently, this approach has led to a higher degree of centralisation in lending operations and diminished efforts to extend credit to lower-income individuals and small businesses.¹⁵⁶

As a result, lower-income individuals and small businesses unable to secure the necessary financial support from the limited traditional financial institutions have turned their attention to P2P lending. This alternative avenue provides them with significant opportunities to access credit and address their financial needs.

For lenders, the access threshold is also lower than many other types of financial investment. Most P2P platforms offer very low initial investment requirements for lenders, although certain platforms, particularly those focusing on secured loans, may have higher minimum investment thresholds. The inclusion of numerous low-entry P2P lending platforms expands the investment opportunities for individuals with limited capital who seek to generate financial returns from their spare funds. It also accommodates lenders who prefer to maintain small investable amounts to achieve diversification in their investment portfolios. For example,

¹⁵⁵ *Ibid.*

¹⁵⁶ *Ibid.*

the minimum required investment on each loan was £10 at *Zopa*.¹⁵⁷ The starting investment amount through *EasyMoney* is £100.¹⁵⁸

In light of these facts, it becomes evident that P2P lending facilitates financial inclusion by providing opportunities for individuals from diverse socioeconomic backgrounds to participate in the financial marketplace. In other words, P2P lending contributes to the diversity of multi-layer capital markets by filling the lending gap left by financial institutions, thereby fostering economic growth and prosperity.

b. favourable interest rates resulting from reduced costs

In P2P lending, substantial cost reductions are possible through the elimination of traditional intermediaries typically involved in a standard loan process. This is advantageous for both lenders, who can earn a higher return on their funds compared to keeping them in a bank account, and borrowers, who may obtain financing more rapidly and affordably than through traditional lending channels.¹⁵⁹

The cost savings in P2P lending also stem from the absence of offline branches. While it is worth noting that some platforms in China have established offline branches, this practice is viewed as deviating from the P2P model and is often associated with fraudulent fundraising

¹⁵⁷ Zopa has ceased its P2P lending business; the data provided is based on its status as a P2P lending platform in 2019. Zopa, 'What is the minimum amount that I can lend in each product?' (*Zopa*, 2018) < <http://help.zopa.com/customer/portal/articles/2329337> > accessed 1 April 2019.

¹⁵⁸ EasyMoney, 'Your Detail' <https://secure.easymoney.com/register?locale=en_GB> accessed 13 March 2024.

¹⁵⁹ Livingston Lynda, 'Could Peer-to-Peer Loans Substitute for Payday Loans?' (2012) 4 Accounting & Taxation 77.

activities. So, such instances are beyond the scope of discussion related to the normal P2P lending model.

Other cost-saving factors include being facilitated by information technology (without capital pooling in most cases), reduced staffing requirements, and streamlined loan processing procedures.

To provide an overview of interest rates for P2P lending, here is a brief comparison of bank rates in the UK and P2P lending rates over the same period. In the UK, the bank rate was between 0.25%-0.5% from 2013-2021, rising to 2.25% in 2022.¹⁶⁰ Comparatively, as examples of P2P platforms, *CrowdProperty* provided lenders with an average of 8.11% actual interest rate during the period of 2015-2022,¹⁶¹ while *Proplend* offered a 7.26% average return in 2020.¹⁶²

The allure of higher interest returns serves as a significant selling point for P2P lending, attracting potential lenders to consider it as an investment tool,¹⁶³ despite an essential difference from bank deposits that P2P loans are not protected by the Financial Services Compensation Scheme (FSCS). A survey conducted by Nesta revealed that 82% of surveyed

¹⁶⁰ Bank of England, 'Official Bank Rate History' < <https://www.bankofengland.co.uk/boeapps/database/Bank-Rate.asp>> accessed 12 October 2022.

¹⁶¹ CrowdProperty, 'Statistic' <<https://www.crowdproperty.com/statistics>> accessed 26 August 2022.

¹⁶² Proplend, '7.26% Average Return on Capital for All Platform Loans During 2020' < <https://www.proplend.com/?aff=eccbc87e4b5ce2fe28308fd9f2a7baf3>> accessed 10 October 2022.

¹⁶³ *Ibid.*

P2P lenders identified “to make a Financial Return” as very important.’¹⁶⁴ Therefore, it is reasonable to argue that the attraction of better interest rates draws a significant number of lenders, thereby providing a substantial increase in access to loans for a greater number of borrowers. In this regard, the business model of higher interest rates, made feasible by low costs, enables P2P lending platforms to cater to a larger number of borrowers. This serves as an indirect aspect of the value of P2P lending in promoting financial inclusion.

In terms of interest rates charged to borrowers, making direct comparisons is challenging due to variations in rates based on individual backgrounds and loan purposes. Additionally, many P2P borrowers are individuals who are unable to obtain a loan from a bank, rendering direct comparison impossible. Nonetheless, instances of interest rate ranges in P2P lending and payday loans suggest lower costs associated with P2P loans for similar circumstances.¹⁶⁵

c. convenience in use

P2P lending innovatively utilises technology to provide users with enhanced flexibility and fast, convenient service, making it appealing to potential users. The application of big data analytics in P2P lending reduces signalling and search costs, allowing users to post and search for information easily, and manage all stages of transactions on online platforms with low transaction costs and time-saving benefits.

¹⁶⁴ Peter Baeck, Liam Collins and Bryan Zhang ‘Understanding alternative finance: The UK Alternative Finance Industry Report 2014’ (*Nesta*, 6 November 2014) <<https://www.nesta.org.uk/report/understanding-alternative-finance-the-uk-alternative-finance-industry-report-2014/>> accessed 23 November 2023.

¹⁶⁵ Kathryn Gaw, ‘P2P Loans Vs. Payday Loans’ (*Alternative Credit Investor*, 25 March 2022) <<https://alternativecreditinvestor.com/2022/03/25/p2p-loans-vs-payday-loans/>> accessed 14 March 2024.

Convenience in use not only acts as a means of attracting users but also serves as one of the competitive advantages within the P2P industry. Alongside the appeal of better interest rates, this feature also attracts certain borrowers and lenders who would otherwise turn to traditional financial institutions for depositing/investing or borrowing purposes. To some extent, P2P lending competes effectively within the lending industry. This is despite the fact that P2P lending does not constitute a disruptive innovation capable of challenging the dominance of banks in lending, as discussed in Section 2.2.3. However, the competition it fosters yields certain advantages, such as encouraging greater adoption of technology within the lending market by the banking sector.¹⁶⁶

Hence, owing to the benefits of the P2P business model, a larger number of individuals (and SMEs), particularly those marginalised within the conventional financial realm, are afforded the opportunity to engage in lending and/or borrowing. With the proliferation of the Internet and personal networking devices, the general public can readily access P2P platforms at their convenience to partake in lending activities, thereby contributing, to some extent, to the democratisation of finance.

Overall, P2P lending plays a vital role in promoting financial inclusion, fostering economic growth, and potentially strengthening social cohesion. By harnessing the power of technology, P2P lending platforms contribute to building more inclusive, democratic, and resilient financial ecosystems.

¹⁶⁶ Barba Navaretti and others, 'Fintech and Banking. Friends or Foes?' (2018) <<https://ssrn.com/abstract=3099337>> accessed 15 March 2024.

2.4 Conclusion

This chapter has provided a detailed examination of P2P lending, highlighting its unique features and outlining the critical issues that need to be considered when designing regulatory frameworks.

First, P2P lending is an evolution rather than a revolution, as it shares several elements with microfinance but expands the potential user base beyond the typical targets of microfinance.

Second, the growth of P2P lending is closely tied to the evolution and proliferation of IT. This relationship suggests that regulatory approaches should consider the technological underpinnings of P2P platforms and ensure that they are equipped to address the unique risks and challenges posed by digital financial services.

Third, P2P lending offers low entry barriers for borrowers and operates on a cost-effective business model. These characteristics allow for favourable interest rates, which can promote financial inclusion and democratisation by reaching underserved segments of the population. However, this also necessitates a regulatory focus on consumer protection and fair lending practices.

Fourth, P2P lending does not function as a disruptive innovation. Rather than challenging the traditional banking sector, P2P lending fills gaps within the existing lending ecosystem by offering alternative financing options. This finding implies that regulatory frameworks should

not aim to curb P2P lending as a competitor to banks but should instead focus on integrating these platforms into the broader financial landscape.

Fifth, P2P lending is not a form of financial disintermediation. While it bypasses traditional financial intermediaries, the platform itself acts as an intermediary, playing a crucial role in the lending process. This insight has significant implications for regulatory design, as it highlights the need for oversight mechanisms that address the platform's intermediary role, ensuring transparency and accountability. The type of intermediary that P2P platforms represent will be discussed in Chapter 7, following an understanding of the role of P2P platforms in the UK and China in Chapters 4, 5, and 6.

Sixth, trust-building is a critical component of P2P lending, operating on two levels: trust between the borrower and the platform and trust between the lender and the borrower. The phenomenon of the “wisdom of the crowd” plays an important role in trust-building, but it can also heighten risks associated with herd behaviour.

Finally, as a form of non-bank intermediated finance rather than disintermediated finance, P2P lending offers social value due to its low costs, low barriers to entry, and user convenience. However, it also raises concerns about the potential risks it introduces, particularly whether these risks outweigh its social benefits. Therefore, Chapter 3 will examine the risk factors associated with P2P lending from the consumers’ perspective.

Chapter 3 P2P lending consumers: opportunity, risks and regulatory protection

3.1 Introduction

The objective of this chapter is to investigate the characteristics of P2P lenders and borrowers, identify the risks they face, and explore strategies for protecting P2P consumers. By examining these aspects, this chapter seeks to establish a comprehensive understanding of the risks associated with P2P lending and provide the theoretical foundation for the subsequent comparative study. It addresses the first research question: What are the justifications for regulating P2P lending? Additionally, it partially explores the second research question: What are the critical issues in evaluating and designing a regulatory regime for P2P lending?

The research method used to address these questions is primarily a literature-based sociolegal study, incorporating both academic publications and industry articles or news. Additionally, this chapter references several cases in China as illustrative examples to support the arguments presented.

This chapter is organised as follows: Section 3.2 argues that both P2P borrowers and lenders are financial consumers. Sections 3.3 and 3.4 delve into the risks encountered by lenders and borrowers respectively, emphasising the risks that make P2P lenders more vulnerable. Section 3.5 provides a theoretical foundation for consumer protection in P2P lending, emphasising that behavioural economics closely aligns with the actual practices of P2P lending consumers. It also suggests that soft paternalism can protect consumers from excessive risks without excessively restricting their freedom when making imperfect decisions. Finally, Section 3.6 concludes by summarising the key concepts and issues explored throughout the chapter.

3.2 Identifying P2P lending users as financial consumers

Compared to P2P borrowers, who are more clearly recognised as financial consumers, there is ambiguity and a lack of consensus regarding the classification of P2P lenders—whether they should be considered consumers, retail investors, or belong to another category altogether. However, clearly defining the role of P2P lenders is essential for ensuring their protection, as different roles may necessitate different protective approaches.

3.2.1 P2P lenders and retail investors

In the legal or finance scholarship on P2P lending, lenders are often referred to as retail investors. For instance, Davis characterises P2P lenders as retail investors in their research on the P2P lending business model and regulation.¹⁶⁷ Similarly, Galema identifies P2P lenders as P2P investors in a quantitative study on credit rationing in P2P lending,¹⁶⁸ Dietrich and Wernli use P2P consumer loans as an example to analyse how retail investors assess risk;¹⁶⁹ Moreover, *Wandaizhijia*, which was the primary professional Chinese P2P lending information portal, had many of its published reports and news articles referring to lenders as retail investors.¹⁷⁰

¹⁶⁷ Kevin Davis and Jacob Murphy ‘Peer-to-Peer Lending: Structures, Risks and Regulation’ (2016) 3 JASSA: The Finsia Journal of the Applied Finance 37 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2862252> accessed 19 October 2023.

¹⁶⁸ Rients Galema, ‘Credit rationing in P2P lending to SMEs: Do lender-borrower relationships matter?’ (2020) 65 Journal of Corporate Finance 101742.

¹⁶⁹ Andreas Dietrich and Reto Rey, ‘Determinants of Interest Rates in the P2P Consumer Lending Market: How Rational are Investors?’ (2019) ResearchGate <https://www.researchgate.net/publication/340172917_Determinants_of_Interest_Rates_in_the_P2P_Consumer_Lending_Market_How_Rational_are_Investors> accessed 29 March 2024.

¹⁷⁰ Wandaizhijia, ‘Research Reports’ <<https://www.wdzt.com/news/yanjiu/>> accessed 7 July 2019.

Certainly, P2P lenders exhibit similarities with retail investors. Retail investors are generally understood to be individuals who are not financial professionals and invest their personal savings or capital in financial products on their own. For example, Black defines a retail investor as any natural person who owns stock, either directly or indirectly, and does not qualify as an “accredited investor”.¹⁷¹ Thus, P2P lenders can be characterised as retail investors to some extent, as they are typically not investment professionals and lend their own funds to others with the expectation of earning a financial return.

However, P2P lenders do not fit neatly into the category of retail investors, as there are important distinctions between the two. In terms of expectations regarding investment time horizons, David Lawton characterises retail investors as those who generally have longer-term investment goals and typically seek to diversify their investments and are willing to take on some level of risk in the hope of achieving higher returns.¹⁷² In contrast, P2P lenders invest in loans to individuals or SMEs with the expectation of receiving repayment with interest over the relatively short term for each loan.¹⁷³

From the perspective of general expectations regarding risk exposure of repayment and return, P2P lending typically appears more straightforward: as long as the borrower and the

¹⁷¹ Barbara Black, ‘Are Retail Investors Better Off Today’ (2008) 2 Brooklyn Journal of Corporate, Financial & Commercial Law 303.

¹⁷² FCA, ‘Investment Funds, Markets Liquidity and the Investor’ (FCA, 24 March 2016) <<https://www.fca.org.uk/news/speeches/investment-funds-markets-liquidity-and-investor>> accessed 1 April 2023.

¹⁷³ Osuji and Amajuoyi (n 40).

platform do not default or commit fraud, lenders can recover the principal and interest. In contrast, retail investors in capital markets face a more complex scenario, where their investments are affected by a wider range of factors and are more closely tied to the overall economic system. For example, stock market fluctuation is affected by not only market-related and microeconomic factors but also macroeconomic factors such as GDP.¹⁷⁴ This makes P2P lending seem more manageable in terms of credit risk. However, since the financial uncertainty faced by P2P lenders is not actually less than that faced by retail investors (as will be discussed in section 3.3), this perception might lower the lender's awareness of credit risk.

Moreover, retail investors typically demonstrate a heightened awareness of risks in relation to their return expectations compared to P2P lenders. They often employ various strategies to manage and mitigate these risks, occasionally seeking advice from financial advisors.¹⁷⁵ However, due to the inclusive nature of P2P lending, P2P lenders generally possess lower levels of experience and financial expertise compared to retail investors.¹⁷⁶ Also, given the relatively low investment amounts and the perceived simplicity of P2P lending relative to a diverse array of financial products, P2P lenders are often disinclined to seek professional financial advice prior to participating in P2P loans or deeming it uneconomical.

However, it is important to note that both retail and professional investors may participate in P2P lending. Retail investors, in particular, might engage in P2P lending as a strategy to

¹⁷⁴ Eka Bertuah and Sakti Indra, 'The Financial Performance and Macroeconomic Factors in Forming Stock Return' (2019) 4 Jurnal Riset Manajemen dan Bisnis Fakultas Ekonomi UNIAT 511.

¹⁷⁵ Gaia Silvia Balp, 'The Corporate Governance Role of Retail Investors' (2018) Loyola Consumer Law Review 31 (2018) 47.

¹⁷⁶ Osuji and Amajouyi (n 40).

diversify their portfolios and mitigate risk. As such, P2P lenders can include a subset of retail investors. However, this does not mean that P2P lenders should be classified as retail investors from a regulatory perspective, as the primary customer base for P2P lending primarily consists of general individuals rather than retail or professional investors.

Clarifying that P2P lenders are not retail investors is important because the protection of retail investors differs fundamentally from consumer protection; it typically assumes that retail investors possess a certain degree of expertise.¹⁷⁷ Nevertheless, due to certain similarities between P2P lenders and retail investors, P2P lenders may exhibit behaviours akin to those of retail investors, such as herding, which can lead to similar risks. Therefore, from a regulatory standpoint, the protective frameworks developed for retail investors can provide valuable insights for the P2P lending sector, such as increased transparency, protection from a misleading market, and enhanced supervisory cooperation and so forth.¹⁷⁸

3.2.2 Exploring the role of P2P lenders: does the concept of prosumer apply?

While P2P lenders do not align perfectly with the definition of a retail investor, it is worth questioning whether a more suitable concept exists that better encapsulates the role of a P2P lender. The concept of “prosumer”, created by Toffler in his book, is worth considering in this context.¹⁷⁹ It represents a hybrid role that combines both consumer and producer functions.

¹⁷⁷ Christian Leuz, Dhananjay Nanda and Peter D Wysocki, ‘Earnings management and investor protection: an international comparison’ (2003) 69 *Journal of Financial Economics* 505.

¹⁷⁸ European Commission, 'Artificial Intelligence: Commission Proposes New Rules and Actions to Address AI's Impact on the Economy and Society' (Brussels, 18 April 2023) <https://ec.europa.eu/commission/presscorner/detail/en/ip_23_2868> accessed 24 August 2024.

¹⁷⁹ Alvin Toffler, *The Third Wave* (1st ed, William Morrow 1980).

This entails consumer participation in the production processes of goods or services that they either purchase or envision purchasing.¹⁸⁰ The prosumer is thus engaged not only in consumption but also in traditionally producer-centric activities.¹⁸¹

In examining the distinction between consumers and prosumers, Dujarier posits that prosumers are characterised by their active involvement in the production processes of the products they consume.¹⁸² Furthermore, Ritzer contends that, unlike traditional customer-centric services where producers permit customers to modify certain product elements, prosumption entails an equitable integration of both production and consumption activities.¹⁸³

Prosumers are motivated by various factors such as personalisation, creativity, sustainability, or community engagement. Their objectives are often multifaceted and go beyond mere economic considerations. Examples of prosumers encompass those purchasing items from vending machines,¹⁸⁴ buying a plain t-shirt but then customising it by adding a design onto it

¹⁸⁰ *Ibid.*

¹⁸¹ *Ibid.*

¹⁸² Marie-Anne Dujarier, 'The Three Sociological Types of Consumer Work' (2014) 16 J Consumer Culture 555.

¹⁸³ Emily M. Weitzenboeck 'Looking Back to See Ahead: The Changing Face of Users in European E-Commerce Law' (2015) 23 Artificial Intelligence and Law 201.

¹⁸⁴ *Ibid.*

themselves¹⁸⁵ and so on. Also, there are P2P energy-trading platforms for prosumers to trade the renewable energy generated at a better price.¹⁸⁶

P2P lenders exhibit traits akin to prosumers when establishing loan contracts due to their involvement in directed self-production. Given that the platform equips lenders with tools to choose borrowers or develop lending plans, P2P lenders can be likened to prosumers engaged in directed self-production.

However, a prosumer's production activities directly serve their own needs or consumption, while the production activities of a P2P lender are not equivalent to the products or services they receive. This distinction prevents P2P lenders from being classified as prosumers. For P2P lenders, their "production" is manifested in their lending decisions aimed at securing interest returns. In fact, their 'consumption' directed at the platform involves paying service fees for access to the platform's lending facilitation services. In other words, the products consumed by lenders do not originate from their own design. Therefore, P2P lenders amalgamate the capabilities of both producers and consumers, while exhibiting distinctions from prosumers. This suggests that protecting P2P lenders does not align with the regulatory framework designed for prosumers.

¹⁸⁵ Clickworker 'Prosumer'
<<https://www.clickworker.com/crowdsourcing-glossary/prosumer/>> accessed 28 March 2024.

¹⁸⁶ Thomas Morstyn and others, 'Using Peer-to-Peer Energy-Trading Platforms to Incentivize Prosumers to Form Federated Power Plants' (2018) 3 *Natural Energy* 94.

3.2.3 P2P lenders as financial consumers

While some literature and News sources describe P2P lenders as retail investors, other studies recognise P2P lenders as consumers. For example, Roure and others refer to P2P users as consumers in their study of the consumer credit market.¹⁸⁷ Greiner and Wang characterise the P2P lending market as a consumer-to-consumer market in their empirical business analysis.¹⁸⁸ Similarly, Hidayat, Alam and Helmi define P2P lenders as consumers in their research on P2P lending consumer protection in Indonesia.¹⁸⁹

Significantly, P2P lending users are classified as consumers under UK regulation. The FCA categorises P2P lenders as consumers under the Financial Service Act 2012, which offers a broad definition encompassing both retail customers and wholesale and professional investors. According to the Financial Services and Markets Act (FSMA) 2000, the consumer is

'a natural person:

(a) who uses, has used, or may use regulated financial services; or

services that are provided by other than authorised persons but are provided in carrying on regulated activities; or

(b) who has relevant rights or interests in relation to any of those services; or

¹⁸⁷ De Roure, Lorian Pelizzon and Paolo Tasca, 'How Does P2P Lending Fit into the Consumer Credit Market?' (2016) Bundesbank Discussion Paper No.30/2016 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2848043 > accessed 23 November 2023.

¹⁸⁸ Martina E Greiner, and Hui Wang, 'Building Consumer-to-consumer Trust in E-Finance Marketplaces: An Empirical Analysis' (2010)15 International Journal of Electronic Commerce 105.

¹⁸⁹ Asep S Hidayat, Faris Satria Alam and Muhammad Ishar Helmi, 'Consumer Protection on Peer to Peer Lending Financial Technology in Indonesia' (2020) 9.

*(c) who has invested, or may invest, in financial instruments; or who has relevant rights or interests in relation to financial instruments; or...*¹⁹⁰

Therefore, it is clear that P2P users are under that definition of the consumer because they use the P2P lending platform which is an FCA-regulated financial service, and obviously they have relevant rights and interests in relation to the platform's service.

However, the UK's Consumer Rights Act 2015 defines a consumer as "*an individual acting for purposes that are wholly or mainly outside that individual's trade, business, craft or profession.*" Therefore, it raises important questions about whether, and to what extent, P2P lenders who are either non-natural persons (e.g., companies) or natural persons professionally engaged in investment activities can be classified as consumers. It also calls into question whether such participants should be entitled to the same level of regulatory protection as non-professional retail lenders.

As the majority of P2P users are non-professional individuals,¹⁹¹ the predominant user profile aligns with that of consumers, particularly when viewed through the lens of legal protection. These users often lack advanced financial literacy, risk assessment skills, and the institutional support available to professional or corporate investors.¹⁹² Accordingly, it is both practical and necessary to conceptualise them as a vulnerable group requiring tailored legal safeguards.

¹⁹⁰ FSMA 2000, Section 1G.

¹⁹¹ Klein, Shtudiner and Zwilling (n 5).

¹⁹² *Ibid.*

In designing appropriate regulatory protections, it is essential to account for the group's core characteristics—namely, limited financial knowledge, asymmetrical access to information, and a reduced capacity to absorb financial losses—as well as the specific risks they are likely to encounter through their participation in P2P lending.

In addition, the primary factor in determining whether an individual is classified as a consumer is the predominant nature of their activity.¹⁹³ Professional investors, whether natural or legal persons, typically adopt diversified investment strategies, spreading their capital across a range of financial products to mitigate risk.¹⁹⁴ Where P2P lending constitutes only a minor or incidental part of such an investor's broader portfolio, this activity alone may not be sufficient to disqualify them from being considered consumers in the specific context of P2P lending. Accordingly, they should not be automatically excluded from the protections afforded to consumers under relevant legal frameworks.

Moreover, while business and professional investors may also engage with P2P platforms, they typically demonstrate a higher risk tolerance, possess financial expertise or have greater access to professional advice, and more diversified investment portfolios. Prioritising regulatory protections for individual users does not negate the importance of maintaining appropriate legal safeguards for business participants.

¹⁹³ Jodi Gardner and Kanchana Kariyawasam K, 'Online Auctions and Consumer Protection in the United Kingdom and Australia: The Value of Transparency' <<https://www.repository.cam.ac.uk/handle/1810/297836>> accessed 10 February 2025.

¹⁹⁴ Mariassunta Giannetti and Andrei Simonov, 'Which Investors Fear Expropriation? Evidence from Investors' Portfolio Choices' (2006) 61*The Journal of Finance* 1507.

While lenders can broadly be classified as consumers, regulatory approaches should account for the diversity in risk exposure and financial capacity across user groups, including the distinct characteristics of “consumer lenders” and “professional lenders”. The UK’s current regulatory framework reflects this by distinguishing between categories of lenders based on their level of sophistication and financial resilience,¹⁹⁵ as will be discussed in Chapter 5. This tiered classification offers a valuable model for implementing proportionate protections. It helps balance investment autonomy for professional lenders with appropriate safeguards for non-professional and inexperienced individuals.

Comparatively, in China, there is no legal definition of P2P users and legal documents refer to P2P users as “lenders” or “borrowers” respectively.¹⁹⁶ But reports from China Banking Regulatory Commission (CBRC) recognise P2P users as consumers.¹⁹⁷ China’s definition of consumer is found solely in Article 2 of the Consumer Protection Law, which states that consumers who purchase or use goods or receive services for their daily needs of consumption are protected by consumer law. This definition has been criticised for being somewhat circular and lacking clarity about who specifically qualifies for protection. It just specifies that those purchasing goods or services for daily consumption are protected, without

¹⁹⁵ FCA, *Strengthening our Financial Promotion Rules for High-risk Investments and Firms Approving Financial Promotions* (PS22/10, August 2022).

¹⁹⁶ General Office of CBRC, ‘网络借贷信息中介机构业务活动信息披露指引的通知’ [Guidelines on Information Disclosure for Business Activities of Online Lending Information Intermediaries] (No.113, 2017).

¹⁹⁷ CBRC, ‘网友关于“银监会等四部委发布《网络借贷信息中介机构业务活动管理暂行办法》”的相关评论’ [Netizens' Comments on the "Interim Measures for the Administration of the Business Activities of Online Lending Information Intermediaries" Issued by the China Banking Regulatory Commission and Three Other Ministries] (2016)
<<http://www.cbrc.gov.cn/chinese/home/docView/98114E06F0DE4153A5A30D8142A96C0D.html>> accessed on 3 April 2019.

clearly defining which individuals or entities are included in this category.¹⁹⁸ This vague wording creates uncertainty regarding the exact meaning of a consumer in China's law.¹⁹⁹

Moreover, it should be noted that after the termination of P2P lending activities in China, China enacted a financial consumer protection law in 2020.²⁰⁰ This makes a tricky issue for defining P2P lenders in China. In this law, a financial consumer is defined as "a natural person who purchases or utilises financial products or services offered by banks or payment institutions, or natural persons served by non-bank payment institutions". However, under the regulatory rules for P2P lending, P2P platforms are constrained to function solely as information intermediaries and are prohibited from acting as financial intermediaries. Hence, P2P users in China were not utilising "financial intermediation services" and consequently do not seem to be classified as financial consumers. Additionally, since P2P platforms are neither financial intermediaries nor financial institutions, lenders do not meet the definition of retail investors in China's Securities Law.²⁰¹ The omission of P2P users could be because the P2P industry in China had already ended before the Consumer Protection Law was enacted. Consequently, this issue did not present any practical problems.

Therefore, this thesis identifies P2P lenders and borrowers as financial consumers. First, they meet the definition of financial consumers, a classification supported by numerous studies.

¹⁹⁸ Kristie Thomas, 'Analysing the Notion of "Consumer" in China's Consumer Protection Law' (2018) 6 The Chinese Journal of Comparative Law 294.

¹⁹⁹ *Ibid.*

²⁰⁰ People's Bank of China, '中国人民银行金融消费者权益保护实施办法' [Measures for the Implementation of Financial Consumer Rights Protection by the People's Bank of China] (No.5, 2020).

²⁰¹ Securities Law of the People's Republic of China (2019 Revision) Chapter 6.

P2P lenders are more vulnerable compared to retail investors and align more closely with the concept of “individual investors... in need of protection as 'consumers' in the financial market,” as described by Wan and others.²⁰² Second, given the focus of this thesis on P2P lending regulations in both the UK and China, it is evident that UK regulations categorise P2P users as consumers. While the classification of P2P users in China is ambiguous, there is evidence suggesting that regulators also recognise P2P lenders as consumers to some extent. Third, attempting to categorise P2P lenders as retail investors or prosumers is not feasible due to inherent differences.

Identifying P2P users as financial consumers would enable the exploration of protective measures for them based on consumer protection approaches. Consumers are not a homogenous group because they must have different tastes, social positions or cultural backgrounds.²⁰³ This creates problems for regulation due to the impossibility of finding an accurate benchmark for protecting consumers within every particular industry. However, there are common elements that make up the concept of the consumer from a regulatory perspective.²⁰⁴

The fundamental reasons for protecting consumers are based on the notion that consumers generally have a lack of expertise when buying a product or service, face a high opportunity

²⁰² Tian Yee Wen, Andrew Godwin and Qinzhe Yao, 'When is an Individual Investor Not in Need of Consumer Protection? A Comparative Study' (*Oxford Business Law Blog*, 20 January 2020) <<https://blogs.law.ox.ac.uk/business-law-blog/blog/2020/01/when-individual-investor-not-need-consumer-protection-comparative>> accessed 10 August 2024.

²⁰³ Iris Benohr, *EU consumer Law and Human Rights* (Oxford University Press 2013) 16.

²⁰⁴ *Ibid.*

cost for the time spent on making purchasing decisions, gain minimal benefits from the time invested in making these decisions, and possess limited bargaining power.²⁰⁵ P2P lenders should be protected as consumers because they have similar behaviours and actions as ordinary consumers towards financial services and goods, and they may struggle to engage in accessing and acting on information that is required for purchasing decisions.

In addition, there are some distinctive features of P2P lenders that need to be considered when protecting P2P lending consumers. First, P2P lenders are more actively involved, participating in both consumption and production. Second, evaluating P2P lending is more complex than assessing ordinary products. These distinctions do not diminish the fact that P2P users are in a similarly vulnerable position as other consumers, particularly financial consumers. However, regulation should take into account these features, especially in consumers' decision-making processes. Specifically, when determining what constitutes "harm" and whether the "harm" should be prevented through regulatory intervention, the consumer protection approach for P2P lending may emphasise distinct aspects compared to other forms of consumer protection, such as daily household consumer protection.

²⁰⁵ Amelia Fletcher, Antony Karatzas and Antje Kreutzmann-Gallasch, 'Small Businesses as Consumers: Are They Sufficiently Well Protected? A Report for the Federation of Small Businesses' (2014) ESRC Centre for Competition Policy, University of East Anglia <https://ueaeprints.uea.ac.uk/id/eprint/95341/1/FSB_Project_Feb_2013.pdf> accessed 29 November 2023.

3.3 P2P lenders: excessive risks in the market

In discussions about the risks associated with P2P lending, the focus predominantly centres on the risks faced by lenders. This emphasis stems from the fact that lenders are the most vulnerable party in P2P lending, as they face the risk of losing some or all of their invested money. When a significant number of lenders experience only losses without any returns, the foundational purpose and justification of the industry are undermined. In more severe cases, such imbalances could threaten the stability of the broader financial system.

Any lending behaviour is susceptible to the risk of lender default, which cannot be entirely avoided.²⁰⁶ Therefore, the objective of understanding risks and protecting lenders from risks is not to entirely eliminate risk, as such an expectation is unrealistic. Instead, the purpose of studying lenders' risks is to examine whether lenders are taking excessive risks that could potentially undermine the stability of the lending platform or the broader financial system, as well as identify any points of vulnerability in their decision-making and lending processes.

3.3.1 Credit risk for P2P lenders: the main concern in the P2P lending sector

Credit risk constitutes the primary risk encountered by P2P lenders.²⁰⁷ It refers to the possibility of financial loss resulting from a borrower's failure to make repayment of a loan or fulfil contractual obligations²⁰⁸, which exposes P2P lenders to financial setbacks when

²⁰⁶ Goel Akanksha, and Shailesh Rastogi, 'Understanding the Impact of Borrowers' Behavioural and Psychological Traits on Credit Default: Review and Conceptual Model' (2023) 15 *Review of Behavioural Finance* 205.

²⁰⁷ Mary E.Barth, Gaizka Ormazabal and Daniel J Taylor, 'Asset Securitizations and Credit Risk' 87 (2012) *The Accounting Review* 423.

²⁰⁸ The Investopedia Team, 'Credit Risk' (*Investopedia*, 15 March 2022)

borrowers default on timely and accurate repayment of agreed amounts. Two primary factors contribute to elevated credit risk in P2P lending. The first is that borrowers often belong to high-risk groups, while the second is the presence of information asymmetry and irrational behaviour exhibited by lenders during decision-making.

a. Borrower default

Although a significant advantage of P2P lending lies in its provision of alternative funding opportunities for individuals rejected by traditional lending institutions, this also implies that many P2P borrowers may lack the creditworthiness required to secure loans from banks. Being excluded from bank lending does not necessarily indicate that these borrowers are entirely non-creditworthy or unlikely to repay their loans punctually. However, they are often categorised as higher-risk borrowers by banking institutions' credit assessments due to reasons such as lack of collateral or insufficient credit scores.²⁰⁹ Therefore, if lenders fail to accurately assess the default risks associated with these borrowers, it could lead to unexpected financial losses.

Obtaining accurate information about products in the credit market can be expensive.²¹⁰ This is especially true for individual P2P lenders. Therefore, although they may sometimes use various methods to assess borrowers' creditworthiness, they predominantly rely on the

< <https://www.investopedia.com/terms/c/creditrisk.asp> accessed 1 May 2024.

²⁰⁹ SuitesMe 'Industry News, 6 Reasons Why People Unbanked or underbanked' <<https://suitsmecard.com/blog/6-reasons-why-people-are-unbanked-or-underbanked>> accessed 19 August 2023.

²¹⁰ Iain Ramsay, *Consumer Law and Policy: Text and Materials on Regulating Consumer Markets* (2nd edn, Hart Publishing 2007) 65.

platform's credit ratings and information disclosure.²¹¹ Although platforms undertake the task of distinguishing borrowers with relatively lower credit risks from those with higher risks and adjust interest rates accordingly to mitigate these risks, two primary factors can impact the accuracy of this process. First, the cost-effective operational model may constrain the platform's capacity to conduct thorough evaluations of potential borrowers' creditworthiness, thereby compromising the precision of loan assessments.

Second, platforms are not held accountable for the accuracy of the information regarding potential borrowers' creditworthiness, whether it is sourced directly from borrowers or third parties, such as credit rating agencies. This introduces a potential moral hazard, wherein platforms might incentivise the origination of expensive and high-risk loans. Suryono and others' systematic literature review on P2P lending highlights that empirical research within the financial business sector has identified various strategies employed by P2P platforms to attract lenders and alleviate their concerns regarding borrowers' trustworthiness.²¹²

b. Information asymmetry, decision-making and herding

Information is essential for decision-making. Information asymmetry happens when one party involved in a transaction possesses more or superior information to the other party.²¹³ While transactions through P2P lending platforms may offer more transparency regarding borrowers'

²¹¹ Carlos Serrano-Cinca, Begoña Gutiérrez-Nieto and Luz López-Palacios, 'Determinants of Default in P2P lending' (2015) 10 PloS One e0139427.

²¹² Ryan Randy Suryono, Betty Purwandari and Indra Budi, 'Peer to Peer (P2P) Lending Problems and Potential Solutions: A Systematic Literature Review' (2019) 161 Procedia Computer Science 204.

²¹³ Richard A. Lambert, Christian Leuz and Robert E. Verrecchia, 'Information Asymmetry, Information Precision, and the Cost of Capital' (2012) 16 Review of Finance 1.

information and processes than some traditional lending institutions, significant information asymmetry between borrowers and lenders can still persist. P2P lenders face a disadvantage compared to borrowers when making loan decisions. Borrowers have almost full knowledge of their financial situation, while lenders can only rely on the information provided by the P2P lending platform.

Information asymmetry can lead to issues like adverse selection and moral hazard, problems that could eventually lead to a high risk of loan default, increasing the likelihood of loan defaults.²¹⁴ Given that most P2P lenders lack financial expertise and are in a vulnerable position due to asymmetric information, they often exhibit herding behaviour in their decision-making processes. Additionally, as users of online platforms, it is convenient for them to search for and exchange lending information online (such as social media, and online discussion forums), which facilitates the herding.

Several quantitative studies in business studies have focused on the herding behaviour among P2P lenders. For example, Yu and others identify the presence of herding behaviour in P2P lending,²¹⁵ while Zhang and Chen find both rational and irrational herding exists in P2P lending markets.²¹⁶ Herzenstein and others determine that a 1% increase in the number of bids

²¹⁴ *Ibid.*

²¹⁵ Haihong Yu and others, 'They All Do It, Will You? Event-Related Potential Evidence of Herding Behaviour in Online Peer-to-Peer Lending' (2018) 681 *Neuroscience Letters* 1.

²¹⁶ Zhang and Chen (n 145).

corresponds to a 15% rise in the likelihood of receiving an additional bid until the loan is fully funded.²¹⁷

While herding can sometimes facilitate the rapid dissemination of information, it also diminishes risk perception.²¹⁸ Herding lenders often mimic the actions of others instead of performing their own independent analyses based on the available information. This can lead to a situation where risks are underestimated or overlooked entirely, as lenders may assume that if others are participating in lending through certain platforms, the opportunity must be sound.²¹⁹

Therefore, P2P Lenders grapple with the detrimental impacts of information asymmetry and herding when making decisions. These challenges, compounded by their often limited financial literacy, create significant hurdles in comprehending the associated risks and making informed, rational choices.

3.3.2 Platform failure

Another reason P2P lenders may lose all or part of their funds is the failure or default of the platform. P2P lending platforms may cease operations if they fail to generate sufficient revenue. A platform's failure does not absolve the borrower of their obligation to repay the loan. When a platform declares bankruptcy, it becomes responsible for collecting any

²¹⁷ Michal Herzenstein, Utpal M. Dholakia and Rick L. Andrews, 'Strategic Herding Behavior in Peer-to-Peer Loan Auctions' (2011) 25 *Journal of Interactive Market* 27.

²¹⁸ *Ibid.*

²¹⁹ Ahmad Maqsood, and Qiang Wu, 'Does Herding Behaviour Matter in Investment Management and Perceived Market Efficiency? Evidence from an Emerging Market' (2022) 60 *Management Decision* 2148.

outstanding debt from borrowers and settling all unpaid loans. However, if the defunct platform evades its responsibilities, lenders will face significant challenges in recovering their funds independently, which will be discussed in section 3.3.3.

Additionally, client accounts within P2P lending platforms may be vulnerable to misuse and manipulation by the platform's owners.²²⁰ The ethical management of these funds depends heavily on the platform's integrity and compliance with regulations. In situations where governance is weak or integrity is compromised, client accounts can be exploited as a means of raising funds for the platform itself, rather than fulfilling their intended purpose of safeguarding the funds of lenders and borrowers.

In light of these factors, P2P lenders confront dual dimensions of financial loss risk, stemming from both borrowers' default and platform default. This aligns with the dual dimensions of trust they must navigate trust in borrowers and trust in platforms when participating in P2P lending.

3.3.3 The reliance of P2P lenders on the platform

P2P lenders rely heavily on platforms in their lending practices, notwithstanding the risks of default/failure associated with them. This dependence magnifies their vulnerability within the P2P lending landscape. While they primarily depend on platforms for borrower information and credit ratings to inform their decisions, P2P lenders assume roles traditionally held by conventional lending institutions in bearing credit risk.

²²⁰ Caimei Lu and Lu Zhang, 'Research on Risk Factors Identification of P2P Lending Platforms' (2018) American Journal of Industrial and Business Management 1344.

Moreover, in the event of borrower defaults, lenders must depend on the platform's efforts to pursue loans from defaulting borrowers, as direct attempts by lenders to recover funds can be challenging. Additionally, if the platform were to collapse, lenders would encounter similar challenges in recovering debts from borrowers.²²¹

This is because, first, attempting to pursue loan repayments individually presents significant challenges for lenders in identifying borrowers without platform support. Second, loans to a single borrower often originate from multiple lenders, and a lender's funds are typically distributed across several borrowers. As a result, even if the lender can identify borrowers, it may not be economically feasible for a lender to assert their rights against a potentially extensive list of borrowers.

3.3.4 Fraud by criminal groups

In addition to the inherent risks associated with the P2P lending business model, P2P lenders are exposed to the dangers of fraudulent activities perpetrated by platforms established with malicious intent, especially in the absence of adequate regulation for this emerging financial service. One of the most concerning crimes related to the use of P2P lending platforms is the Ponzi scheme, which deceives P2P lenders by using funds from new investors to pay returns to earlier participants, rather than from genuine profits.²²² A notable example of such a Ponzi

²²¹ Eric C Chaffee and Geoffrey 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 Review 485.

²²² Chad Albrecht and others, 'Ezubao: a Chinese Ponzi Scheme with a Twist' (2017) 24 Journal of Financial Crime 256.

scheme is the *Ezubao* case that unfolded in China in 2015. This case will be discussed in Chapter 4, illustrating the detrimental impact of fraudulent platforms on lenders and subsequently on the P2P lending industry.

Although regulatory measures, such as platform registration requirements, have minimised the likelihood of exploitation by criminals, this situation provides valuable lessons in that financial innovation products that operate under lax or unregulated can present opportunities for illicit exploitation.

3.3.5 Personal information leakage

Engaging in any online activity inherently poses risks to personal data security. The leakage of personal data for P2P users can be attributed to two primary factors. First, due to the cost-efficient nature of their business model, many P2P lending platforms are built and maintained on a relatively modest budget. As a result, a significant portion of the platform's programming is based on open-source code, which can introduce vulnerabilities susceptible to hacking.²²³ Once a platform is compromised, it becomes vulnerable to information security breaches, potentially leading to data leaks.²²⁴ Second, some platforms (or some of their staff) may share users' personal data with third parties without obtaining proper consent.²²⁵

²²³ Peng Wang, Mei Su and Jingyi Wang, 'Organised Crime in Cyberspace: How Traditional Organized Criminal Groups Exploit the Online Peer-to-Peer Lending Market in China. (2021) 61 The British Journal of Criminology 303.

²²⁴ *Ibid.*

²²⁵ Riaili Susilawaty Hutapea and Devi Rahayu Andista, 'The Effect of Perceived Ease of Use, Perceived Usefulness, and Risk on User Interest in Using Financial Technology Peer to Peer Lending' (2021) 207 Advances in Engineering Research 619.

3.3.6 Summary of risks for lenders

Despite the inherent risks, P2P loans lack comprehensive insurance or governmental protection. Although platforms attempt to minimise financial losses through strategies like buy-back guarantees or provision funds, these measures often fall short of effectively mitigating losses.²²⁶ Furthermore, provision funds or buy-back guarantees, although seemingly reassuring, can inadvertently create a false sense of security among lenders. These guarantees might cause lenders to view platforms offering such features as inherently less risky. However, in reality, these protective measures often fall short due to their discretionary nature.²²⁷

Additionally, the option for lenders to partially fund individual loans, which could aid effective diversification and risk mitigation, introduces a classic challenge in portfolio optimisation.²²⁸ Accurately assessing the credit risk of each loan poses a significant challenge for optimal portfolio management in P2P lending.

In light of these considerations, it is evident that P2P lenders are exposed to significant credit risks from both borrowers and platforms. While the lack of adequate regulation exposes them to potential criminal offences, it is important to recognise that financial crimes can manifest in various forms beyond just targeting P2P lenders. Regarding personal information leakage, P2P lenders face greater risks compared to customers of traditional financial institutions.

²²⁶ Osuji and Amajouyi (n 40).

²²⁷ *Ibid.*

²²⁸ Mu-En Wu and others, 'Portfolio management system in equity market neutral using reinforcement learning' (2021) 51 *Applied Intelligence* 8119.

However, the extent to which these risks are deemed excessive largely depends on internet safety protocols and the effectiveness of personal information regulations.

Lenders' vulnerability is also caused by the heavily reliance on platforms for decision-making and loan recovery. However, platforms are not held liable for the comprehensiveness and accuracy of the information provided, and there even exists a potential risk of fraud or default by the platform.

Also, unlike bank deposits, which offer certain guarantees for depositors' funds, P2P lending lacks such assurances, and risk-mitigation strategies often fall short in addressing these risks. Additionally, the relatively high default rates among borrowers, coupled with lenders' limited financial expertise, place lenders in a vulnerable position when making informed and rational decisions. Moreover, since most lenders are individuals with lower financial capabilities compared to professional investors, their ability to absorb financial losses is also diminished.

Regulation can mitigate vulnerabilities and risks for P2P lenders through various approaches. The vulnerability of lenders stems from their dependence on platforms, and these platforms are not held accountable for them. Therefore, one way to reduce lenders' vulnerability is to rethink the liability perspective of platforms. Additionally, enhancing the transparency of information and improving lenders' literacy on P2P loans can empower them to make more informed and rational decisions.

However, expecting regulation to provide P2P lending with equivalent safeguards as traditional banking deposits is not only unrealistic but could also encourage lenders to become

“free riders”. This could result in lenders relying excessively on regulatory protection without assessing risks themselves, thereby shifting the burden of risk onto the regulator. This will be discussed further in section 3.5.

3.4 Risks for P2P borrowers

When discussing P2P borrowers, the primary focus tends to be on the benefits provided by the P2P industry, specifically the alternative fundraising opportunities. The risks faced by borrowers often receive less attention compared to those encountered by lenders. Nonetheless, P2P borrowers, like many other financial consumers, face a variety of risks when engaging with P2P lending. It is crucial not to overlook these risks, as they deserve protection due to potentially unfair circumstances for them.

3.4.1 Do borrowers face the risk of financial loss?

Similar to lenders, borrowing relationships are also predicated on trust in the platform, thereby posing the risk of that trust being potentially exploited by the platform. However, when considering financial loss, borrowers seem to face minimal risk as they are the ones obtaining the funds. However, this does not imply a complete absence of that risk for borrowers.

Borrowers would encounter potential losses under a specific circumstance: when a lending contract has been formalised and the borrower has settled their obligation with the platform, yet the platform fails to remit the funds to the lender. In such situations, if the platform is unable to transfer the funds to the lender, borrowers might still be deemed to have outstanding contractual repayment obligations. This is because the lending contract is formed

exclusively between the lender and the borrower, with the platform not being directly involved as a party to the contract.

The service agreement (or 'terms and conditions') between the platform and its users typically outlines the platform's liability for the managed funds in the client account, thereby borrowers and lenders have the right to trace their funds if the platform defaults. However, this is often not practically feasible. In situations where such circumstances arise, the platform may experience operational disruptions or, in more severe instances, its actual controller might abscond with the funds, a phenomenon exemplified by several cases in China (to be discussed in Chapter 4). Therefore, the retrieval of funds from the platform poses a formidable challenge for borrowers.

However, the likelihood of such occurrences is relatively very rare. Given that the loan due dates and amounts are transparent, platforms typically expedite the transfer of borrowers' repayments and refrain from retaining these repayments for extended durations. Furthermore, borrowers are less vulnerable to the repercussions of this risk aspect. This is primarily because the predominant portion of funds in platforms' customer accounts comprises unmatched funds from lenders rather than unrepaid funds from borrowers.²²⁹ Additionally, as most borrowers make payments in instalments, the risk of experiencing a platform default in this scenario is dispersed.

²²⁹ Rainer Lenz, 'Peer-to-Peer Lending: Opportunities and Risks' (2016) 7 *European Journal of Risk Regulation* 688.

Therefore, while there is a possibility of this type of financial loss risk for P2P borrowers, its impact seems to be relatively less significant. Regulatory considerations addressing this risk align with the security measures that can be imposed on lenders' funds, such as the requirement for the ring-fenced separation of customer accounts.

3.4.2 Personal/Private information leakage and debt collection

Compared to the risks of platform defaults during the provisional repayment holding period as aforementioned, the harm from information leakage poses a greater threat to borrowers. This risk becomes even more detrimental when compounded by abusive debt collection practices and escalates further when borrowers are ensnared in loan shark schemes.

P2P borrowers are more vulnerable to personal information leakage compared to lenders. First, they provide platforms with a broader range of their personal information than lenders. In addition to the borrower's required personal details and credit history, platforms or lenders may gather supplementary data from the borrower's social media profiles to evaluate creditworthiness.

Second, in cases of default, borrowers' information can be leveraged against them, posing a potential risk of abusive debt collection. Dai and others find that digital footprints can be collateral for debt collection.²³⁰ They demonstrate that lenders can decrease debt delinquency by leveraging digital footprints, which pose a threat to borrowers' social standing

²³⁰ Lili Dai and others, 'Digital Footprints as Collateral for Debt Collection' (2024) <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4135159> accessed 1 September 2024.

and provide access to their physical whereabouts.²³¹ However, this debt collection approach should be implemented within a transparent and equitable regulatory framework to prevent unfairness or harm to borrowers. Otherwise, abusive debt collection could occur, which harms borrowers.

Cases in China demonstrate how borrowers' information can be improperly exploited during debt collection processes. In China's P2P lending market, a prevalent form of abusive debt collection involves platforms contacting all available colleagues, friends, and family members of the defaulted borrower.²³² The platform discloses information about the borrower's default and solicits their assistance in urging the borrower to promptly fulfil their repayment obligations.²³³ Sometimes, they even send text bombs to all the contacts in the borrower's phone.²³⁴ This practice exerts social pressure on borrowers, leading to an increased repayment rate; however, it infringes not only on borrowers' privacy but also harasses those around them.

In another form of abusive debt collection, more severe criminal offences have been reported in China. Some lenders, and potentially even platforms, coerce borrowers—often young females—into providing photographs of themselves naked as collateral for a loan.²³⁵ This

²³¹ *Ibid.*

²³² P. Wang, Su and J.Wang (n 223).

²³³ Yunxia Pang and Chaoqun Wang, '网络“裸持”信贷中的犯罪及其刑法规制' [Crimes and Criminal Regulation in Online 'Naked Pledge' Lending] (2018) 35 河北工程大学学报(社科版) [Journal of Hebei University of Engineering (Social Science Edition)] 66.

²³⁴ *Ibid.*

²³⁵ Chunhong Xu, '裸贷时间报道框架与女大学生印象分析' [Analysis of the Media Coverage Framework of Naked Loan Incidents and the Perception of Female University Students] (2017) 8 Journal of News Research 14.

alarming and illegal method of securing loans garnered significant public attention following the exposure of a 10GB collection of nude photos and videos in December 2016, which served as collateral for P2P loans.²³⁶ The leaked zip file contained explicit images and videos of 167 women, along with their full names, identity card details, screenshots of conversations, and contact information of their friends and family. A majority of the victims were female university students.²³⁷ They were coerced into sending nude photographs as collateral for loans and were instructed to hold their identity cards in front of them while taking these photos. Platforms/lenders threatened to publish the borrowers' images online and send them to their families if there was a delay in repayment.²³⁸ What is worse, the nude loan selfies were not only used as collateral in loan agreements but were also being sold on various social media platforms.²³⁹ In other words, these photos became non-consensual pornography featuring the women in the photos/videos.²⁴⁰

The phenomenon of “naked loans” has even manifested on legitimate platforms such as *Jiedaibao*. Despite these occurrences, *Jiedaibao* claimed that these “naked loans” are private dealings between users, thereby asserting that the platform has no right to intervene. In response, the platform merely advised its users to safeguard their privacy independently and

²³⁶ *Ibid.*

²³⁷ Zhenfan Wu, ‘The Legal Application and Resolving Mechanism of Campus Naked Loans’ Threat’ (3rd International Conference on Management Science and Innovative Education, 2017) 283-298.

²³⁸ Xiaoyu Gui, ‘透视大学生裸贷的法律问题’ [An Insight into the Legal Issues of Naked Loans Among University Students] (2018) 16 *Legality Vision* 7.

²³⁹ Ya Zhang and Tiezhu Li, ‘大学生欠款裸条陷网上黄色利益链’ [University Students’ Debt and Nude Collateral Trapped in an Online Pornographic Profit Chain] (*Beijing Youth Daily*, 17 June 2016). <http://epaper.yinet.com/html/2016-06/17/content_203814.htm > accessed 10 April 2022.

²⁴⁰ *Ibid.*

encouraged victims to resort to law enforcement to seek justice, as well as asking lenders to cease their demands for explicit photographs.

This case illustrates that, by portraying itself as an independent third party, the platform attempts to evade responsibility for offences occurring during the lending process, even when aware of the illicit practices taking place on its platform. This raises the question of whether it is justified for platforms to be entirely exempt from detecting or reporting wrongdoing in lending activities. While the platform itself does not directly engage in wrongdoing in this case, borrowers utilise the platform's services under the premise of trust in the platform. Even if the platform is not directly responsible for any users' misconduct, it should bear a significant responsibility to uphold and protect this trust by ensuring the transparency, fairness, and legality of all lending activities conducted through its platform. The question will be further explored in Chapter 7, following a comparison of P2P regulation in China and the UK.

Overall, there is a range of potentially damaging consequences when borrower information is leaked and unlawfully misused. Such misuse can lead to significant personal and financial harm for the individuals involved. It can result in identity theft, emotional distress, reputational damage and so on. Additionally, the unauthorised dissemination of personal information can erode trust in the P2P lending sector, deterring potential borrowers from participating in P2P lending or even other online financial services.

3.4.3 Loan sharks

Another type of offence that utilises P2P platforms to target borrowers is loan sharking. Loan sharks face significant risks when extending credit to consumers, as their borrowers are

typically already in debt or financially compromised. To enforce repayment, loan sharks primarily employ violence and intimidation. They may also collude with corrupt police officers to mitigate the risk of law enforcement actions.²⁴¹

To exploit P2P lending for illegal purposes, loan sharks must appear legitimate by meeting normative expectations. This requires them to outwardly comply with the law, follow government rules, and adhere to online platform regulations, all while hiding their unlawful tactics and avoiding detection by law enforcement and platform administrators.²⁴² As a result, detecting their crimes in the unregulated and chaotic P2P lending market is challenging. This difficulty explains why loan sharks were active in China's P2P lending market prior to the implementation of regulatory measures.

Loan sharks often unlawfully exploit the information provided by borrowers and employ violent debt collection methods, causing significant harm to borrowers in various aspects.²⁴³ Therefore, it is crucial to monitor, prevent, and deter the illicit activities of loan sharks using P2P platforms. A regulated P2P lending market can effectively prevent platforms from being misused by criminals. For instance, after the promulgation of regulatory measures in China in 2016, such phenomena ceased to occur frequently.²⁴⁴ Nevertheless, understanding the

²⁴¹ Patrick Saunders, 'Loan Sharking: Changing Patterns in, and Challenging Perceptions of, An Abuse of Deprivation' (2021) 43 *Journal of Public Health* 62.

²⁴² *Ibid.*

²⁴³ Shuai Shao and Hong Bo, 'Behavioural Aspects of China's P2P Lending' (2019) 28 *The European Journal of Finance* 30.

²⁴⁴ Saunders (n 241).

calculation methods and amount for loan interest rates may still pose a challenge for some borrowers.²⁴⁵

3.4.4 Risk of over-indebtedness

P2P lending unquestionably offers increased credit opportunities for individuals in need of funds. However, this presents a double-edged sword for potential borrowers, particularly those with less-than-perfect credit scores. While it expands loan accessibility, it also amplifies the risk of borrowers accumulating debt that can snowball into substantial debt burdens, thereby raising concerns about over-indebtedness.

There could be many reasons for over-indebtedness, such as changes in interest rates, unexpected reduction of income, increases in the cost of living and others. Disney and others identify several factors contributing to over-indebtedness, one of which is over-borrowing.²⁴⁶ This phenomenon is not solely attributable to excessive purchasing habits among certain groups but is also linked to innovations within the lending market. These innovations may encourage consumers to assume greater debt obligations, often without consideration of their repayment capacity.²⁴⁷

²⁴⁵ Shao and Bo (n 243).

²⁴⁶ Richard Disney, Sarah Bridges and John Gathergood, 'Drivers of Over-indebtedness' (2008) Report to the UK Department for Business, Enterprise and Regulatory Reform <<https://citeseerx.ist.psu.edu/document?repid=rep1&type=pdf&doi=48ce47444647720cc2249afe869a809e48173932> > accessed 23 October 2023.

²⁴⁷ *Ibid.*

P2P lending is one of these innovations. To maximise profitability, platforms often employ promotional and advertising strategies to appeal to a broad customer base. The accessibility of P2P lending enables borrowers to conveniently secure multiple loans concurrently from various platforms, even if they already have existing loans from traditional lending institutions.

In addition, borrowers with lower creditworthiness are often charged higher interest rates to offset the risk of default. Such high-cost credit can be exploitative to borrowers.²⁴⁸ Even more concerning, this creates an incentive for platforms to promote larger and riskier loans in order to maximise profits.²⁴⁹ However, given that lower creditworthiness is frequently associated with a poor financial situation, the elevated interest rates may further strain their financial capacity, potentially leading to over-indebtedness. While borrowers have the freedom to decide whether to borrow, they may be compelled to do so due to poverty or urgent needs.²⁵⁰

Besides, P2P lending may serve as a conduit through which merchants stimulate excessive consumption among individual consumers, potentially disregarding borrowers' actual spending capacity. The accumulation of multiple loans amplifies the financial burden due to accruing interest payments. Without exercising rational financial judgment, P2P borrowers risk becoming over-indebted,²⁵¹ particularly when faced with ongoing challenges in meeting repayment deadlines.

²⁴⁸ Jodi Gardner, *The Future of High-Cost Credit: Rethinking Payday Lending* (Bloomsbury Publishing 2022).

²⁴⁹ Riza Emekter and others, 'Evaluating Credit Risk and Loan Performance in Online Peer-to-Peer (P2P) Lending (2015)47 Applied Economics 54.

²⁵⁰ Gardner (n 248).

²⁵¹ Ceylan Cizmeli and Mert Demir, 'Online Peer-To-Peer Lending as a New Profit Industry and Debt Trap' in Carl Walker, Katherine Stewart and Rowena Roberts (eds), *Social and Psychological Dimensions of Personal Debt and the Debt Industry* (Palgrave Macmillan 2015) 225.

Furthermore, overborrowing is attributable not only to subjective perceptions of consumption or shifts in living conditions but also to the victimisation resulting from criminal behaviour. For instance, in numerous telecommunication fraud cases in China, fraudsters have led victims to secure funds from wherever possible, often through quick loans obtained under false pretences. P2P platforms have emerged as a predominant channel due to their convenience and prompt service.²⁵² Consequently, these victims are deceived not out of “existing cash” but rather through “borrowed money”. The lending relationship, including the interest rates and service fees payable between the victim (borrower), the platform, and the lender, remains unaffected regardless of whether the borrowing is a result of fraud.

To relieve the repayment distress, many platforms facilitate borrower repayments through instalment plans as a risk mitigation strategy.²⁵³ Instalment-based repayments afford borrowers more manageable debt servicing options, alleviating immediate financial burdens and granting greater flexibility in meeting repayment obligations. This structured repayment methodology not only bolsters borrowers' capacity to fulfil their financial commitments but also serves to mitigate potential default risks associated with lump-sum repayments.

However, these measures do not fundamentally mitigate the risk of long-term over-indebtedness. As instalment payments make the debt burden appear less significant than it

²⁵² Qu Jia and Hongming Cheng, ‘Policing Telecommunication and Cyber Fraud: Perceptions and Experiences of Law Enforcement Officers in China’ (2024) 1 *Crime, Law and Social Change* 23.

²⁵³ Anna Eugenia Omarini, ‘Peer-to-Peer Lending: Business Model Analysis and the Platform Dilemma’ 2 (2018) *International Journal of Finance, Economics and Trade* 31.

actually is, particularly easing short-term pressure from individual debts, it might even promote the occurrence of over-borrowing.

In fact, over-borrowing and over-indebtedness are a multifaceted issue that involves the study of consumer behaviour, psychology, sociology and so on. From the perspective of consumer protection at the regulatory level, consideration of the risk of borrowers' over-indebtedness primarily aims to address the platforms' moral hazard in promoting excessive lending beyond what borrowers can bear. Second, it seeks to protect borrowers from making unexpected or financially unsustainable borrowing decisions due to a lack of proper understanding of risks and interest rate pricing.

When over-indebtedness becomes pervasive among borrowers, it not only escalates the default rate but also poses a significant risk to the stability and integrity of the P2P lending sector. Such elevated default rates can subsequently exert adverse effects on the broader financial market. In addition, increased defaults may erode investor confidence in P2P platforms, leading to reduced investment inflows and heightened market volatility. Thus, considering the over-indebtedness factor by regulation is crucial not only for the health of the P2P lending industry but also for safeguarding the resilience and stability of the broader financial system.

While multiple factors contribute to over-indebtedness, and P2P platforms are not exclusively or primarily responsible for consumer over-indebtedness, regulatory intervention remains crucial in safeguarding P2P borrowers. Despite limited research specifically focusing on over-indebtedness among P2P borrowers, there are some regulatory measures that aim to mitigate

this risk. For instance, in the UK, P2P lending is categorised as a regulated financial service with promotional restrictions.²⁵⁴

In conclusion, P2P borrowers face multifaceted risks throughout their lending activities, particularly concerning personal information security and illicit debt collection practices. Unlike lenders, some borrowers find themselves in precarious financial situations, making loan acquisition challenging. In such circumstances, these borrowers may overlook potential risks when presented with a loan opportunity from a P2P platform. Hence, regulation cannot overlook the necessity of protecting P2P borrowers.

3.5 Exploring consumer protection approaches for P2P lending consumers

Discussions following the 2008 financial crisis have consistently highlighted regulatory failures, prompting an in-depth reflection on the role, rationale, and characteristics of various regulatory approaches. Within the discourse on financial consumer protection, there are arguments that non-interventionist strategies have proven inadequate, advocating instead for a shift towards more interventionist regulatory frameworks.²⁵⁵

In the realm of P2P lending, the meteoric ascent and subsequent decline of this industry in China, punctuated by numerous scandals and victimised users, have intensified concerns regarding regulatory approaches, particularly in terms of consumer protection. As financial

²⁵⁴ Kieran Garvey and others, 'Guide to Promoting Financial & Regulatory Innovation: Insights From the UK' (2018) <https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/701847/UK_financial___regulatory_innovation.pdf> accessed 18 July 2023.

²⁵⁵ Folarin Akinbami, 'Financial Services and Consumer Protection after Crisis' (2011) 29 International Journal of Bank Marketing 134.

consumers, P2P users warrant consideration within the framework advocating for a more interventionist regulatory stance. This sentiment is echoed in the UK's 2019 updated regulatory guidelines, which exhibit increased intervention in both the P2P lending market and its participants.

However, it is still questionable what kind of intervention is fit for protecting P2P lending consumers. This thesis suggests a soft paternalistic approach, based on behavioural economic theory to understand P2P consumers.

3.5.1 The impracticality of the free-market theory in P2P lending

With the initial emergence of P2P lending, many countries' regulators tended to adopt a *laissez-faire* approach, allowing for innovation with minimal regulatory pressure to foster the development of social value.²⁵⁶ However, this regulatory approach, based on free-market regulation theory, has not only proven unsuccessful, as evidenced in China and some other P2P lending markets but also fails to protect P2P lending consumers in theory.

Free-market regulation operates on the theory of rational choice, which posits that people act reasonably when presented with multiple options, selecting the one they believe will maximise their welfare.²⁵⁷ From the perspective of rational choice theory, rationality involves striving to achieve goals that decision-makers have good reason to believe are in their best

²⁵⁶ Jussi Keppo, Tuan Q. Pan and Tianhui Tan, 'Microbanks in Online Peer-to-Peer Lending: A Tale of Dual Roles' in Volodymyr Babich, John R. Birge and Gilles Hilary (eds) *Innovative Technology at the Interface of Finance and Operations* (Springer 2022).

²⁵⁷ Akinbami (n 255).

interests.²⁵⁸ Consequently, when consumers make decisions, they can prioritise different objectives according to their preferences and provide reasons for their choices. If individuals can consistently make rational choices, then the market should accurately reflect all the participants' preferences.²⁵⁹

Information plays a crucial role in enabling consumers to make efficient and rational choices. For a choice to be truly rational, consumers must be equipped with all pertinent facts related to that decision. Without this comprehensive information, the rationale behind a choice may be flawed or incorrect. Insufficient information can hinder consumers from making decisions that align with their objectives. Consequently, the theory of rational choice advocates for a non-interventionist approach to consumer protection regulation. This includes practices like information disclosure, self-regulation, and fostering competition among companies.²⁶⁰

The rational choice theory and free-market approach operate under the assumption that consumers possess sufficient information to make informed decisions. This assumes that their choices are transparent and rational, grounded in the available information.²⁶¹ Under this approach, P2P lending regulations should mandate platforms to accurately provide consumers with essential information. However, it remains unclear whether and how platforms should

²⁵⁸ Peter French, 'Agency Theory, Rational-Choice Theory, and Ethics' (1995) 5 *Business Ethics Quarterly* 621.

²⁵⁹ *Ibid.*

²⁶⁰ Geraint Howells, 'The Potential and Limits of Consumer Empowerment by Information' (2005) 32 *Journal of Law and Society* 349.

²⁶¹ Gerald Spindler, 'Behavioural Finance and Investor Protection Regulations' (2011) 34 *Journal of Consumer Policy* 315.

be held liable for undetected false information, especially when the platform is not at fault and acts in good conscience.

Besides, this approach falls short of addressing potential market failures that may arise throughout the duration of the loan agreement, from inception to repayment. Once the loan is active, and consumers no longer need to make decisions, information-centric protections become less relevant. Instead, consumers require robust enforcement of their rights as stipulated in the loan agreement.

Moreover, the rational choice theory fails to account for emotional, cultural, or other biases that might influence consumer behaviour. Consequently, it inadequately explains real-world decision-making processes. The theory's focus on disclosure is primarily confined to pre-contractual issues, making it insufficient in addressing the outcomes of consumer decisions. This limitation means it does not fully elucidate the various challenges faced by P2P lending users.

This issue with rational choice theory is evident in the UK's mis-selling of payment protection insurance (PPI). In instances where consumers purchased PPI without advice, meaning the financial institution was solely responsible for offering necessary information for an informed decision on PPI, many consumers either neglected to review all terms and conditions or failed to ensure their understanding before signing. This resulted in the mis-selling of the policy to them.²⁶² This example highlights that, while giving individuals information, it should, in theory,

²⁶² Financial Ombudsman Service, 'Our Approach to Payment Protection Insurance (PPI) Mis-Sale Complaints' < <https://www.financial-ombudsman.org.uk/businesses/complaints-deal/ppi/ombudsmans-approach/approach-payment-protection-insurance-ppi-mis-sale-complaints> > accessed 3 April 2024.

enable them to make rational decisions. In reality, their behaviour can often hinder their ability to do so, and this example shows that the actual behaviours of individuals can often hinder their ability to make rational decisions. In addition, the PPI case demonstrates that focusing on strengthening market competition and boosting consumer confidence did not result in better treatment of consumers by financial firms, nor did it reduce consumer detriment.²⁶³ This provides valuable lessons and insights for the regulation of P2P lending.

3.5.2 Behavioural economic and soft paternalism

In contrast, behavioural economic theorists argue that people do not always make rational choices and often base decisions on cognitive biases, emotions, social influences, and other psychological factors.²⁶⁴ Many studies have found that P2P lending consumers sometimes make poor decisions or simply mimic others' choices. For instance, Ravina argues that some P2P lenders exhibit bias towards attractive photographs, which is irrational.²⁶⁵ Pope and Sydnor discover that some lenders seek profitability by statistically discriminating against racial minorities.²⁶⁶ Additionally, herding behaviour, a typical distortion of rational behaviour, is observed across various individuals.²⁶⁷

²⁶³ Toni Williams, 'Who Wants to Watch? A Comment on the New International Paradigm of Financial Consumer Market Regulation' (2013) 36 Seattle University Law Review 1217.

²⁶⁴ Richard H Thaler, 'Behavioural Economics: Past, Present, and Future' (2016) 106 American Economic Review 1577.

²⁶⁵ Enrichetta Ravina, 'Love & Loans: The Effect of Beauty and Personal Characteristics in Credit Markets,' (2019) < https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1107307 > accessed 23 November 2023.

²⁶⁶ Devin G. Pope and Justin R. Sydnor, 'What's in a Picture? Evidence of Discrimination from Prosper.com,' (2009) 46 Journal of Human Resources 54.

²⁶⁷ *Ibid.*

Compared to rational choice theory, the behavioural theory provides a more accurate view of understanding P2P lending users' behaviour. Instead of relying on a single factor, behavioural economic theory considers the presence of additional factors that can impact an individual's behaviour when making loan decisions.

Different from rational choice theory and free-market regulation, which suggest a non-interventionist regulatory paradigm, behavioural economics always advocates for interventionist regulation and refers to paternalism.²⁶⁸

Paternalistic and interventionist regulation is rooted in collectivist perspectives, diverging from the influence of neoliberal theories.²⁶⁹ This regulation operates on the assumption that information is frequently inadequate. It emphasises the implementation of standardised rules and controls over activities susceptible to market failures, with the overarching goal of protecting societal interests.²⁷⁰

The narrative of consumer protection inherently embodies paternalism, as it acknowledges consumers as being in a vulnerable position requiring safeguarding.²⁷¹ When a regulator steps in to protect individuals from the outcomes of their own actions, such as impulsive decisions that result in poor choices, or from market failures like information asymmetries, it is taking a

²⁶⁸ Daniel M. Hausman, 'Behavioural Economics and Paternalism' (2018) 34 *Economics & Philosophy* 53.

²⁶⁹ Roman Tomasic, 'Beyond "Light Touch" Regulation of British Banks after the Financial Crisis (2010) in Iain G MacNeil and Justin O'Brien (eds) *The Future of Financial Regulation* (Hart Publishing 2010) 111-130.

²⁷⁰ *Ibid.*

²⁷¹ Joanna Benjamin, 'The Narratives of Financial Law' (2010) 30 *Oxford Journal of Legal Studies* 787.

paternalistic approach. In doing so, the regulator assumes a role similar to that of a parent, acting as if it has the right and authority to oversee and direct individuals' behaviours.

The concept of paternalism is controversial, and there is no consensus on its definition. Garren states that there are as many interpretations of paternalism as there are scholars discussing the subject.²⁷² However, in all definitions, Paternalism involves an external entity, such as a regulator, intervening in an individual's private matters, and this interference must be justified to be deemed appropriate.²⁷³ In the context of P2P lending, where multiple parties are involved, each with potentially conflicting or differing interests and goals, consumer protection regulations could unintentionally harm one party's interests or limit their autonomy for the benefit of another. Therefore, advocating for increased regulatory intervention to protect P2P participants—despite their voluntary involvement in private loan agreements—requires a clear justification for why such interference is necessary or appropriate.

Behavioural economics research has highlighted numerous decision-making errors individuals make, expanding the discussion on paternalism. If these errors cause people to act against their best interests, one could argue that paternalistic intervention is warranted.

Paternalism is a concept that sparks debates around various philosophical and political issues, such as the value of freedom and autonomy and the relationship between the state and the individual. Some oppose paternalism due to its inherently intrusive nature. For instance, Mill

²⁷² David J. Garren, 'Paternalism, Part I' (2006) 47 *Philosophical Books* 334.

²⁷³ *Ibid.*

argued against all forms of paternalism except when it is necessary to prevent harm to others, suggesting that individuals are typically best positioned to understand their own happiness and how to pursue it.²⁷⁴

To mitigate its impact on the principles of liberty and autonomy and to address criticism, paternalism has been categorised into different forms, primarily hard and soft paternalism. As delineated by Joel Feinberg, hard paternalism involves intervening in voluntary, informed decisions, which compromises autonomy. Conversely, soft paternalism pertains to intervening in choices that are either nonvoluntary or made with insufficient information, all while preserving autonomy.²⁷⁵

In P2P lending, consumers primarily face excessive risks arising from uncertainties. For example, lenders may make decisions that diverge from their intentions due to factors like asymmetric information, while borrowers may misunderstand interest rates because of the complexity or lack of clarity in the calculation of interest rates offered by the platforms. Therefore, soft paternalistic interventions are well-suited to safeguard P2P lending consumers by ensuring transparency and clarity.

Conversely, hard paternalism is less suitable for the P2P sector. First, it is unrealistic to completely eliminate the inherent risks associated with financial activities. Second, striving to

²⁷⁴ John Stuart Mill, *On Liberty* (Hackett Publishing Company 1978).

²⁷⁵ Jason Hanna, 'Hard and Soft Paternalism' in Kalle Grill and Jason Hanna (eds) *The Routledge Handbook of the Philosophy of Paternalism* (1st Edn, Routledge 2018) 24-34.

ensure optimal decision-making to maximise consumer welfare in financial transactions by the regulator is impractical and results in unnecessary costs.

Third, if P2P lenders heavily depend on regulators to mitigate financial losses, a moral hazard arises. Lenders may become less vigilant, taking on a more careless approach, and essentially becoming free riders by shifting risks to regulators. A notable example is the regulated compensation scheme. While this might not pose significant problems when borrower defaults are infrequent, substantial bailout costs can accrue during periods of high default rates or when combined with a platform's insolvency or inefficiencies in debt collection.

From a soft paternalistic perspective, addressing the moral hazard can involve incorporating an element of consumer responsibility, specifically in terms of lender prudence, by limiting lenders' reliance on compensation systems. For instance, access to a compensation scheme could be restricted to lenders who have taken reasonable measures to assess platforms and borrowers before investing in P2P loans. One suggested protective measure is for lenders to opt for quasi-riskless borrowers, such as those with higher credit ratings or those previously deemed unlikely to default. Conversely, loans categorised as subprime or extended to borrowers with lower credit grades might be excluded from compensation schemes, given that these loans entail accepting the risks associated with potentially higher returns.

Soft paternalism appears in the middle ground between neo-liberalism and traditional paternalism, making it particularly well-suited to protect the vulnerabilities observed in P2P consumers without infringing upon their freedom to pursue their own welfare or choose their

own risk preferences. It emphasises information disclosure and risk warnings²⁷⁶, which safeguard P2P consumers during the decision-making process from information asymmetry. Additionally, it underscores interventions to prevent evident harm²⁷⁷ in cases of malfeasance or wrongdoing in P2P lending.

As a result, this thesis will be based on the concept of soft paternalism to evaluate and explore the framework for protecting P2P consumers. For the approach, Chapter 7 will propose a more interventional approach by strengthening platform liability through the implementation of gatekeeper responsibilities and enhancing consumer protection through collaboration between regulators and platforms.

3.6 Conclusion

This chapter identifies the role of P2P users as financial consumers. While lenders may sometimes be conflated with retail investors, it is essential to differentiate between them. Lenders are inherently more vulnerable and possess less investment experience than retail investors. Moreover, although they engage in both production and consumption, they cannot be classified as prosumers since they do not consume the products they produce. The term “financial consumer” most accurately encapsulates the role of lenders. While nuances exist among financial consumers across various industries, their vulnerability remains consistent, necessitating similar levels of protection.

²⁷⁶ Wendy K. Mariner, ‘Paternalism, Public Health, and Behavioural Economics: A Problematic Combination (2017) Scholarly Commons at Boston University School of Law

²⁷⁷ Jason Hanna, ‘Soft Paternalism I: The Ignorance Exception’ in *In Our Best Interest: A Defence of Paternalism* (Online edn, Oxford Academic, 2018) 145-169.

Also, this chapter explores the risks faced by P2P lending consumers. Lenders confront credit risks stemming from both borrowers and platforms. In contrast, borrowers generally encounter a reduced risk of financial loss, though such situations can arise in extreme cases. Moreover, both lenders and borrowers are susceptible to the risk of personal information breaches. However, borrowers are vulnerable when their information is exploited for abusive debt collection practices. Furthermore, both parties are at risk of harm from illegal offences when utilising P2P lending services, especially within an unregulated market.

It is noteworthy that lenders heavily rely on platforms for information to inform lending decisions and to pursue debt repayment. However, platforms are not legally accountable for the accuracy of this information or for debt recovery, as long as they are not at fault. This situation creates a moral hazard for platforms and exacerbates the vulnerability of lenders. Another moral hazard associated with platforms is the potential encouragement of high-risk, more expensive loans, which could amplify both lenders' unforeseen risks and borrowers' unexpected over-indebtedness.

Based on these findings, the research question regarding the justifications for regulating P2P lending is addressed: consumer protection serves as the primary justification for regulating P2P lending.

This thesis selects behavioural economics and soft paternalism as the theoretical background and approach for P2P lending consumer protection. Behavioural economics acknowledges irrational choices, aligning more closely with the practices of P2P consumers. Soft paternalism intervenes only in cases of involuntary poor choices stemming from information asymmetry

or inadequate literacy, making it well-suited for the P2P lending landscape. Accordingly, P2P lending consumer protection should emphasise information disclosure during the decision-making stage, prevent harm during the loan transaction and post-contractual stages, and ensure transparency in every stage.

Therefore, to understand the reality of P2P lending regulation, it is essential to consider whether it is characterised by paternalism or liberalism and whether it effectively safeguards P2P consumers from excessive risks. The following chapters will examine the P2P lending markets and regulatory frameworks in China and the UK, followed by a comparative analysis of their respective regulatory approaches.

Chapter 4 From boom to failure: P2P lending in China

4.1 Introduction

P2P lending in China has become a thing of the past, with all platforms being phased out by the end of 2020.²⁷⁸ However, the experience of China's P2P lending market and its regulation holds significant meaning in two aspects. First, it offers valuable lessons for other P2P lending markets and their regulators by providing insights into how regulation impacts P2P lending—

²⁷⁸ Jie Song, 'P2P 十年兴衰, 清零落幕' [Ten Year of P2P: Rise and Fall, Ending with a Complete Shutdown] *中国经济周刊* [China Economic Weekly] (No.4, 2020) <http://paper.people.com.cn/zgjjzk/html/2020-12/30/content_2027515.htm > accessed 10 August 2024.

both positively and negatively—and the extent to which P2P lending presents challenges for regulation. Second, some of China's P2P lending platforms transitioned into online micro-loan companies or loan facilitators, but the borrower base remains largely the same base as that of the previous P2P borrowers, as it shares a similar social value with P2P lending in aiming to improve access for those unable to borrow from banks.²⁷⁹ This means that some consumer protection challenges for borrowers, such as over-indebtedness, privacy protection and abusive debt collection, continue to persist.

Therefore, this chapter aims to provide an account of China's P2P lending market and its regulation. While the comparative analysis in Chapter 6 will focus on functional comparison and concentrate solely on the regulatory rules themselves, this chapter and Chapter 5 will introduce the rules and also discuss other factors behind the rules in China and the UK, respectively. The purposes of Chapters 4 and 5 are twofold: first, to provide a comprehensive analysis of the P2P lending markets and regulations in China and the UK as two distinct examples, and second, to lay the foundation for the comparative study.

This chapter contributes to addressing question 2 regarding the issues of regulation based on China's experience and also addresses the China-specific aspect of research question 3: how do the UK and China resolve the regulatory challenges of P2P lending? Similar to previous chapters, this chapter primarily relies on literature-based study, supplemented by discussions

²⁷⁹Centre for Financial Development and Regulatory Technology Research, '国内外助贷业务实践发展与监管研究' [Research on the Practices, Development and Regulation of Loan Facilitator Business Domestically and Internationally] (2023) Tsinghua PBCSF IFR Research Paper <<https://thuifr.pbcfsf.tsinghua.edu.cn/zongdi130qijinrongkejijianjiubaogao202310guoneiwaizhudaiyewushijianfazhanyujianguanyanjiu.pdf>> accessed 4 June 2024.

of a relevant case, *Ezubao*, and analysis of data collected from other research outputs or public data resources.

Three sub-questions are designed to help answer this overarching question. First, what issues can be observed in China's P2P lending market? This will be explored through a discussion of the development of China's P2P lending market. Second, what challenges exist for regulation? This will consider the broad economic and legislative background, as well as other factors. Third, the reasons for the failure of China's P2P lending will be analysed.

The discussion is structured as follows: section 4.2 describes the rise and fall of P2P lending in China; Section 4.3 discusses China's regulatory framework for P2P lending while Section 4.4 evaluates regulatory efforts responding to the disordered P2P lending market. Section 4.5 concludes the chapter by summing up the main findings and the main reflections raised in connection with them.

4.2 A brief history of P2P lending in China

4.2.1 The emergency of P2P lending in China

The first Chinese P2P lending platform, *Ppdai*, was launched in 2007,²⁸⁰ two years after *Zopa* and one year after *Prosper* was founded. Interestingly, when recounting the establishment of *Ppdai* or tracing the origins of P2P lending in News, blogs, industry reports, and even some academic publications in China, the Grameen Bank is often highlighted as an inspiration for *Ppdai*, rather than *Zopa* or other P2P lending platforms that predated *Ppdai*. They explain the

²⁸⁰ Ppdai, 'Investor FAQs' <<http://ir.ppdai.com/faqs>> accessed 2 March 2022.

idea of P2P lending as an effort to advance public welfare development through business strategies.²⁸¹

Given that Grameen Bank is a type of microfinance²⁸², and the genesis of P2P lending is often associated with microfinance (as discussed in Chapter 2), drawing a connection between the two is not unwarranted though there are distinctions in both their operational models and objectives. However, China's P2P lending aligns closely with Grameen Bank for two more reasons.

First, China's P2P lending played a role in addressing fundraising challenges related to agriculture, farmers, and rural areas, contributing to poverty alleviation.²⁸³ Rural finance has long been a challenge, with many mainstream lending institutions reluctant to engage with the rural market due to the absence of solid collateral and the uncertainties stemming from both natural risks in the agricultural production chain and market risks associated with agricultural services, processing, and distribution of agricultural products.²⁸⁴ Given these circumstances, P2P lending provides an alternative credit mechanism to rural finance, supporting activities such as e-commerce of agricultural products, agricultural finance leasing, and agricultural supply chain financing. This access to startup funding enables rural

²⁸¹ Diyicaijing Lujiazui, 'P2P 下的蛋, Ppdai "另类" 创业史' [P2P's Offspring: The 'Unconventional' Entrepreneurial History of Paipaidai] (*Sohu*, 12 November 2017) <https://www.sohu.com/a/203824819_694776> accessed 12 April 2024.

²⁸² Yunus Muhammad, 'The Grameen Bank' (1999) 281 *Scientific American* 114.

²⁸³ Liu Lei, 'Agricultural P2P Online Lending: Issues and Regulatory Solutions' (2019) 3 *Rural Finance Research* 61.

²⁸⁴ Jiali Zhou and others. 'Factors Influencing the Coupling of the Development of Rural Urbanization and Rural Finance: Evidence from Rural China' (2022) 11 *Land* 853.

populations to develop their businesses, which can play a significant role in alleviating poverty among the rural poor. This aligns with the foundational idea of Grameen Bank that “*the poor have skills but have no chance to use their skills without some money*”.²⁸⁵

Despite P2P platforms that focus on rural and agricultural loans yielding below-average returns and involving longer loan terms,²⁸⁶ over the 13 years of their existence in China, rural and agriculture-related lending has proven to be sustainable.²⁸⁷ Particularly since 2015, the government has allowed the use of management rights for rural contracted land and farmers' housing property rights, among other assets, as collateral²⁸⁸, thereby mitigating the loss caused by borrowers' default risks.

Second, China's P2P lending platform collaborated with Grameen Bank. This was exemplified by *Hepai Online's* work with Grameen China, aiming to empower impoverished women by helping them start small, self-employed businesses as a means of alleviating poverty.²⁸⁹ However, as this collaboration took place in 2015, a period when China's P2P market was fraught with regulatory challenges and uncertainties, and Grameen Bank's operations in China

²⁸⁵ Yunus Muhammad, 'Poverty alleviation: Is economics any help? Lessons from the Grameen Bank experience.' (1998) *Journal of International Affairs* 47.

²⁸⁶ Haojie Luo, '解读中央一号文, P2P 农村金融服务探索新模式' [Interpreting Document No. 1 from the Central Government: Exploring New Models for P2P Rural Financial Services] (*01Caijing*, 15 February 2017) <<https://www.01caijing.com/blog/106520.htm>> accessed 12 April 2024.

²⁸⁷ *Ibid.*

²⁸⁸ State Council, '国务院关于开展农村承包土地经营权和农民住房财产抵押贷款试点的指导意见' [Guiding Opinions of the State Council on Implementing the Pilot Programs of Loans with Mortgage of the Right to Contractual Operation of Rural Land and Farmers' Housing Property Rights] (No.45, 2015).

²⁸⁹ Ifeng, '格莱珉银行借道 P2P 登陆中国' [Grameen Bank's Collaboration with P2P Lending in China] (*Ifeng*, 19 Oct 2015) <https://news.ifeng.com/a/20151019/45579963_0.shtml> accessed 12 April 2024.

were not well-adapted to local conditions, its impact on alleviating rural poverty remained limited.²⁹⁰

Nonetheless, this collaboration, and P2P lending's contribution to rural finance, underscores that P2P lending in China has the potential not only to promote financial inclusion but also to offer avenues for poverty alleviation. This indicates that the frequent mention of Grameen Bank in discussions about the origins of P2P lending in China is not just an attempt to leverage the prestige of Grameen Bank to attract attention and gain trust from lenders, but also reflects a genuine aspiration and effort to achieve similar social values.

4.2.2 The development of P2P lending in China

After the establishment of *Ppdai*, the story of P2P lending in China began. Initially, the market witnessed modest growth. However, starting in 2011, its expansion accelerated significantly, leading to a dramatic surge from 2013 to 2014. This growth trajectory propelled China to become the world's largest P2P lending market,²⁹¹ with its size surpassing the combined size of the P2P lending industries in all other countries.²⁹²

²⁹⁰ Changjin L, '格莱珉模式中国实践 30 年' [30 Years of Grameen Bank in China] (*snzg*, 22 November 2023) <http://www.snzg.cn/article/2023/1122/article_42772.html> accessed 14 April 2024.

²⁹¹ Luke Deer, Jackson Mi and Yuxin Yu, 'The Rise of Peer-to-Peer Lending in China: An Overview and Survey Case Study' (Think Ahead ACCA, 2015) <https://www.accaglobal.com/content/dam/ACCA_Global/Technical/manage/ea-china-p2p-lending.pdf> accessed 28 November 2023.

²⁹² Chris Holmes, 'The Rise and Fall of P2P Lending in China' (*Finextra*, 10 April 2019) <<https://www.finextra.com/blogposting/17107/the-rise-and-fall-of-p2p-lending-in-china>> assessed 29 July 2024.

However, despite its large scale, the P2P market, due to a lack of regulation before 2015, was rife with activities that undermined fair trading and included numerous violations and criminal acts.²⁹³ The scandals, and the large number of problematic platforms, led to a substantial erosion of public trust in P2P lending, particularly among lenders.²⁹⁴ Despite regulatory efforts to address the proliferation of problematic activities and scams in the sector since 2015, these interventions proved inadequate in transforming the market into a well-regulated and trustworthy space. As an ultimate result, China's P2P lending industry was completely terminated in 2020.²⁹⁵

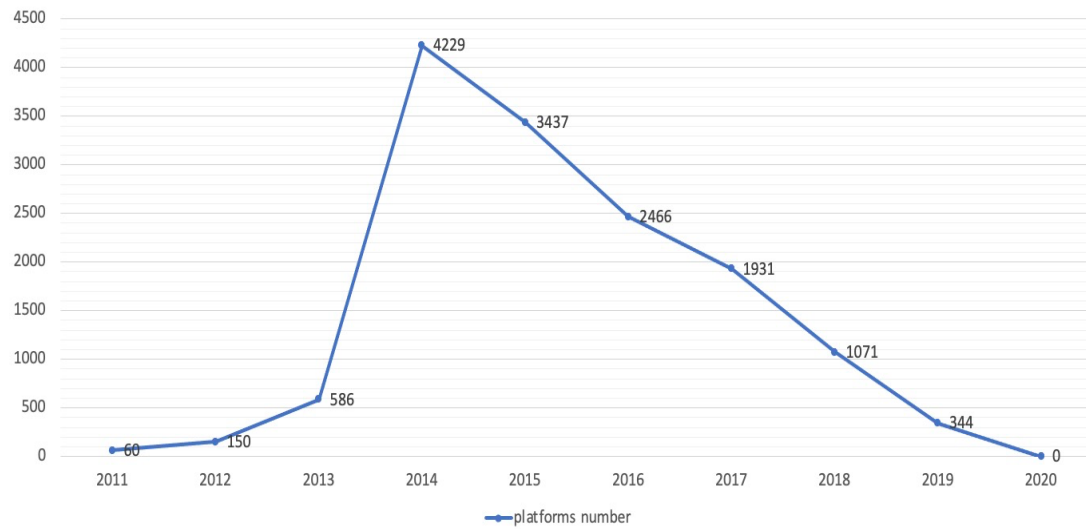
Figure 2 provides an overview of the rise and fall of China's P2P platforms from 2011 to 2020. Based on this trajectory and regulatory interventions, the development of China's P2P industry can be delineated into four distinct phases: the nascent phase from 2007 to 2011; the developmental phase from 2011 to 2013; the expansionary phase from 2013 to 2015; and the regulatory intervention phase from 2015 to 2020. Subsequently, this section discusses significant events and regulatory issues corresponding to each phase delineated by this temporal division.

²⁹³ Chen Ding, Anil S Kavuri and Alistair Milne, 'Lessons from the Rise and Fall of Chinese Peer-to-Peer Lending' (2021) 22 *Journal of Banking Regulation* 133.

²⁹⁴ *Ibid.*

²⁹⁵ Rectification Campaign, '关于网络借贷信息中介机构转型为小额贷款公司试点的指导意见' [Guiding Opinions on the Pilot Program of Transforming Online Lending Information Intermediaries into Small Loan Companies] (No.83, 2019).

Figure 2: The number of P2P lending platforms in China from 2011 to 2020



Source: Wandaizhijia

- **The nascent phase (2007-2011)**

Following the establishment of *Ppdai*, nine additional platforms were launched by 2010.²⁹⁶ Prior to 2009, these platforms predominantly operated on a basic P2P lending model, facilitating connections between lenders and borrowers while generating profit through administration fees. During these nascent years, P2P lending garnered limited public attention, and transaction volumes remained relatively low.²⁹⁷ However, by 2011, the market landscape had evolved, with the presence of 60 P2P lending platforms. Despite this proliferation, only 20 platforms reported having active user engagement and transactional activity.²⁹⁸

²⁹⁶ Hexun, 'the History of P2P lending in China' (*Hexun*, 2014) <<http://iof.hexun.com/2014-05-16/164842883.html>> accessed 5 Jan 2024.

²⁹⁷ *Ibid.*

²⁹⁸ Caroline Stern, Millo Makinen and Zongxin Qian, 'FinTechs in China – With a Special Focus on Peer-to-Peer Lending' (2017) 10 *Journal of Chinese Economic and Foreign Trade Studies* 215.

In the early stages of any innovative finance service model, capturing widespread attention and engaging a substantial customer base can be challenging due to its newness in the market and the unfamiliarity of consumers with the concept. When P2P lending first emerged in the UK, it was initially perceived as a “niche market” and experienced gradual growth rather than immediate expansion²⁹⁹. However, a significant factor contributing to the restrained growth of P2P lending in China during its early years was the absence of an established social credit rating system. This meant limited repercussions for borrowers who defaulted on loans, leading to challenges in accurately assessing loan risks. As a result, this uncertainty discouraged potential lenders, impeding the advancement of the P2P lending industry.

Furthermore, unlike *Zopa's* co-founders, who possessed prior experience in online banking before establishing the platform, or the founder of the Grameen Bank who was a professional economist,³⁰⁰ many of the creators and operators of Chinese P2P lending platforms had transitioned from the Internet Technology sector, rather than from the financial industry.³⁰¹ This divergence in professional backgrounds implies that they may be more adept at navigating technological aspects of the business rather than possessing sufficient experience in attracting lenders and effectively managing borrower default risks, along with other associated financial risks.³⁰²

²⁹⁹ Bednorz (n 30).

³⁰⁰ The Economist ‘The Trials of Muhammad Yunus’ (*The Economist*, 24 August 2023) <<https://www.economist.com/asia/2023/08/24/the-trials-of-muhammad-yunus>>accessed 7 May 2024.

³⁰¹ Li Liao and Weiqiang Zhang, ‘P2P 网络借贷实证研究：一个文献综述’ [Empirical Research on P2P Online Lending: A Literature Review] (2017) 12 *Journal of Tsinghua University (Philosophy and Social Sciences)* 256.

³⁰² *Ibid.*

Given these circumstances, compounded by the inherent limitations in risk control due to the cost-management model of P2P lending platforms, certain borrowers exploited these vulnerabilities to obtain loans without the intention of repayment. They borrowed the maximum amount possible from as many platforms as they could. The largest recorded stack of loans amounted to a total of CNY 5 million (approximately GBP 0.48 million)³⁰³ borrowed by an individual known by the nickname “Tank”, who defaulted on the loans and could not be traced or identified for debt recovery.³⁰⁴

Operating as isolated data silos, P2P platforms struggled to freely exchange or share borrower information among themselves at the time.³⁰⁵ This limitation made it challenging for both platforms and lenders to identify the true loan history and detect any disguised performance of borrowers. Additionally, the absence of a social or institutional credit rating system that could be utilised by P2P platforms further complicated the assessment of borrower default risk.³⁰⁶ Consequently, during this initial phase of P2P lending, there was a lack of effective measures to deter malicious borrowing.

To mitigate the substantial information asymmetry, platforms improved risk management by drawing insights from other lending sectors, particularly private lending and microcredit, to

³⁰³ The currency rate is based on the average spot exchange rate for 2011. <<https://www.exchangerates.org.uk/CNY-GBP-spot-exchange-rates-history-2011.html>> accessed 10 April 2024.

³⁰⁴ Lingyicaijing, ‘网贷简史（实践篇）：33 个大事件细数沧桑’ (A Brief History of Online Lending (Events): 33 Major Events Highlighting the Industry's Changes) (Sohu, 2019) <https://www.sohu.com/a/343344880_104992> accessed 20 April 2023.

³⁰⁵ *Ibid.*

³⁰⁶ *Ibid.*

enhance their borrower information audits.³⁰⁷ Concurrently, they refined their business models to bolster lenders' trust. A pivotal innovation emerged with the introduction of a guarantee model by the platform *My089* in 2009.³⁰⁸ In this model, lenders receive an advance payment should a borrower default, signifying that either the platform or its collaborating financing guarantee company bears responsibility for the borrower's defaults.³⁰⁹ This model shares similarities with the UK's provision funds employed by platforms. However, unlike provision funds, which do not guarantee full reimbursement of losses³¹⁰, the advance payment model promises the recovery of all principal amounts.³¹¹

However, when the default rate is high, the advance payment model appears impractical. Although under the advance payment model, borrowers may be required to provide collateral or a co-signer for the loan in some cases,³¹² it becomes unsustainable when default rates surpass acceptable levels. Therefore, this guarantee model does not really address the risk inherent in P2P lending. However, platforms employing such a model tended to be more appealing to lenders and thus gained a competitive edge in the market compared to those with basic models. This spurred other platforms to either adopt similar guarantee models or innovate new operational approaches. Consequently, P2P lending in China began to diverge from its original business model from that time onward.

³⁰⁷ Wang and others (n 31).

³⁰⁸ *Ibid.*

³⁰⁹ *Ibid.*

³¹⁰ AssetzCapital, 'Discretionary Provision Funds' <<https://retail.assetzcapital.co.uk/provision-fund>> accessed 20 August 2024.

³¹¹ Wang and others (n 31).

³¹² *Ibid.*

Overall, the nascent phase of China's P2P lending industry can be delineated by four characteristics. First, the industry was predominantly introduced by entrepreneurs hailing from the information technology sector. Second, during this stage, most platforms operated on a basic model. The platform primarily functioned as an online venue facilitating lending and borrowing opportunities, with a limited function of effective information disclosure and risk assessment. Third, the industry operated in an environment characterised by limited transparency and information asymmetry. In this setting, lenders often found themselves at a significant disadvantage compared to borrowers. Fourth, to attract more lenders and enhance competitiveness in the market, some platforms began innovating in P2P lending transactions by adopting the “advance payment model”.

- **The developmental phase (2011-2013)**

From 2011, the P2P lending market accelerated its development. On one hand, entrepreneurs with experience in private offline lending began to set up P2P lending businesses.³¹³ On the other hand, software development companies had created mature P2P lending platform templates for direct use by these entrepreneurs, improving cost efficiency.³¹⁴ This facilitated the growth of P2P lending platforms.

In addition, during this stage, many participants with experience in private lending became involved in founding P2P lending platforms, bringing with them a deep understanding of the

³¹³ Lingyicaijing (n 304).

³¹⁴ *Ibid.*

inherent risks.³¹⁵ Drawing lessons from earlier platforms and based on their experiences in offline lending, they adopted a hybrid model of online financing and offline lending.³¹⁶ Some platforms even implemented a franchising strategy, as seen with platforms like *GKKXD* and *Yooli*.³¹⁷ As a result, the customer sourcing expanded to include offline channels through local platform offices.³¹⁸ They also prioritised identifying local borrowers and conducting thorough on-site inspections to assess the use of funds, repayment sources, and collateral.³¹⁹ This strategy effectively mitigated the risk of borrower defaults, particularly by reducing the occurrence of malicious loans, which were frequent in the initial stages.³²⁰

During this stage, although some platforms faced bankruptcy due to mismanagement and an inability to control borrower default rates, leaving lenders unable to recover their funds, overall, integrating the offline model effectively reduced default rates, contributing to the industry's generally positive development.³²¹

While this blend of online and offline approaches may appear to deviate from P2P lending's Fintech nature, it was a localised strategy aligned with China's unique characteristics at the

³¹⁵ *Ibid.*

³¹⁶ *Ibid.*

³¹⁷ *Ibid.*

³¹⁸ *Ibid.*

³¹⁹ *Ibid.*

³²⁰ *Ibid.*

³²¹ *Ibid.*

time. Given China's relatively lower labour costs and the absence of a social credit scoring system, this approach proved beneficial for both platforms and lenders.

However, practices from debt collection in the private lending sector, including abusive methods, were also used in the P2P lending area, frequently occurring in cases of borrower default.³²² What was worse, when abusive debt collection methods did not result in criminal-level direct physical hurts or property damage to the borrower, but were mere threats and harassment, it was often difficult for the borrower to seek help from the police or pursue legal actions at that time.³²³ (It is worth noting that since 2020, China has incorporated anti-abusive debt collection measures into the regulatory rules of financial supervisory authorities, the Public Security Administration Punishment Law, and as newly added offenses in the Criminal Law. This can be seen as a legal response to numerous cases of abuse, including those in the P2P lending sector.)

Also, due to limited financial literacy among many borrowers, they were sometimes misled or misunderstood the platforms' interest rates. For instance, confusion between simple and compound interest led borrowers to underestimate the actual interest they would need to pay, resulting in higher-than-expected costs, which might be beyond their affordability.³²⁴

³²² Hexun (n 296).

³²³ *Ibid.*

³²⁴ *Ibid.*

Overall, during this phase, a distinctive feature was the combined operation of online platforms and offline offices. While this approach effectively controlled default risks, it also introduced potential harm for borrowers. This highlights that striking a balance between risk mitigation and borrower welfare is a critical concern for the industry. This issue requires not only the attention of the regulator for P2P lending but also extends to other areas of law, such as Criminal Law, Public Security Penalties Law and Civil Law.

- **The expansionary phase (2013-2015)**

Since 2013, China's P2P lending sector witnessed remarkable growth, peaking in 2014 in terms of the number of platforms. On one hand, the foundation for this growth was rooted in China's large population base and the escalating rate of internet penetration.³²⁵ On the other hand, supportive government policies promoting financial inclusion served as facilitators.³²⁶

Besides, this rapid growth can be understood from the perspective of the later-mover advantage. The late-mover advantage theory suggests that innovative late entrants hold an edge over pioneers due to greater market potential and a higher rate of repeat purchases.³²⁷ China's P2P lending market aligned well with this theory. Due to the later inception of its financial system compared to developed countries, there had been limited types of debt

³²⁵ Pingfan Song and others, 'Performance Analysis of Peer-to-Peer Online Lending Platforms in China' (2018) 10 Sustainability 2987.

³²⁶ Wang and others (n 31).

³²⁷ Venkatesh Shankar, Gregory S. Carpenter and Lakshman Krishnamurthi, 'Late Mover Advantage: How Innovative Late Entrants Outsell Pioneers' (1998) 35 Journal of Marketing Research 54.

financing available for individuals and SMEs before the P2P lending emergency.³²⁸ However, there had long been potential market demand for more inclusive debt finance in China.

Despite SME financing being a global challenge due to issues such as under-collateralisation and a lack of credit information, SMEs in China faced greater credit constraints and had more limited access to bank loans than those in many other countries.³²⁹ In 2006, fewer than 0.5 million out of over 40 million SMEs were able to obtain bank loans, indicating that approximately 98% of SMEs did not have access to formal financing.³³⁰ For individuals, the use of formal credit is also less prevalent in China compared to most other countries. Less than 7% of individuals utilise formal credit, with borrowing from family or friends being the most common method of obtaining credit.³³¹

The primary reason for unmet financial needs in China is that state-owned banks primarily favour large and state-owned companies due to their economies of scale and risk management capabilities.³³² Also, China's financial system is predominantly controlled by state-owned banks that employ a locally centralised management approach to enhance the

³²⁸ Wang and others (n 31).

³²⁹ For example, SMEs in China obtain only 12% of their capital from bank loans, while their peers obtain 21% in Malaysia and 24% in Indonesia. Dollar D and others, 'The Development of Private Enterprise in the People's Republic of China' (2003) Asian Development Bank Report

³³⁰ Y.F. Lin, 'Developing Small and Medium Bank to Improve Financial Structure' (Working paper, China Centre for Economic Research, Peking University, 2007).

³³¹ Zuzana Fungáčová and Laurent Weill, 'Understanding Financial Inclusion in China' (2015)34 China Economic Review 196.

³³² Veselin Kuntchev and others, 'What Have We Learned from the Enterprise Surveys Regarding Access to Finance by SMEs' (2012) Enterprise Analysis Unit of the Finance and Private Sector Development, The World Bank Group <<https://openknowledge.worldbank.org/handle/10986/16885>> accessed 26 April 2024.

supervision of lending services and tighten credit issuance.³³³ Consequently, this system exacerbates the challenges faced by these underserved groups, making it even more difficult for them to secure loans from the limited traditional financial institutions available.

On the loan supply side, as the income of residents in China had continued to increase alongside national economic growth at that time, an increasing number of individuals held idle funds. However, the investment channels available to residents in China were relatively narrow, and the range of investment products accessible to those with limited funds was quite limited.³³⁴

Moreover, the improvement of credit information bolstered potential lenders' confidence in the market. Starting in 2013, advancements in assessing borrowers' creditworthiness were observed following the launch of the Network Financial Credit Investigation System by Shanghai Credit Information Service Company. Engaging over 400 platforms, this system, while facing criticism for its constrained information-sharing features, significantly enhanced the risk management protocols across the platforms.³³⁵

³³³ Wang (n 31).

³³⁴ This phenomenon has changed gradually since 2010 as the growth of banks' off-balance-sheet wealth management products offering relatively higher interest returns almost substitutes deposits. Viral V. Acharya and others, 'In the Shadow of Banks: Wealth Management Products and Issuing Banks' Risks in China' (2020) CEPR Discussion Paper No. DP14957 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3401597> accessed 26 April 2024.

³³⁵ Shanghai Credit Information Services Co. Ltd, '网络金融征信系统' [Network Financial Credit Investigation System] <<http://www.shanghai-cis.com.cn/cisgrzx.aspx> > accessed 20 April 2024.

In addition to the market potential, P2P lending in China benefited from a substantial base of repeat consumers, particularly borrowers. This was primarily attributed to the limited alternative financing options available to them. Nevertheless, during a period of rapid P2P lending expansion in China, immense market potential emerged as a more crucial factor, surpassing the significance of repeat consumers. This is evident by the volume of transactions that continued to experience tremendous growth. For example, the trading volume was CNY 253 billion in 2014, but it surged to CNY 982 billion in 2015.³³⁶

Therefore, the “late-mover's advantage” theory can explain the rapid expansion of China's P2P lending landscape. As a “late-mover”, China quickly advanced in P2P lending market transaction volume and the number of market participants, surpassing other P2P lending markets in countries with established digital finance sectors.

Another important reason for the rapid growth is the prevalence of regulatory arbitrage and speculation in the unregulated market. During the early stages of P2P lending, the sector did not exhibit remarkable profitability, largely due to inexperienced risk control, which culminated in the first wave of collapses in 2011. However, the landscape changed after that. As the P2P sector gained momentum, it began to attract not only innovative entrepreneurs from various fields but also speculators. These speculators identified the potential for regulatory arbitrage and speculation within this unregulated sector. They engaged in financial

³³⁶ Yu Zhou, ‘金融危机的视角：P2P 雷潮的深层形成机理’ [From the Perspective of Financial Crisis: The Deep Formation Mechanism of the P2P Thunderstorm] (2019) 2 Jingji 109.

activities that would otherwise be subject to stricter regulation, operating under the guise of P2P lending through innovative business models.³³⁷

For example, some platforms claimed to be P2P lending services but, in reality, functioned more like commercial banks. They did not match lenders with borrowers but consolidated scattered borrowing demands into financial products, conducting transactions with lenders on behalf of the platforms themselves.³³⁸ In this model, lenders did not contract directly with borrowers; instead, they contracted with the platform by clicking “I agree” to the platform’s “terms and conditions”.³³⁹ Moreover, some platforms had consumers who were only lenders without borrowers. Some of these platforms cooperated with companies in need of financing, while others specialised in debt assignments.³⁴⁰ In the absence of clear regulatory guidelines, distinguishing the legality of these business models becomes challenging.

Furthermore, the lack of regulation during this period enabled not only operators to exploit regulatory loopholes but also facilitated many to engage in fraudulent activities. They capitalised on the absence of oversight to mask their illegitimate intentions as legitimate operations, unlawfully acquiring assets from unsuspecting individuals. For example, *Ezubao*, which was implicated in the largest scandal in China's P2P sector, ostensibly operated on a

³³⁷ Lingyicaijing (n 304).

³³⁸ Yu Gao, Shih-Heng Yu and Yih-Chearnng Shiue, ‘The Performance of the P2P Finance Industry in China’ (2018) 30 *Electronic Commerce Research and Application* 138.

³³⁹ Mei Zhen, ‘你在 P2P 签订的合同合法吗?’ [Is the contract you signed on the P2P platform legal?](*Weiyang*, 8 July 2015) < <https://www.weiyangx.com/136667.html> > accessed 15 April 2024.

³⁴⁰ Lingyicaijing (n 304).

business model of debt assignment within the financing lease industry.³⁴¹ *Ezubao* is the main example among several platforms leveraging P2P lending to commit offences like illegal fundraising, but it is not the only notorious case with a large number of victims.

Without specific regulations in place, detecting and preventing such criminal behaviours was very difficult. In fact, it was due to regulatory intervention that *Ezubao* was investigated and halted from further operations, preventing potentially more severe consequences. Concurrently, the *Ezubao* scandal intensified the Chinese government's and financial regulators' scrutiny of the already troubled P2P lending sector. Thus, the unregulated phase of China's P2P lending came to an end. However, to what extent did the regulation effectively rectify the industry and enable it to function properly? The next phase is the regulatory intervention stage.

- **The regulatory intervention phase (2015-2020)**

Prior to *Ezubao*'s collapse, China's government and regulators had already begun to recognise the chaos within the P2P lending market.³⁴² "Confronted with widespread disorder, marked by fraudulent schemes, the government shifted from its earlier hands-off stance by investigating platforms involved in suspicious illegal activities and enacting a series of regulatory measures.

³⁴¹ Neil Gough 'Online Lender Ezubao Took \$7.6 Billion in Ponzi Scheme, China Says' (*The New York Times*, 1 February 2016)
<<https://www.nytimes.com/2016/02/02/business/dealbook/ezubao-china-fraud.html>> accessed 29 January 2024.

³⁴² Lingyicaijing (n 304).

Through investigations and interventions in 2015, issues were identified in 896 P2P platforms, with more than half implicated in fraudulent activities.³⁴³ Besides, some faced liquidity issues due to poor management, preventing them from fulfilling their guaranteed repayments to lenders.³⁴⁴ As *Ezubao*'s downfall spotlighted the industry's troubles, the following section will discuss the *Ezubao* case, illustrating the harm inflicted on lenders.

Ezubao Scandal: Ponzi Schemes Disguised as P2P Lending

Ezubao was established in July 2014, distinguishing itself as an innovative P2P lending platform operating on an A2P (Asset-to-Person) model. In this model, *Ezubao* partnered with finance lease lessors, subsequently facilitating the assignment of creditors' rights to its customers: individual lenders.³⁴⁵ In other words, *Ezubao*'s customers are individuals who invested in the assignment of lessors' credit rights.

Ezubao launched a total of six investment products with expected annual returns ranging from 9% to 14.6%, far exceeding the yields of typical bank wealth management products.³⁴⁶ *Ezubao* also claimed guarantees for principal and interest, as well as flexible withdrawal rules. However, as later investigated by the regulator, 95% of the projects on the platform were fake

³⁴³ *Ibid.*

³⁴⁴ *Ibid.*

³⁴⁵ Yang Bai and Ji Chen, 'Ezubao 非法集资案真相调查' [Investigation into the Truth of the *Ezubao* Illegal Fundraising Case] (*The Supreme People's Procuratorate of the PRC*, 1 February 2016) <https://www.spp.gov.cn/zdgz/201602/t20160201_111982.shtml> accessed 2 February 2024.

³⁴⁶ *Ibid.*

and fabricated.³⁴⁷ *Ezubao* acquired genuine information about numerous companies and then utilised this data to fabricate fictitious projects. It is a typical Ponzi Scheme, a type of fraud by which the illusion of a profitable but non-existent business is maintained by paying quick returns to early investors with funds from later investors.³⁴⁸

Exploiting the limited financial literacy of some ordinary people and the lack of regulation, *Ezubao* crafted a “trap” with false promises. It used new lenders' funds to pay interest and short-term returns to existing lenders, creating an illusion of profitability to deceive more investors. As fraudulent financing projects could not generate genuine profits, to maintain a continuous funding chain, *Ezubao* continuously launched new projects and focused on attracting new lenders by any means.³⁴⁹

Ezubao promoted the benefits of P2P lending through advertising slogans like “start with just ¥1, withdraw anytime”. Marketed under the banner of financial inclusion, these advertisements were prominently featured on China Central Television (CCTV) and public transportation, specifically targeting potential lenders with limited funds and little investment experience.³⁵⁰

³⁴⁷ Local Financial Supervision and Administration Bureau of Hunan Province, ‘Ezubao 非法集资案真相调查：95%项目是假的’ [Investigation into the Ezubao Illegal Fundraising Case: 95% of the Projects were Fake] (2016) < https://dfjrjgj.hunan.gov.cn/dfjrjgj/ztl/fjz/xajs/201605/t20160527_3063045.html > accessed 18 April 2024.

³⁴⁸ Mitchell Zuckoff, *Ponzi Scheme: The True Story of a Financial Legend* (Random House, 2006).

³⁴⁹ Bai and Chen (n 345).

³⁵⁰ *Ibid.*

These programmes attracted a significant number of elderly viewers, many of whom place great trust in the CCTV brand and its reputation. Given the relatively late development of China's financial industry and the innovative nature of Internet finance at the time, many older individuals were either not aware of or less informed about the associated risks. Compounding this issue, advertisements frequently lacked explicit risk warnings, making them more susceptible to being misled by promises of high yields and low risks. As a result, many of *Ezubao's* victims were elderly individuals who had invested their life savings.³⁵¹

In order to accelerate the speed of expansion, *Ezubao* also set up a large number of offline branches and sales companies. *Ezubao* employed a sizable sales force, offering a low entry barrier but relatively competitive salaries. It set ambitious sales targets for its employees. On one hand, it incentivised salespeople to invest in *Ezubao's* programmes themselves and to encourage their friends and family to do likewise. On the other hand, it trained the sales staff with various sales strategies, including targeting individuals seeking emotional reassurance and providing them with thoughtful and enthusiastic service to encourage investment in *Ezubao's* projects.³⁵² Given the difficulty lenders faced in verifying the flow of invested funds and authenticating projects, they were unable to ascertain the actual utilisation of their investments.

Operating as a Ponzi scheme, *Ezubao* initially provided real returns to early lenders and allowed them to withdraw their principal as it had promised; nevertheless, many lenders were

³⁵¹ *Ibid.*

³⁵² *Ibid.*

persuaded to reinvest. This deceived a large number of people into trusting *Ezubao*. As a result, *Ezubao* successfully attracted a large number of lenders, most of whom had some savings but were not affluent and had no intention of making risky investments. In just one and a half years of operation, it attracted over 909,500 lenders, and by the end of 2015, when government intervention halted its operations, the capital pool had reached CNY 74.5 billion.³⁵³ After accounting for repeated investments, the remaining amount was CNY 59.8 billion. Some of these funds had already been laundered and were unrecoverable, resulting in a total loss of over CNY 38 billion for lenders.³⁵⁴

Ultimately, the principal orchestrators of *Ezubao* faced criminal sanctions for a range of offences, encompassing fundraising fraud, illicit trafficking of precious metals, unlawful possession of firearms, and cross-border smuggling. The primary figure at the helm, Ning Ding, received a life sentence.³⁵⁵

Reflecting on the *Ezubao* case underscores the severe repercussions of P2P lending in the absence of regulatory oversight. First, transparency is crucial in investment-related businesses, with regulatory frameworks serving as the primary mechanism to ensure it. Had regulatory mandates required information disclosure on P2P platforms, *Ezubao* users would have been more likely to uncover the fraudulent nature of the projects. Similarly, companies whose information was misappropriated could have detected its unlawful use.

³⁵³ Jiahui Chen and Likun Wang 'Illegal Fundraising of Ezubao' (*Caixin*, 31 Jan 2016) *Caixin* <https://special.caixin.com/event_0131/> accessed 7 March 2024.

³⁵⁴ *Ibid.*

³⁵⁵ *Ibid.*

Second, effective oversight of client accounts is essential. Without adequate regulation, platforms can easily divert funds from client accounts as they see fit. Unfettered control over client accounts directly facilitated *Ezubao's* illicit fundraising activities.

Third, given that media outlets often lack the capacity to authenticate the veracity of every advertised product, regulating advertising within emerging financial services becomes vital to prevent the proliferation of misleading or fraudulent advertisements.

Fourth, regulators should consider both the financial literacy of the general public and the marketing strategies employed by platforms, especially concerning the potential for misleading information. When new financial products emerge, the public often relies on merchants for information about the benefits and risks of participation. Even if contracts include risk disclosures, plain text may not capture attention as effectively as engaging in face-to-face explanations.

Besides *Ezubao*, about 40% of P2P lending platforms in China were in fact Ponzi schemes in 2016.³⁵⁶ In addition to Ponzi schemes, other fraud cases and offences also existed, including the platform's owner absconding with funds, trap loans, loan sharks, abusive debt collection and so on.³⁵⁷

³⁵⁶ Shao and Bo (n 243).

³⁵⁷ *Ibid.*

The magnitude of the disordered P2P lending market and the subsequent economic and social repercussions exceeded the government's expectations. In response, a stringent regulatory framework was introduced. Following the regulatory intervention, most platforms were compelled to alter their business models, which was a challenging endeavour. Numerous smaller, less robust platforms with inadequate internal controls were forced out of the market.³⁵⁸ In tandem with the introduction of regulatory guidelines, regulators escalated their scrutiny of platforms. By the end of 2017, 50.69% of platforms were found to be problematic, of which 54.2% of owners had absconded with funds.³⁵⁹

As stringent regulatory measures and government crackdowns on high-risk financing resulted in the closure of several hundred P2P platforms, China's P2P market experienced a significant contraction. The total monthly transaction volume dropped from its peak of CNY 253 billion in June 2017 to approximately CNY 90 billion by July 2019.³⁶⁰ Nevertheless, it remained notably larger than in many other countries. Contrary to the declining transaction volume, the volume of unrepaid loans surged. In 2019, the default rate for P2P lending reached an alarming 87.2%.³⁶¹ *Table 3* presents the number of affected platforms and the volume of unrepaid loans involving their lenders.

³⁵⁸ *Ibid.*

³⁵⁹ Sara Hsu, Jianjun Li and Hong Bao, 'P2P Lending in China: Role and Prospects for the Future' (2021) 89 *The Manchester School* 526.

³⁶⁰ *Ibid.*

³⁶¹ M.Gao, J.Yen and M.Liu, 'Determinants of Defaults on P2P Lending Platforms in China' (2021) 72 *International Review of Economic & Finance* 334.

Table 3: Impacts of problematic P2P platforms

| Year | Problematic Platforms | Outstanding Loans involved (billion CNY) | Lenders Involved (thousand) |
|------|-----------------------|--|-----------------------------|
| 2015 | 1686 | 272 | 16.79 |
| 2016 | 3407 | 454 | 26.59 |
| 2017 | 4129 | 576 | 33.24 |
| 2018 | 5417 | 2154 | 176.65 |
| 2019 | 5433 | 2162 | 177.21 |

source: wandaizhijia

While China's regulatory authorities had diligently endeavoured to enhance regulatory frameworks, resulting in certain positive outcomes, they had not entirely surmounted the challenges confronting the P2P industry to foster its sustainable development. From a market perspective, the tarnished reputation of P2P lending due to prevalent scams and scandals has significantly eroded consumer trust and confidence. On the regulatory side, certain initiatives appear overly idealistic and pose considerable enforcement challenges.

After a series of regulatory efforts, beginning in September 2017 with the "Guidelines for the Exit of Online Lending Information Intermediary Institutions in Shenzhen", some local governments began guiding P2P platforms to exit the market.³⁶² In December 2018, regulatory authorities issued the "Opinions on the Proper Disposal and Risk Prevention of Online Lending Institutions," advocating for the principle of "exiting where possible and

³⁶² *Ibid.*

closing where necessary" for P2P lending platforms. And some legally operated platforms were guided to terminate their P2P businesses and transition into loan facilitators, micro-loan institutions, or licensed asset management institutions.³⁶³ Following this, the pace of closures across various provinces began to accelerate. As of November 2020, the number of P2P lending platforms in China had dwindled to zero, marking the conclusion of the P2P lending industry in the country.³⁶⁴

The direct reason for this might be as follows: regulatory authorities had made considerable efforts, but they had not been able to steer the industry towards a healthy and sustainable development path. The regulation had identified numerous problems and led many platforms with minor issues to collapse due to compliance difficulties. While most regulatory requirements were theoretically reasonable, they were challenging to implement, especially when consumer market confidence had almost collapsed, and most platforms had issues.

While the P2P lending industry in China came to an end, the lessons learned from its rise and fall serve as valuable insights for policymakers, regulators, and industry participants globally. They underscore the importance of robust regulation, transparency, and responsible lending practices in fostering a healthy and sustainable innovative financial ecosystem.

³⁶³ Rectification Campaign (n 295).

³⁶⁴ China News, '央行副行长: P2P 平台已全部清零' [Deputy governor: P2P lending Platforms have all zeroed out] (*China News*, 15 January 2021) <<https://www.chinanews.com.cn/cj/2021/01-15/9388113.shtml>> accessed 20 March 2024.

4.3 Regulatory efforts for China's P2P lending market

When the P2P lending industry began to flourish, it initially did not attract significant regulatory attention regarding its potential risks. However, concerns and calls for regulatory measures began to surface in 2011, following the first wave of collapses among P2P lending platforms due to inadequate risk management.³⁶⁵ However, this did not directly trigger the introduction of borrower and lender protection measures as the government sought to incentivise innovation in the financial market and development of P2P lending platforms. This is evident when examining how the chairman of the China Securities Regulatory Commission highlighted the lack of innovation as the most significant issue in China's financial system in 2012.³⁶⁶ Additionally, before 2013, the regulator considered P2P lending less crucial for regulation due to its minor role in the financial sector.³⁶⁷ As a result, P2P lending in China remained largely unregulated until fraud issues surfaced in 2015.

In fact, before P2P lending was regulated, China had gradually established a vertical regulatory framework for the financial sector. Regulatory bodies were structured with a central headquarters in Beijing and local branches nationwide. At the central level, these regulators were sector-specific, comprising the People's Bank of China responsible for monetary policy and financial system stability, and the China Banking and Insurance Regulatory Commission (CBIRC) and the China Securities Regulatory Commission (CSRC), overseeing the banking and

³⁶⁵ Weihuan Zhou, Douglas W. Arner and Ross P. Buckley, 'Regulation of Digital Financial Services in China: Last Mover Advantage' (2015) 8 *Tsinghua China Law Review* 25.

³⁶⁶ The chairman of the China Securities Regulatory Commission, Mr. Guo Shuqing, made a speech at the Seminar on Innovation and Development of Securities Companies on 7 May 2012. Shuqing Guo, '积极地, 深深地探索和创造' [Actively and Prudently Explore and Create] (Seminar on Innovation and Development of Securities Companies, 7 May 2012) <www.csrc.gov.cn/pub/newsite/zjhxwfb/xwdd/201207/t20120719_212941.html> accessed 20 April 2024.

³⁶⁷ Zhou, Arner and Buckley (n 365).

insurance sectors and the securities sector, respectively. However, when P2P lending emerged, it did not fall under the purview of any sector-specific regulatory body.

To address the chaotic P2P lending market, rife with distorted business models and fraudulent schemes, the Chinese government changed from its hands-off approach and introduced several departmental rules to enhance supervision of P2P lending starting in 2015. A consortium of ten ministries and commissions issued the “Guiding Opinions on Promoting the Sound Development of Internet Finance” in 2015. This was the inaugural regulatory document for the P2P lending sector. Subsequently, a regulatory framework was instituted to delineate the boundaries between various business models and designate their respective regulators. Classified as a form of banking business, P2P lending was put under the supervision of the banking regulator, which was the CBRC (it has been replaced by the CBRIC since 2018).³⁶⁸ The CBRC, along with its local branches, was tasked with formulating a supervisory and administrative system for P2P lending platforms. This involved overseeing their day-to-day operations and guiding local regulators in institutional supervision and risk management of these platforms.³⁶⁹

- **Central level: “1+3” regulatory framework**

In 2016, the division of regulatory responsibilities for P2P lending became more clearly defined. In addition to the CBRC, other regulatory departments also play regulatory roles within their respective domains to oversee the P2P lending sector: 1) the Ministry of Industry

³⁶⁸ People’s Bank of China, ‘关于促进互联网金融健康发展的指导意见’[Guiding Opinions on Promoting the Healthy Development of Internet Finance], (No.221, 2015), Part 2, article 8.

³⁶⁹ *Ibid* article 33.

and Information Technology oversees telecommunications business; 2) the Ministry of Public Security regulates network service security; and 3) both the Ministry of Public Security and the State Internet Information Office are responsible for monitoring internet content.³⁷⁰

Then, the CBRC, along with the aforementioned departments, issued the Interim Measures 2016, establishing the first regulatory framework specifically tailored to the P2P lending market.³⁷¹ Then, three supplementary rules were introduced to provide detailed guidance on record-keeping and registration, information disclosure, and custodian business practices.³⁷² Consequently, a regulatory framework for China's P2P lending sector was established, it is called the “1+3” regulatory framework, including the following key aspects:

1. Confirming that both natural persons and legal entities can act as online lending users.
2. The nature of P2P lending platforms is that of information intermediaries, not financial intermediaries.
3. Requirements for filing and registration.
4. The platform must report all debt-related information to the central database of the online lending industry.
5. Limitations on offline operations: aside from necessary operational activities explicitly defined by risk management and other regulatory provisions related to online lending

³⁷⁰ Interim Measures 2016, article 4.

³⁷¹ In China's regulatory framework, the term “online lending” refers to “P2P lending”. Interim Measures 2016.

³⁷² They are 1) General Office of CBRC, ‘网络借贷信息中介机构备案登记管理指引’ [Guidelines for the Administration of Recordation and Registration of Online Lending Information Intermediary Institutions] (No.160, 2016); 2) ‘网络借贷资金存管业务指引’ [Guidelines for the Custody of Funds in Online Lending] (No.21, 2017); 3) ‘网络借贷信息中介机构业务活动信息披露指引的通知’ [Guidelines on Information Disclosure for Business Activities of Online Lending Information Intermediaries] (No.113, 2017).

(such as credit information collection, verification, post-loan tracking, and collateral management), online lending platforms are prohibited from conducting business in physical locations outside of the internet, fixed-line telephones, mobile phones, and other electronic channels.

6. Online lending platforms must not make lending decisions on behalf of lenders in any capacity. Each lending decision must be made and confirmed by the lenders themselves.
7. Platforms are prohibited from engaging in self-financing, establishing capital pools, using any guarantee models, setting up maturity mismatch arrangements, acting as sales agents for financial products, or conducting equity crowdfunding.
8. Specific requirements for platforms in these areas: auditing, client account management, ensuring information and transaction security, information disclosure, and bankruptcy isolation.
9. If an institution acting as an online lending information intermediary, established prior to the enactment of these measures, fails to adhere to the stipulations outlined herein, it shall, in addition to liability for any illegal or criminal conduct, be mandated by local financial supervisory authorities to undertake corrective actions. The prescribed period for such rectification shall not exceed 18 months from the date of notification.

These regulatory measures encompass a wide range of considerations related to P2P lending, from platform establishment, data collection, and risk management to bankruptcy. Notably, lessons drawn from cases like *Ezubao* and other fraud incidents have been incorporated into the regulatory rules. Nonetheless, there remain direct issues with this regulatory framework.

First, the regulations define platforms as information intermediaries and require them to disclose borrowers' basic information, credit ratings, credit scores, and guarantee status. However, the rules do not offer clear guidance on whether platforms should verify the authenticity of borrowers' information, provide risk disclosures, and ensure the accuracy of credit ratings. If platforms are required to assume responsibility, it implies they serve not only as information intermediaries but also as financial intermediaries to some extent. Without such requirements, platforms might simply shift all responsibility onto lenders. In such a scenario, attracting lenders to borrowers with uncertain information and no guarantee becomes very challenging for platforms.

There is a fundamental distinction between online lending and other information intermediary services like mainstream e-commerce. Typically, consumers possess a significant ability to discern risks when shopping online, and there is a relatively symmetrical exchange of information between both parties in a transaction. As a result, consumers' dependency on online shopping platforms tends to be limited. In contrast, identifying the risks associated with borrowers in P2P lending without platform assistance proves more challenging for consumers. Furthermore, there is contradiction in that P2P is categorised under the banking regulatory department for supervision, yet it is prohibited from providing financial intermediary services.

Second, the regulatory requirements outlined in the detailed rules had some positive effects in curbing the chaos in the industry. However, due to the relatively broad nature of the rules and a lack of strong enforcement power, these regulations had not been able to directly drive dishonest or disorderly platforms out of the market. Instead, they increased costs for

legitimate platforms without providing any advantageous factors, further exacerbating the situation of “bad money driving out good”.

- **Local level: specific issues**

At the local level, financial regulation is overseen by the financial work office or bureau established by local governments. These local regulators are tasked with both fostering financial development and enforcing financial regulations. They assist central-level regulators in their oversight and also wield their own regulatory authority over specific issues. Regarding P2P lending, local regulators oversee organizational issues of P2P lending platforms within their competency, including their establishment, modifications, and dissolution.³⁷³ For example, should a platform modify its previously registered details, it must report these changes to the local financial regulator within five working days. Moreover, platforms intending to cease operations must notify the local regulator in writing at least ten working days in advance, and subsequently comply with relevant regulations to terminate their registration.³⁷⁴

Additionally, local regulators are responsible for implementing a system to identify, report, and address major events in the local financial market. This includes significant operational risks associated with platforms, any legal violations by the platform's directors or management, and any lawsuits pertaining to the platform's commercial fraud. In response to these events, local regulators must develop contingency plans. They are also required to

³⁷³ Interim Measures 2016, article 8.

³⁷⁴ *Ibid.*

promptly report relevant information and outcomes of these major events to the provincial people's government, the CBIRC and the PBOC.³⁷⁵

- **Rectification campaign**

In response to the rising challenges threatening financial security due to disorderly development, the Chinese government initiated rectification measures in 2016. A leading group, comprising the CBRC along with 14 other ministries and commissions, was tasked with overseeing this campaign. Their objective was to cleanse the market and facilitate the seamless transition of P2P lending platforms within the regulatory framework. The group issued a notice mandating that online lending institutions adhere strictly to regulations and complete the requisite recordation and registration within a specified timeframe. Furthermore, the notice elucidated key aspects of the rectification campaign, including debt assignment, risk guarantee funds, borrowing costs, and business scale.³⁷⁶

According to the leading group's directives, online lending platforms not strictly adhering to the "1+3" regulatory framework must exit the market, with those suspected of criminal activities being reported to the police for investigation.³⁷⁷

³⁷⁵ *Ibid*, article 36.

³⁷⁶ Rectification Campaign '关于做好 P2P 网络借贷风险专项整治整改验收工作的通知' [Notice on the Completion of the Rectification and Inspection of P2P Online Lending Risk Special Remediation] (No.57, 2017).

³⁷⁷ Rectification Campaign, '关于开展 P2P 网络借贷机构合规检查工作的通知' [Notice on Conducting Compliance Inspections of P2P Online Lending Institutions](No.63, 2018).

At the local level, online lending institutions must undergo a three-step compliance review before registering with the financial regulator. Under the “1+3” regulatory framework, the platform and the industry association are tasked with institutional self-assessment and self-regulatory examination, respectively. The leading group overseeing the rectification campaign then conducts an administrative verification of the review results and pertinent platform data, subsequently issuing a summary report. This report requires endorsement from the heads of the local financial regulatory authority and the local branch of the CBRC.³⁷⁸ The three-step review process aids in identifying risks associated with each platform and facilitates the implementation of additional regulatory measures. The local regulator can adjust the compliance review schedule in accordance with market conditions.

In 2018, the central regulator released a list of compliance review issues, encompassing prohibitions on specific business practices, statutory obligations, risk management requirements, borrower and lender protection, information disclosure, and key regulatory stipulations.³⁷⁹ This list highlights common challenges identified during the rectification campaign and aims to standardise compliance reviews across different provinces and cities. This standardisation works to prevent regional regulatory arbitrage. Upon successfully completing the compliance review, P2P lending platforms can proceed to apply for

³⁷⁸ *Ibid.*

³⁷⁹ Rectification Campaign, ‘网络借贷信息中介机构合规检查问题清单’ [Compliance Inspection Checklist for Online Lending Information Intermediaries] (2018).

recordation and registration with the local financial regulator, enabling them to conduct online lending activities in compliance with relevant regulations.

However, in October 2019, the local financial regulator in Hunan announced on its official website that all online lending operations within its administrative jurisdiction would be terminated because the regulator identified all P2P platforms under its supervision that had failed to fully comply with the “1+3” regulatory framework and did not pass the compliance review.³⁸⁰ As a result, these platforms were instructed to either cancel their registration or modify their names and business scopes accordingly.

Hunan was the first province in China to declare the termination of all operational P2P lending platforms, setting a precedent for other provinces to follow suit by officially prohibiting P2P lending activities within their administrative jurisdictions. Concurrently, many platforms in different regions announced the termination of their P2P lending business and voluntarily exited the market. Several local financial regulators subsequently released lists of online lending institutions exiting the industry.³⁸¹

By the end of 2019, the Internet Financial Risk Special Rectification Work Leadership Team Office in China, established by CBRC to mitigate risks in the online lending sector, issued the 'Guidelines on Transforming Online-lending Information Intermediaries into Micro-loan

³⁸⁰ Hunan Local Financial Supervision and Administration, ‘公告’ [Announcement] (2019) <dfjrjgj.hunan.gov.cn/dfjrjgj/xxgk_71626/tzgg/gggs/201910/t20191016_10485618.html> accessed 29 April 2022.

³⁸¹ China News (n 342).

Companies' (No. 83 Notice). This notice outlines the conditions and procedures for transitioning existing P2P lending platforms into microloan institutions, loan facilitators, or licensed asset management institutions. The transition process must be completed within a two-year timeframe.³⁸² From this point onwards, China's P2P industry began its formal winding down, culminating in its conclusion with the closure of the last platform in November 2020.³⁸³

4.4. An evaluation of China's effort to regulate P2P lending

4.4.1 From hands-off to overly-strict: political and economic background for the regulatory strategy

Chinese regulators at both central and local levels initially made concerted efforts to foster financial innovation, including the P2P lending industry. However, they later shifted their policy approach, implementing stringent measures to rectify the market. The change in regulatory attitudes toward P2P lending was largely influenced by political-economy considerations.

When a P2P lending platform engages in misconduct, the local regulator often deflects responsibility to the central government due to conflicts and overlaps in the co-regulatory regime. While the CBIRC possesses extensive experience in regulating traditional financial sectors and is adept at designing risk control mechanisms, overseeing the innovative market demands additional funds, expertise, and technical means. This incurs significant regulatory

³⁸² Rectification Campaign (n 281).

³⁸³ China News (n 364).

costs. Given the substantial losses suffered by the public due to P2P lending malpractices, it may seem cost-effective and expedient to shut down all platforms to eliminate market risks.

In addition, despite efforts by Chinese authorities to correct the bias of evaluating political achievements solely based on economic growth, local governments continue to benefit from good economic growth.³⁸⁴ Technological innovation remains a crucial indicator in the evaluation system for local development progress. Thus, local financial regulators have commercial incentives to effectively discharge their duties to maintain their reputation and attract investments. Benefitting from national policies promoting innovation, some local governments issued guidelines to cultivate a business-friendly environment for financial innovation. For instance, the Shenzhen Municipal People's Government issued guiding opinions in 2014 to foster Internet financial innovation, offering preferential policies on establishing and operating Internet financial enterprises.³⁸⁵ Several provinces and cities, including Guangzhou, Nanjing, Wuhan, and Shanghai, subsequently introduced a series of policies to encourage the development of the Internet finance industry.³⁸⁶

After the introduction of central-level regulations, local regulators assumed responsibility for the recording, registration, and risk management of P2P lending platforms within their

³⁸⁴ Central Committee of the Communist Party of China (CCCPC), '十八届中共中央关于全面深化改革若干重大问题的决定' [Decision of the 18th CCCPC on Several Major Issues Concerning Comprehensive Reform] (2013) part 4, article 14.

³⁸⁵ Shenzhen Municipal People's Government, '深圳市人民政府关于支持互联网金融创新发展的指导意见' [Guiding Opinions of the Shenzhen Municipal People's Government on Supporting the Innovative Development of Internet Finance] (2014).

³⁸⁶ Wangdaizhijia (n 170).

jurisdictions.³⁸⁷ However, the central government's stance on P2P lending shifted from fostering positive development to implementing stringent regulation. The proliferation of problematic platforms tarnished the market's reputation and eroded public trust. During the rectification campaign, local regulators found it challenging to effectively oversee the P2P lending market due to resource constraints. The financial work office may lack the necessary resources to manage large-scale crises due to discrepancies between its responsibilities and financial power.³⁸⁸ Moreover, overseeing diverse financial institutions with varying regulatory requirements poses a considerable challenge to the regulator's capacity. Consequently, local regulators tended to allocate limited resources to well-managed sectors rather than the chaotic P2P lending market.

Furthermore, failure by the local financial regulator to report major risk identification and management or provide industry statistics to the CBRC as per regulations could lead to administrative penalties or even criminal liability for responsible individuals.³⁸⁹ In light of these stringent consequences, financial regulatory authorities may be reluctant to oversee the P2P lending market to avoid potential legal repercussions. Faced with the daunting task of managing non-compliant platforms, local regulators opted for a one-size-fits-all approach, terminating all P2P lending operations to expedite the rectification campaign.

³⁸⁷ Interim Measures 2016, article 5.

³⁸⁸ Youxing Li and Da Ke, '论政府竞争视角下的德方金融监管权配置' [The Allocation of Local Financial Regulatory Power from the Perspective of Government Competition] (2018) 9 Zhejiang Social Science 47.

³⁸⁹ Interim Measures 2016, article 39.

4.4.2 Central-local regulation: lack of effective coordination mechanism

With the rapid expansion of the P2P lending market, addressing large-scale problems in the sector became time-consuming for the central regulator. In response, the Chinese government decided to delegate some regulatory authority to local governments. Provincial regulators could establish customised rules based on local market conditions. However, the lack of certain mechanisms limited regulators' ability to effectively exercise their supervisory powers.

a. Lack of coordination mechanisms for central-local regulation

There is a deficiency in coordination mechanisms and permanent government agencies to formalise the central-local regulatory structure.³⁹⁰ The establishment of the leading group for the rectification campaign was composed of various government departments to address the chaotic P2P lending market. It relied on a series of short-term measures to rectify the P2P lending crisis. However, it is not a permanent structure for regulatory coordination between central and local regulators and this hampers regulatory coherence.

b. Lack of clarity regarding the workability of the cooperative regulatory framework

This complicates the process of the central regulator devolving power to local governments. While the central regulator spearheaded the rectification campaign and delegated some of its authority through a series of normative documents, this devolution of regulatory power is fragmented. The rectification measures were designed to address specific issues in the P2P

³⁹⁰ Delia Rodrigo, Lorenzo Alli and Pedro Andres-Amo, 'Multi-Level Regulatory Governance: Policies, Institutions and Tools for Regulatory Quality and Policy Coherence' (OECD Working Papers on Public Governance No.13, 2009)

lending market across different provinces, yet there was no supporting mechanism to facilitate interactions and streamline the relationship between central and local regulators.

c. There is no specific regulation on the allocation of financial regulatory power between the central and local governments

There existed a mismatch between authority and responsibility. While the central regulator holds the power to make rules, the local regulator is primarily responsible for implementation. Consequently, it becomes challenging for the local regulator to tailor rectification measures against P2P lending platforms within its jurisdiction.

d. Cross-regional issues

The cross-regional operation of P2P lending platforms introduces challenges due to multiple regulations imposed by different local regulators. A P2P platform's operation can differ from its registered address, leading to potential conflicts or passing the buck between local regulators. For example, *Phoenix Finance* established a P2P lending platform in May 2016, registered in Beijing, but changed its business registration and relocated to Haikou in July 2019. When the platform suddenly suspended its online lending business in September 2020, resulting in numerous overdue investment products and difficulties for lenders/investors to recover their debts, the local regulator in Beijing declined involvement, citing jurisdictional limitations. Conversely, the Haikou regulator claimed limited knowledge about the platform's operations, noting that most of its operations had been conducted in Beijing. After consultations between local regulators from both locations, the Hainan Local Financial Regulatory Bureau assumed responsibility for terminating *Phoenix Finance* and managing

associated risks.³⁹¹ Therefore, conflicts between local regulators regarding the cross-regional operations of P2P platforms can amplify regulatory uncertainty and coordination costs.

4.4.3 Vagueness of rectification measures

From 2015, the Chinese government introduced a series of regulatory measures and initiated a rectification campaign to clean up the disorderly market. However, while the regulatory rules themselves made implementation challenging, the rules implemented during the rectification campaign were too ambiguous to effectively achieve the intended rectification goals.³⁹²

First, the leading group of the rectification campaign issued a normative document in 2018 to categorise existing P2P platforms into different types, including those under investigation, high-risk, or operating normally.³⁹³ However, it failed to specify the criteria that would trigger an investigation.

Second, most provinces lacked clear procedures and criteria for P2P lending platforms to exit the market. As the central regulator delegated this decision to local governments based on their respective market conditions, the rectification measures adopted by local regulators varied. Shenzhen stands out as the only city that issued guidance facilitating the exit of P2P platforms and introduced a voting system to enhance communication between investors and

³⁹¹ Hainan Local Financial Regulatory Bureau, ‘海南省互联网金融风险专项整治工作领导小组办公室关于当前网络借贷风险处置工作的公告’[Announcement of the Office of the Leading Group for the Special Rectification Campaign against Internet Finance Risks in Hainan Province on the Current Online Lending Risk Disposal] (2020).

³⁹² *Ibid.*

³⁹³ Rectification Campaign, ‘关于做好网贷机构分类处置和风险防范工作的意见’ [Opinions on Properly Handling the Classification and Risk Prevention of Online Lending Institutions] (No.175, 2018).

platforms.³⁹⁴ This guidance outlines the procedures and criteria for platforms in Shenzhen to gracefully exit the market. These included establishing a group responsible for the platform's exit, declaring creditor rights, voting on repayment plans and other critical matters, as well as asset collection and disposal.³⁹⁵ In contrast, other local regulators, such as Hunan, simply announced that all P2P platforms failed the compliance review and were banned from the lending market, without providing clarity on subsequent actions.³⁹⁶

Third, the rectification campaign failed to differentiate between the various business models of different P2P lending platforms. Instead, it employed a one-size-fits-all approach, using criminal prosecution as a threat to compel P2P lending platforms to comply with administrative orders. When a P2P lending platform fails to formulate an appropriate repayment plan for lenders, it may be referred to the police for investigation and face potential charges of illegally absorbing public deposits. This contradicts the 2016 Interim Measures. The measures state that a P2P lending platform is merely an information intermediary prohibited from guaranteeing principal and interest, meaning that a P2P lending platform cannot repay debts on behalf of borrowers under any circumstances.

Overall, the rectification campaign was intended to restore public confidence in the market and strengthen compliance with P2P lending platforms operating under the “1+3” regulatory

³⁹⁴ Huixi Xie, ‘深圳已有 203 家 P2P 平台完全退出’ [203 P2P platforms Have Exited the Market in Shenzhen] (*People.cn*, 6 January 2020) < <http://sz.people.com.cn/n2/2020/0106/c202846-33690970.html> > accessed 29 April 2024.

³⁹⁵ Shenzhen Internet Finance Association, ‘深圳市网络借贷信息中介机构良性退出指引’ [Guidance of Shenzhen City on the Exit Mechanism for Online Lending Information Intermediary Institutions] (2019). While the guidance was issued by the industry association rather than the local financial regulator, it is applicable to all members of the Shenzhen Internet Finance Association and non-members can refer to this guidance.

³⁹⁶ Hunan Provincial Financial Regulatory Bureau (n 380).

framework. However, due to its vagueness, it did not work efficiently and ultimately led to the termination of the P2P lending industry in China. Nonetheless, the extensive investigations conducted by the rectification campaign successfully halted the operations of problematic platforms, preventing further harm to consumers. They also exposed some illegal and criminal activities. Hence, to a certain extent, they played a role in protecting consumers from ongoing harm and stabilising the broader financial market.

4.5 Conclusion

As a once significant aspect of inclusive finance and a major form of Fintech in China, the P2P lending industry experienced a meteoric rise followed by a swift decline. Due to lax regulations before 2015 and a low entry barrier for launching a platform, numerous P2P lending platforms were established and they engaged in illicit activities like Ponzi schemes, loan sharking, and illegal fundraising. They deviated from normal operational practices not only in the intended goals of financial inclusion and poverty alleviation but also jeopardised a significant number of individual lenders.

From the four stages of China's P2P development, it can be concluded that the basic model of P2P lending, where platforms merely provide a place for borrowers and lenders to exchange information and thus facilitate loan transactions, is unfeasible in a market lacking reliable personal credit ratings. For platforms to sustainably operate and profit, they inevitably need to find approaches to enhance the confidence of potential lenders to attract them. Therefore, regulatory strategies on those credit-enhancing approaches are crucial.

From 2015, the Chinese government endeavoured to bring order to the chaotic P2P lending market through the establishment of a central-local co-regulatory framework. Although the regulations effectively prevented the market chaos from further deterioration, identified a large number of illegal and criminal activities, and played a certain role in protecting lenders, the regulatory measures did not successfully correct the P2P lending market to become a healthy and orderly developing market.

Under this co-regulatory framework, central and local regulators collaborated to oversee online lending activities. While this approach offered certain advantages, it was plagued by significant challenges at both central and local levels. Initially, the central-level regulator failed to proactively address the rapid and disorderly expansion of online lending. Subsequently, they resorted to stringent rectification measures that effectively shuttered all P2P platforms. This uneven distribution of regulatory authority, coupled with a lack of coordination mechanisms, hindered effective oversight of the P2P lending sector.

Moreover, local regulators found themselves caught in a quandary, struggling to exercise their supervisory authority with both independence and flexibility. This predicament stemmed from conflicting development goals and regulatory objectives, unclear delineations of regulatory authority across different levels, and the limited capacity and resources available to local regulators.

Regarding the regulatory rules themselves, the “1+3” regulatory framework, while drawing on lessons from industry turmoil and specific cases, proved to be overly idealistic. Mandating that P2P lending platforms operate solely as pure information intermediaries is impractical and

lacks supportive measures for legitimately functioning platforms. Consequently, not only did problematic platforms collapse due to regulatory pressures, but well-run platforms also closed down because of the challenges of compliance. Moreover, the specific measures of the rectification campaigns are too ambiguous, failing to account for the operational nuances among different platforms.

Despite the termination of China's P2P lending industry, the insights garnered from this experience hold significant implications for the formulation of P2P lending regulatory frameworks and more expansive regulatory approaches to financial innovations. To begin with, the Chinese experience underscores the detrimental impact that an unregulated P2P lending market can have on consumers. Although the existence of clear provisions in criminal and civil laws target illicit fundraising and fraudulent activities, such harmful behaviours remained challenging to detect in an emerging financial innovation market devoid of regulatory oversight. By the time these activities were identified, irreversible consequences had already ensued, highlighting the critical role of proactive regulation in safeguarding consumer interests and market integrity.

In addition, the clarity and feasibility of regulatory measures are crucial. Without clear and achievable regulations, particularly in challenging enforcement scenarios, resorting to a one-size-fits-all approach becomes inevitable. Despite significant efforts, Chinese regulators chose a cost-minimising preventative regulatory strategy. This strategy mandated platforms which could not comply with regulatory standards to exit the industry entirely, effectively clearing out the entire sector when no platform met the requirements. While this approach eliminated

harm for consumers from the risk of P2P lending, it also undermined financial market diversity and neglected the positive societal contributions of the P2P lending model.

Last but not least, in financial innovation regulation, achieving an equilibrium between the imperatives of innovation and rigorous regulatory oversight is important. In the rapidly evolving fintech landscape, innovation can serve as a catalyst for growth, fostering new business models, enhancing efficiency, and expanding access to financial services. However, the dynamic nature of innovation often outpaces regulatory frameworks, presenting challenges in ensuring compliance, safeguarding consumer interests, and preserving financial stability. To strike this delicate balance, regulatory frameworks should be agile and adaptive, capable of accommodating innovative practices while maintaining robust oversight. Achieving a harmonious balance between fostering innovation and enforcing rigorous regulatory oversight would be not only essential for the sustainable growth of the fintech sector but also critical for maintaining trust, ensuring financial stability, and protecting consumer interests in the long run. The next chapter will explore the development of P2P lending in the UK and how the UK's regulatory framework has responded to this financial innovation while maintaining relatively stable growth.

Chapter 5 P2P lending and regulation in the UK

5.1 Introduction

As the birthplace of P2P lending, the UK has the longest history in this industry. Its relatively mature market exemplifies several typical features that may have already emerged or could potentially arise in the P2P lending markets of other countries. Therefore, it is significant to explore the development and regulation of P2P lending in the UK to understand key aspects of this fintech practice. Furthermore, this chapter, along with the preceding Chapter 4, establishes the foundational basis for the comparative analysis presented in Chapter 6.

This chapter aims to provide first a discussion of the P2P lending market in the UK by mapping significant factors and events, and second, to discuss and evaluate the regulatory framework. Through these analyses, the chapter addresses the UK's part of the research question (3): how do the UK and China resolve the regulatory difficulties of P2P lending? In addition, the chapter provides a discussion on research question (4): is there any regulatory paradigm fit to solve regulatory difficulties by striking a balance between industry progression and consumer protection in P2P lending. However, question (4) will be further addressed in Chapters 6 and 7. Similar to other chapters, this chapter applies a literature-based study, encompassing regulatory rules, academic literature, and industry reports. It also includes case analysis and data discussion.

Regarding market development, section 5.2 finds that the development of the P2P lending industry in the UK has been relatively stable, without drastic fluctuations. Its resilience during the pandemic further reflects the robustness of the P2P lending sector. In analysing the reason,

it has been identified that this stability is not only due to the inherent advantages of the P2P lending model, which can fill the market lending gap, especially in the aftermath of the 2008 financial crisis when the lending gap expanded significantly, but also due to the policy support provided by the government. However, excessive risks and unfair harm faced by lenders in the UK's P2P market persist. This section analyses the situation in the *Lendy* case, illustrating how, as the industry develops, more risks are beginning to surface. This is also the reason the FCA's regulatory framework has shifted from a light-touch to a more stringent paternalistic approach. Section 5.3 provides a chronological examination of the development and specific content of the regulatory framework, illustrating how it has progressively become more comprehensive and interventionist. It also discusses the impact and significance of key regulatory rules.

Based on the discussion in Sections 5.2 and 5.3, Section 5.4 provides an evaluation of the FCA's approach to regulating P2P lending with a focus on consumer protection. It finds that the FCA's adaptive regulation demonstrates flexibility and responsiveness to the industry's development. The current approach has shifted from primarily an arms-length narrative to a predominantly consumerist narrative, which includes paternalistic interventions aimed at preventing unfair harm. Although these interventions contribute to more effective protection by preventing unexpected losses for certain consumers, they also leave some issues: 1) the focus on the pre-contractual stage and lack of sufficient consideration for the post-contractual stage. 2) the emphasis on risk warnings and increasing the threshold may discourage certain consumers. In addition, the increased requirements have raised platforms' operational costs and compliance burdens, potentially challenging the balance between consumer protection and industry progression.

Therefore, the chapter is structured as follows: Section 5.2 analyses the UK's P2P lending market; Section 5.3 discusses the regulatory framework; Section 5.4 evaluates the FCA's regulation; Section 5.5 serves as a conclusion.

5.2 P2P lending market in the UK

5.2.1 The development of P2P lending in the UK

As described in Chapter 2, P2P lending was created by the establishment of the first platform, *Zopa*, in 2005 in the UK. From then, the trajectory of P2P lending in the UK evolved from a very niche market to one that has gradually attracted more users. This growing user base, in turn, encouraged more entrepreneurs to start new platforms and become platform operators.

According to an informational article on *P2PMarketData*, the first few years of P2P lending in the UK were described by one of *Zopa's* co-founders as "very, very tough" due to the lack of awareness and interest among potential lenders, coupled with the presence of many uncreditworthy prospective borrowers.³⁹⁷ The turning point came with the 2008 financial crisis, which triggered austerity policies in many European countries and the United States, worsening the low-income debt crisis.³⁹⁸ In this context, a large number of individuals and SMEs who were unable to secure funding from banks turned to P2P lending.³⁹⁹ Similar views are echoed in legal research articles. For example, Bavoso illustrates that the wave of fintech emerged from the difficulties start-ups and SMEs face in obtaining credit from mainstream

³⁹⁷ Bednorz (n 30).

³⁹⁸ Mia Gray, Katharina Möser and Jodi Gardner, 'Understanding Low-Income Debt in a High-Income Country' in Jodi Gardner, Mia Gray and Katharina Möser (eds) *Debt and Austerity* (Edward Elgar Publishing 2020) 2.

³⁹⁹ Bednorz (n 30).

banks in the post-crisis years, with P2P lending being the most common form of fintech.⁴⁰⁰

Rogers states that the rise and expansion of P2P lending platforms is to maintain aggregate demand following the Global Financial Crisis.⁴⁰¹

However, it is worth noting that while the financial crisis created a larger potential market for P2P lending and can be seen as a catalyst for the development of P2P lending, the more crucial underlying factor contributing to the development of the UK's P2P lending market was also the inherent advantages of the business model, which had the potential to fill market gaps that existed even before the financial crisis. From another perspective, the 2008 financial crisis had a limited impact on the China's financial market⁴⁰², yet China's P2P lending also developed and prospered after 2008, as Chapter 4 shows. This indicates that the P2P business model inherently possesses qualities that allow it to grow, primarily because it offers alternative financial opportunities to individuals and small businesses who are unable to obtain loans from banks. As the number of unbankable individuals and SMEs increased in the UK due to the 2008 financial crisis, the growth of P2P lending, in turn, supported the financing of SMEs, which has been important for the economy. As stated by Lord Sharkey in 2012, there is a strong demand for innovative financial services to create genuine competition for traditional banks and to provide funding, especially for SMEs and start-ups.⁴⁰³

⁴⁰⁰ Bavoso (n 42).

⁴⁰¹ Chris Rogers and Chris Clarke, 'Mainstreaming Social Finance: The Regulation of the Peer-to-Peer Lending Marketplace in the United Kingdom' (2016) 18 *The British Journal of Politics and International Relations* 930.

⁴⁰² John Whalley and others, 'China and the Financial Crisis' (2009) *The Centre for International Governance Innovation* <https://www.cigionline.org/sites/default/files/task_force_2.pdf> accessed 29 January 2024.

⁴⁰³ HL Deb 18 July 2012, col 325.

Another reason for the growth of P2P lending in the UK, as stated in Chapter 2, is the lower operating costs (than traditional financial institutions), which make it feasible to offer relatively higher interest returns to lenders while charging comparatively lower interest rates from borrowers than traditional financial institutions.⁴⁰⁴ This advantage has led market participants to perceive P2P lending as a favourable financial service tool,⁴⁰⁵ though the essential difference from bank deposits is that P2P loans are not protected by the Financial Services Compensation Scheme (FSCS).⁴⁰⁶

The following is a brief illustration of the differences in interest rates between depositors and P2P lenders in the UK. The official bank rate was between 0.25%-0.5% from 2013-2021.⁴⁰⁷ Then it has continued to rise, reaching 5.25% in 2024⁴⁰⁸, due to Quantitative Easing.⁴⁰⁹ In August 2022, the effective interest rate paid on new fixed-term deposits made by individuals with banks and building societies was 1.94%, while interest paid on non-financial businesses was 1.55%.⁴¹⁰ In addition, the up-to-date typical cash ISA rate is up to 5.17% for easy access or up to 4.75% fixed.⁴¹¹ Comparatively, as examples of P2P lending platforms, *CrowdProperty*

⁴⁰⁴ Milne and Parboteeah (n 41).

⁴⁰⁵ *Ibid.*

⁴⁰⁶ *Ibid.*

⁴⁰⁷ BoE, 'Official Bank Rate History' <<https://www.bankofengland.co.uk/boeapps/database/Bank-Rate.asp>> accessed 12 October 2022.

⁴⁰⁸ BoE, 'Interest Rate and Bank Rate' <<https://www.bankofengland.co.uk/monetary-policy/the-interest-rate-bank-rate>> accessed 21 May 2024.

⁴⁰⁹ Economic Affairs Committee, *Quantitative Easing: A Dangerous Addiction?* (HL 42, 2021) ch3.

⁴¹⁰ BoE, 'Money and Credit - August 2022' (BoE, 30 September 2022) <<https://www.bankofengland.co.uk/statistics/money-and-credit/2022/august-2022>> accessed 10 October 2022.

⁴¹¹ Benjamin Taylor, 'Top Cash ISAs 2024/25' (*Money Saving Expert*, Updated Daily)

provided lenders with an average 7.93% actual interest rate during 2015-2023, including 8.07% in 2019, 7.45% in 2022 and 8.13% in 2023 ;⁴¹² *Proplend* offers a 7.26% average return during 2020⁴¹³.

From this data, it can also be observed that P2P lending interest rates have remained relatively stable, despite the significant increase in bank interest rates. This stability may be due to a ceiling on the maximum interest rates that P2P borrowers can afford to pay; excessively high interest rates would exacerbate the debt burden on borrowers, who are often already financially constrained, and increase the probability of default. The underlying reasons for this warrant further research in the business area. However, for the purposes of this thesis, the data primarily serves to highlight the distinctions between bank deposits and P2P loans.

Returning to the development trajectory of P2P lending in the UK, inspired by *Zopa* and recognising the market potential, several other P2P lending platforms were established in the UK over the following years. Among these, the most popular were *RateSetter* and *Funding Circle*, both launched in 2010.⁴¹⁴ After being a minority player in the financial services sector during its initial years, P2P lending eventually became a mainstream option in the alternative finance and FinTech sectors of the UK market.⁴¹⁵ According to an alternative finance market report by Zhang *et al*, in 2015, out of the total funding of £3.2 billion secured in the UK's

<<https://www.moneysavingexpert.com/savings/best-cash-isa/>> accessed 14 May 2024.

⁴¹² CrowdProperty, 'Statistic' < <https://www.crowdproperty.com/statistics>> accessed 14 May 2024.

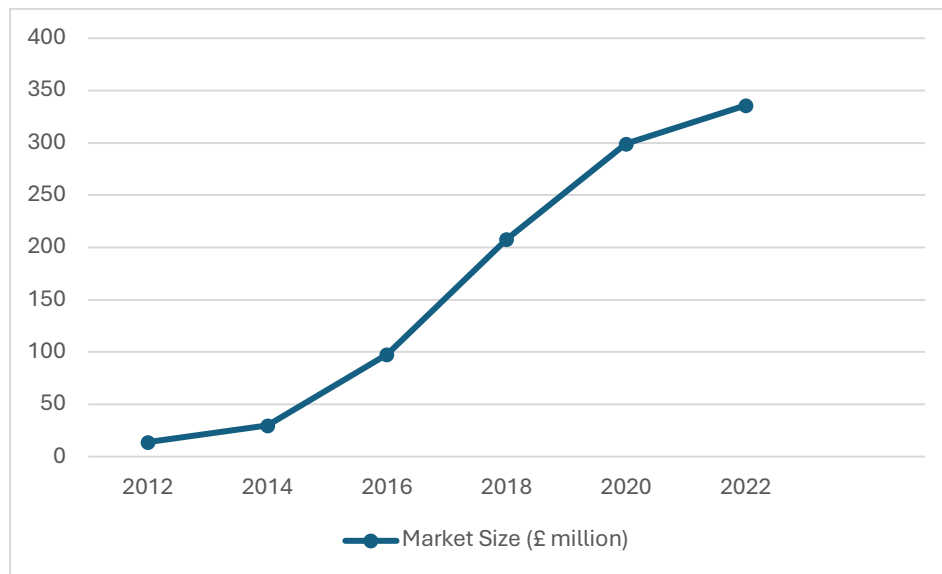
⁴¹³ Proplend (n 162).

⁴¹⁴ Bednorz (n 30).

⁴¹⁵ Unbolted Team, 'From Minority to Mainstream: A Brief History of P2P Lending' (*Unbolted*, 26 February 2016) < <https://unbolted.com/pawn/blog/minority-mainstream-brief-history-p2p-lending/> > accessed 12 August 2022.

alternative finance sector, P2P lending accounted for £2.4 billion of gross lending.⁴¹⁶ Figure 3 illustrates the growth trajectory of the UK's P2P lending market, measured by revenue, from 2012 to 2022.

Figure 3. P2P lending market size in the UK 2012-2022⁴¹⁷



It can be seen that the market size for P2P lending in the UK had remained below £50 million before 2014. However, the growth rate experienced a significant increase after 2014. In addition to the inherent time required for P2P lending to develop, this surge in growth can largely be attributed to the supportive policies that have been introduced since 2014.

Those supportive policies have helped create a more favourable environment for P2P lending, encouraging more participants and fostering the sector's expansion. The primary motivation

⁴¹⁶ Zhang and others (n 44).

⁴¹⁷ Ibisworld, 'Peer-to-Peer Lending Platforms in the UK - Market Size 2010–2028' (*Ibisworld*, 21 March 2022) <<https://www.ibisworld.com/united-kingdom/market-size/peer-to-lending-platforms/>> accessed 3 July 2023.

behind these policies is to provide financial resources for SMEs and stimulate economic development. As Stephen Barclay, the Economic Secretary to the Treasury, stated:

*“Peer-to-peer lending has brought about real benefits, not only for the UK’s small and medium sized business community, but our economy at large. This vital clarification will mean that businesses can continue to access the finance they need to grow and expand, helping us to build an economy that is fit for the future.”*⁴¹⁸

Specifically, these policies can be divided into two categories. The first category contributes to encouraging the establishment of more platforms and fostering innovation, while the second category aims to encourage greater consumer participation in P2P lending.

First, in 2014, FCA, the UK’s financial regulatory body, launched “Project Innovate”, designed to *“support industry innovation in both small and large businesses who are developing innovative approaches that can benefit consumers in financial services markets”*.⁴¹⁹ Through the “Innovation Hub,” the FCA has sought to support these entities by offering direct assistance and guidance on complying with regulatory requirements and obtaining FCA authorisation, a prerequisite for establishing an incubator through which the FCA assesses areas of its regulatory framework requiring adaptation to facilitate further development of

⁴¹⁸ HM Treasury and The Rt Hon George Osborne MP, ‘Protecting the Future of Peer-to-Peer Lending’ (21 December 2017) <<https://www.gov.uk/government/news/protecting-the-future-of-peer-to-peer-lending>> accessed 3 July 2023.

⁴¹⁹ FCA, ‘FS14/2: Feedback Statement on Project Innovate: Call for Input’ (28 October 2014) <<https://www.fca.org.uk/publications/feedback-statements/fs14-2-feedback-statement-project-innovate-call-input>> accessed 2 July 2023.

technology-based innovation.⁴²⁰ P2P lending platforms, as innovative financial ventures, have benefited from this support. This regulatory support signals the regulator's encouragement of financial innovation and fintech, instilling confidence in more entrepreneurs within the industry. Meanwhile, rather than reducing entry barriers, it has actively facilitated and assisted market entry.

Another regulatory support is the regulatory sandbox regime, which was created in 2016 and transitioned to a permanent model in 2021.⁴²¹ The definition of the sandbox by FCA is “*a safe space in which businesses can test innovative products, services, business models and delivery mechanisms.*” The financial regulatory box “*allows firms to test innovative propositions in the market with real consumers.*”⁴²² The FCA’s sandbox is the first regulatory sandbox for financial services, underscoring the FCA’s commitment to innovation.⁴²³ It plays an important role in driving the innovation necessary to break down the barriers to financial inclusion that keep poor and excluded customers marginalised from the formal financial system.⁴²⁴ Cornelli and others in their business research have found that entering into the sandbox in the UK is linked to a higher likelihood of raising funding for fintech firms, with an approximate 15% increase

⁴²⁰ FCA, ‘Project Innovate: Call for Input, Feedback Statement’ (October 2014) <<https://www.fca.org.uk/publication/feedback/fs-14-2.pdf>> accessed 7 July 2023.

⁴²¹ FCA, ‘Regulatory Sandbox’ (28 March 2022) <<https://www.fca.org.uk/firms/innovation/regulatory-sandbox>> accessed 18 July 2022.

⁴²² *Ibid.*

⁴²³ Garvey and others (n 254).

⁴²⁴ Ivo Jenik and Kate Lauer, ‘Regulatory Sandboxes and Financial Innovation’ (2017) CGAP Working Paper <<https://www.cgap.org/sites/default/files/researches/documents/Working-Paper-Regulatory-Sandboxes-Oct-2017.pdf>> accessed 7 July 2024.

in the average amount raised.⁴²⁵ They state that regulatory sandboxes enhance access to funding by alleviating information asymmetries and reducing regulatory costs.⁴²⁶ Thus, it has been a contributor to the growth of the P2P lending sector in the UK.

Second, since April 2016, the UK government has introduced the Innovative Finance Individual Savings Accounts (IF-ISAs), which promise tax-free returns for those who invest their money in P2P loans in the UK.⁴²⁷ ISAs are accounts that provide British residents with tax relief on the interest they earned from their savings or investments, up to a specified limit.⁴²⁸ The investment limit was £15,240 per person in the 2016/17 tax year and has increased to £20,000 since the 2017/2018 tax year⁴²⁹ (until now 2024/2025).⁴³⁰

Before the introduction of IF-ISAs, there were cash ISAs, and stocks and shares ISAs.⁴³¹ The inclusion of P2P lending within ISA schemes may encourage more savers to participate, potentially fuelling industry growth by attracting a wider pool of lenders. In addition, there is

⁴²⁵ Giulio Cornelli and others, 'Inside the Regulatory Sandbox: Effects on Fintech Funding' (2020) BIS Working Paper No.901 <<https://ideas.repec.org/p/bis/biswps/901.html> > accessed 23 January 2024.

⁴²⁶ *Ibid.*

⁴²⁷ Emma Dunkley, 'P2P ISA Investment Confirmed for Next Year', (*Financial Times*, 10 July 2015) <<https://www.ft.com/content/cc4ac0fe-26ee-11e5-9c4e-a775d2b173ca> > accessed 8 July 2023.

⁴²⁸ Individual Savings Accounts (ISAs) <<https://www.gov.uk/individual-savings-accounts>> accessed 23 September 2023.

⁴²⁹ The Innovative Finance ISA, '2017 Guide to the Innovative Finance ISA' (2017) <<http://innovativefinanceisa.org.uk/the-isa/>> accessed 8 July 2022.

⁴³⁰ ISAs (n 428).

⁴³¹ Jordan Stodart, 'Innovation Finance ISA 2016: An overview' (*Altfi*, 29 January 2016) <https://www.altfi.com/article/1696_innovative_finance_isa_2016_an_overview> accessed 16 August 2023.

a tax relief policy for P2P lenders, offering relief from taxation on lost funds when their loans go unpaid.⁴³²

Those measures further illustrate the government's objective of broadening the range of financing options available to borrowers by promoting expansion of the P2P lending sector.⁴³³

Also, they indicate that the government encourages the growth and development of the P2P industry as a viable solution to address financial exclusion. As a result, as seen in *figure 3*, there was a significant increase since 2014 and a dramatic upsurge from 2016 (to 2020).

Although the growth of the UK's P2P lending industry has not reached the astonishing levels seen in China, its steady development and increase still indicate the prosperity of the P2P lending sector in the UK. Before the termination of China's P2P lending market, the UK was the third largest P2P lending market in the world.⁴³⁴ After China's exit, the UK became the second largest.⁴³⁵ Additionally, it is the largest P2P lending market in Europe and in 2020, the UK accounted for 72.5% of the European market share.⁴³⁶

⁴³² HM Revenue & Customs, 'Peer to Peer Lending' (6 April 2016) <<https://www.gov.uk/guidance/peer-to-peer-lending#claiming-tax-relief-on-unpaid-loans>> accessed 10 July 2023.

⁴³³ HM Treasury and David Gauke MP, 'Government Sets out Options to Include Peer-to-Peer (P2P) Loans in ISAs' (2014) <<https://www.gov.uk/government/news/government-sets-out-options-to-include-peer-to-peer-p2p-loans-in-isas>> accessed 10 July 2023.

⁴³⁴ Tania Ziegler and others, 'The 2nd Global Alternative Finance Market Benchmarking Report' (Cambridge Centre of Alternative Finance, June 2021) <<https://www.jbs.cam.ac.uk/wp-content/uploads/2021/06/ccaf-2021-06-report-2nd-global-alternative-finance-benchmarking-study-report.pdf>> accessed 11 May 2024.

⁴³⁵ *Ibid.*

⁴³⁶ Jonas Schmidt 'P2P Lending in the United Kingdom' (*P2PMarketData*, 29 March 2020) <<https://p2pmarketdata.com/blog/p2p-lending-united-kingdom/%3E/>> accessed 10 July 2023.

The prosperity of P2P lending in the UK has successfully helped SMEs with their financing needs, particularly by alleviating the financial burden on those impacted by Brexit. SMEs are a fundamental component of the UK economy, playing a vital role in job creation, driving innovation, and contributing to productivity growth.⁴³⁷ However, Brexit has negatively affected SMEs in various ways, such as resultant skill shortages⁴³⁸ and the decline in imports and exports.⁴³⁹ The agility of P2P lending in adapting to the evolving financial landscape offers a lifeline for SMEs, allowing them to weather the economic uncertainty brought on by Brexit. In 2017, approximately 68% of all alternative finance market volume (£4.2 billion in total) was raised for UK start-ups and SMEs, of which P2P lending occupies 75% of the total volume.⁴⁴⁰ The P2P lending industry has opened up access to lending as a mainstream investment to consumers and forms a vital part of the UK's financial services industry.⁴⁴¹ This highlights that P2P lending has realised its social value by providing essential financial support to SMEs. Furthermore, it aligns with the regulator's intention of fostering innovation and expanding access to finance.

However, from 2020 to 2022, although the market data in the P2P sector continued to grow, the growth rate slowed down. On one hand, this was due to the impact of the Covid-19

⁴³⁷ R. Brown, J. Liñares-Zegarra and JOS Wilson, 'The (Potential) Impact of Brexit on UK SMEs: Regional Evidence and Public Policy Implications' (2019) 53 *Regional Studies* 761.

⁴³⁸ Pattanapong Tiwasing, 'Brexit and Skill Shortages: An Empirical Analysis of UK SMEs' (2021) 10(1) *Economics and Business Letters* 9.

⁴³⁹ Office for Budget Responsibility, 'Brexit Analysis' < <https://obr.uk/forecasts-in-depth/the-economy-forecast/brexit-analysis/#assumptions>> assessed 24 August 2024.

⁴⁴⁰ Zhang and others (n 44).

⁴⁴¹ Innovate Finance, '36 Group Powered by Innovate Finance' <<https://www.innovatefinance.com/36hgroup/>> accessed 11 July 2023.

pandemic on the entire economy and financial sector. On the other hand, in 2019, the FCA implemented stricter regulatory policies, increasing the costs and compliance pressures on P2P platforms and raising the procedures and requirements for ordinary consumers to become P2P lenders. This was mainly because the increasing risks in the P2P lending market had come to the surface, raising concerns and harming some consumers. The risks in the UK P2P market will be analysed in Section 5.2.3 and the regulation rules will be discussed in Section 5.3.

Another feature of the UK's P2P lending market after 2020 is that the market has been reshaped. One striking sign is that the top three P2P lending platforms in the UK, *Zopa*, *RateSetter* and *Funding Circle*, which had occupied most of the market share, exited the P2P lending sector in 2020-2022.⁴⁴² Also, many other platforms have left the P2P lending sector. For example, *Octopus Choice* permanently stopped conducting P2P lending in 2021 and is winding down gently;⁴⁴³ *ThinCats* switched away from P2P lending at the end of 2019 and so forth.⁴⁴⁴ The reasons for their exit could vary, but some main aspects can be seen from *Zopa's* statement.

"... over the last few years, customer trust in P2P investing has been damaged by a small number of businesses whose approach led to material losses for retail investors.

⁴⁴² Marc Shoffman, 'Who are the 'Big Three' In P2P Now?' (*P2Pfinancenews*, 2 October 2020) <<https://p2pfinancenews.co.uk/2020/10/02/who-are-the-big-three-in-p2p-now/>> accessed 12 August 2023.

⁴⁴³ Neil Faulkner, 'What Happened to P2P Lending Companies that Closed' (*4thway*, 17 March 2021) <<https://www.4thway.co.uk/news/p2p-lending-companies-that-closed/>> 5 September 2023.

⁴⁴⁴ *Ibid.*

Linked to this, the changing regulation which followed raised the operational costs of running a P2P business, as well as the cost of attracting new investors to the Zopa platform. To offset these increased costs and ensure we have a sustainable and profitable business, we'd need to reduce investor returns to a point where they'd no longer be attractive and commensurate with the risk that investors take on."⁴⁴⁵

Therefore, Zopa's decision to exit the P2P lending sector can be seen as a result of a combination of eroded customer trust, increased regulatory and operational costs, and the subsequent impact on interest returns. These factors potentially lowered the platform operator's confidence in the sustained successful operation of the business.

These reasons mentioned by Zopa are worthy of consideration by regulators on the question of how to strike a balance between protecting consumers from excessive risk and maintaining industry operations. Section 5.4 will explain why new regulatory measures have increased the operational and marketing of platforms and will provide an evaluation of those measures.

The exit of many platforms from the P2P lending sector raised questions about whether it signified the decline of the P2P lending industry. However, other platforms have quickly captured the market share left by those which exited and have successfully maintained market growth. *Table 4* lists the 10 largest P2P platforms in the UK by loan volume in 2021.

⁴⁴⁵ Zopa, 'Why did You Stop P2P Investment' (Zopa, 2022), <<https://www.zopa.com/help/article/why-are-you-stopping-p2p-investments>> accessed 17 July 2023.

Table 4: Top 10 P2P lending platforms in the UK in 2021⁴⁴⁶

| Platform | Sector | Loans (£ million) |
|----------------|----------|-------------------|
| Assetz Capital | SME | 1,401 |
| FOLK2FOLK | Property | 502 |
| CrowdProperty | Property | 177 |
| Invest&Fund | Property | 161 |
| Kuflink | Property | 156 |
| Proplend | Property | 143 |
| ArchOver | SME | 119 |
| HNW Lending | Consumer | 106 |
| Relendex | Property | 94 |
| Lending Crowd | SME | 89 |

From the table, it can be seen that six out of the top ten platforms are in the property sector, which means that their main operation is to facilitate secured loans between lenders and borrowers, with borrowers using a property as collateral. Because of the collateral, these secured loans pose less risk to lenders, though they are not risk-free (this is exemplified by the failure of *Lendy*, a P2P property lending platform, which resulted in unexpected losses for its

⁴⁴⁶ Innovate Finance, 'Innovate Finance/36H Group P2P Sector Ranking 2021' (1 April 2022) <<https://www.innovatefinance.com/blogs/innovate-finance-36h-group-p2p-sector-rankings-2021/>> accessed 15 July 2024.

lenders).⁴⁴⁷ In comparison, the largest P2P lending platforms that previously exited the market, *Zopa*, *Funding Circle*, and *RateSetter*, operated under the unsecured P2P lending model.

However, due to its narrow scope, P2P property lending makes a limited contribution to financial inclusion, particularly for financially disadvantaged groups who lack property as collateral or whose borrowing purposes are not related to property. While property loans can serve as one form of P2P lending, competing in the market and providing services to borrowers and lenders in this sector, it is necessary to reconsider whether the market is straying from its original social values if property loans dominate the P2P lending sector. From a regulatory standpoint, the pertinent question is whether this tendency has been shaped by regulation or if it is, in turn, influencing regulatory focus. This will be examined in section 5.3 when discussing new regulatory rules.

It is also evident that in both the UK and China, platforms offering secured P2P loans began to emerge and grow as the P2P industry expanded and more users and platforms entered the market, although the security models differ between the two countries. In China, as discussed in Chapter 4, the secured model involves the guarantee of repayment by platforms or their corporate companies. The secured model in the UK differs in that it requires borrowers to provide their own property as collateral, and the loan purposes are property-related. This makes the operation more feasible, although it also significantly narrows the scope of the borrowers they can serve.

⁴⁴⁷ FCA, 'Lendy Ltd Enters Administration' (24 May 2019) <<https://www.fca.org.uk/news/statements/lendy-ltd-enters-administration>> accessed 18 May 2024.

In summary, this section has described the development of P2P lending in the UK, from its emergence to its robust growth as an important form of alternative finance in the market. It has analysed the reasons for its development in the UK. On the borrower side, P2P lending filled the market gap left by traditional financial institutions. Following the 2008 financial crisis, more individuals and small businesses were unable to obtain loans from banks, expanding the market gap, and P2P lending seized this opportunity for further growth. On the lenders' side, P2P lending offers better rates than traditional financial institutions. Additionally, the UK's policy support has directly and significantly promoted the prosperity of the P2P lending market.

However, as increasing risks within the P2P lending market have harmed consumer confidence, coupled with the implementation of stricter regulatory measures in 2019, a significant number of platforms had to exit the P2P industry or close down. Despite this, the industry did not suffer a setback, as other existing or new platforms took over the market share of those that exited. It is worth noting, however, that after the industry was reshaped in 2019, P2P property lending made up more than half of the top 10 platforms. This raised concerns about the potential dominance of P2P property loans, as it could undermine the social value of P2P lending as a tool for promoting financial inclusion.

5.2.2 P2P lending during the Covid-19 Pandemic

From 2020 to 2023⁴⁴⁸, the Covid-19 Pandemic impacted all sectors of the economy.⁴⁴⁹ As a part of the broader financial ecosystem, P2P lending can be influenced by external economic conditions and was thus affected by the Pandemic. Since China's P2P lending industry had ended before the Pandemic, there is no data on how P2P lending performed during this specific period in China. Therefore, the UK P2P lending market during the Pandemic serves as a significant case for understanding how P2P lending is affected by broader economic and financial conditions, and how, or whether, it contributes to or impacts the economy and society.

The pandemic created a crisis for P2P lending platforms in the UK, leading to liquidity problems. Many P2P platforms were in a dilemma when balancing withdrawal requests and maintaining liquidity to approve the fund loans during the pandemic. Some platforms had to pause money withdrawals from the accounts or inform lenders of increasing delays. For example, lenders of *RateSetter* had to queue for withdrawal requests due to increased demand.⁴⁵⁰ Besides, *FundingCircle's* secondary market was also temporarily closed.⁴⁵¹ Also,

⁴⁴⁸ WHO, 'With the International Public Health Emergency Ending, WHO/Europe Launches its Transition Plan for COVID-19' (*WHO*, 12 June 2023) <<https://www.who.int/europe/news/item/12-06-2023-with-the-international-public-health-emergency-ending--who-europe-launches-its-transition-plan-for-covid-19>> accessed 18 May 2024.

⁴⁴⁹ Yunzhang Li and others, 'The Impact of COVID-19 on UK and World Financial Markets' (2022) 24 *Jundishapur Journal of Microbiology* 373.

⁴⁵⁰ Omar Faridi, 'UK Based P2P Lender RateSetter is Reportedly Struggling to Process Withdrawal Requests from Investors' (*Crowdfund Insider*, 18 October 2020) <<https://www.crowdfundinsider.com/2020/10/168077-uk-based-p2p-lender-ratesetter-is-reportedly-struggling-to-process-withdrawal-requests-from-investors/>> accessed 12 July 2023.

⁴⁵¹ Kathryn Gaw, 'Funding Circle Suspends Secondary Market' (*Peer2Peer Finance News*, 9 April 2020) <<https://p2pfinancenews.co.uk/2020/04/09/funding-circle-suspends-secondary-market/>> accessed 12 July 2023.

Octopus Choice paused lending and then decided to close.⁴⁵² Moreover, some platforms, like *Mintos*, had to suspend certain loan originators and implement stricter lending criteria.⁴⁵³ However, there were also some platforms that managed to continue growing during the Pandemic.⁴⁵⁴ So, what are the reasons that P2P lending can remain stable in the UK market?

The first reason pertains to business strategy. Many P2P lending platforms implemented policies preventing lenders from selling their loans at discounted prices to expedite their exit.⁴⁵⁵ Consequently, lenders were compelled to retain their loans and continue earning interest returns. This approach helped maintain market stability and prevented a potential collapse in loan values, thereby protecting both the platforms and their consumers from severe disruptions.

Second, as interventions issued by the UK Government to combat and slow the spread of COVID-19 involved the closure of non-essential businesses and issuing stay-at-home orders,⁴⁵⁶

⁴⁵² *Ibid.*

⁴⁵³ Mintos, 'About Updates on the Suspended and Defaulted Lending Companies' (*Mintos*, 30 October 2020) <<https://www.mintos.com/blog/about-updates-on-the-suspended-and-defaulted-lending-companies/>> accessed 12 July 2023.

⁴⁵⁴ Marc Shoffman, 'How the Pandemic has Changed P2P Lending' (*Peer2Peer Finance News*, 16 March 2021) <<https://p2pfinancenews.co.uk/2021/03/16/how-the-pandemic-has-changed-p2p-lending/>> accessed 12 July 2022.

⁴⁵⁵ Rupert Jones, 'Peer-to-Peer Lending: I am 19,050th in the Queue to get my Savings Back' (*The Guardian*, 27 October 2020) <<https://www.theguardian.com/money/2020/oct/17/peer-to-peer-lending-savings-covid-pandemic>> accessed 28 July 2024.

⁴⁵⁶ Industrial Injuries Advisory Council 'COVID-19 and Occupational Impacts' (16 November 2022) <<https://www.gov.uk/government/publications/covid-19-and-occupational-impacts>> accessed 20 May 2024.

many individuals and businesses, particularly SMEs⁴⁵⁷, faced worsened financial difficulties, which expanded their need to borrow amid falling profits and cash flow.⁴⁵⁸ This means an overall expansion in demand within the lending market, and as a form of lending service focusing on individuals and SMEs, P2P lending naturally became part of how this increased demand was met.

However, due to the economic downturn caused by the Pandemic, some individuals who might have had the potential to become P2P lenders may no longer have held investable funds, and others became more cautious and reluctant to invest.⁴⁵⁹ Therefore, although the demand from borrowers increased, the supply of funds from lenders decreased.

Nevertheless, the UK government's supportive policies helped platforms alleviate this issue. In response to the economic shock caused by the Pandemic, the UK Government made efforts to help expand lending opportunities, including the introduction of the Coronavirus Business Interruption Loans Scheme (CBILS) in March 2020 to support struggling companies.⁴⁶⁰ Some platforms stopped lending to lenders and instead chose to only lend government funds through this scheme designed to prop up failing businesses. *FundingCircle* was the first

⁴⁵⁷ HM Treasury, 'Kalifa Review of UK FinTech' (26 February 2021) <https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/978396/KalifaReviewofUKFintech01.pdf> accessed 7 July 2022.

⁴⁵⁸ Zhigang Yao and Yao Liu, 'How Covid-19 Impacts the Financing in SMEs: Evidence from Private Firms' (2023) *Econ Anal Policy* PMC 10290738.

⁴⁵⁹ Dimitris K. Chronopoulos, Marcel Lukas and John O.S. Wilson, 'Consumer Spending Responses to the COVID-19 Pandemic: An Assessment of Great Britain' (2020) <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3586723> accessed 18 October 2023.

⁴⁶⁰ Department for Business, Energy & Industrial Strategy and British Business Bank, 'Apply for the Coronavirus Business Interruption Loan Scheme' (2020) <<https://www.gov.uk/guidance/apply-for-the-coronavirus-business-interruption-loan-scheme>> accessed 12 July 2022.

accredited lender under CBILS, followed by several other platforms that also joined the scheme.⁴⁶¹

Thus, with government programmes supporting the supply of funds and an expanded market driving the demand for funds, P2P lending, despite facing liquidity pressures due to the Pandemic, ultimately achieved stable growth. A report from the analyst *4thWay* shows that the market size of the P2P lending platforms in the UK increased faster than other technology sectors overall.⁴⁶² Moreover, P2P lenders still made positive returns while the Pandemic pushed stock markets down in 2020.⁴⁶³

In fact, P2P lending demonstrated relatively stable performance not only in the UK but also in other countries during the Pandemic. Research on how the Pandemic has affected P2P lending primarily focuses on the US market. For example, quantitative research in the field of business by Najaf *et al.* indicates that the Pandemic expanded the potential market for P2P lending.⁴⁶⁴ The high rate of staying at home during the pandemic led many borrowers to prefer completing services online. Although banks have expanded their online banking services, they are not as efficient as P2P lending platforms.⁴⁶⁵ Additionally, Cumming *et al.* conclude that P2P

⁴⁶¹ Marc Shoffman, 'Funding Circle Becomes First Approved P2P CBILS Lender' (*Peer2Peer Finance News*, 17 April 2020) <<https://p2pfinancenews.co.uk/2020/04/17/funding-circle-becomes-first-approved-p2p-cbils-lender/>> accessed 12 July 2023.

⁴⁶² *Ibid.*

⁴⁶³ Matthew Howard, 'How Covid-19 Shows that P2P Lending is a Fairer Investment' (*4thWay*, 6 April 2020) <<https://www.4thway.co.uk/candid-opinion/how-covid-19-shows-that-p2p-lending-is-a-fairer-investment/>> accessed 12 July 2022.

⁴⁶⁴ Khakan Najaf, Ravichandran K. Subramaniam and Osama F. Atayah, 'Understanding the Implications of Fintech P2P Lending during the COVID-19 Pandemic (2022) 12 *Journal of Sustainable Finance & Investment* 87.

⁴⁶⁵ *Ibid.*

lending was significantly more stable, prompt, and resilient during the Pandemic than traditional bank consumer lending in their economic and policy research.⁴⁶⁶ Also, Sindreu's market research found that the Pandemic could have further shifted investors' preferences toward non-traditional markets, which are more transparent.⁴⁶⁷ These findings show the common stability of the P2P lending sector during the Pandemic. These conclusions offer valuable reference for understanding P2P lending.

Overall, the pandemic posed a liquidity crisis for P2P lending platforms in the UK, but it also served as a test of the robustness of the platforms and the P2P lending concept under extreme conditions. The continued growth of the P2P industry indicates that the UK P2P lending sector has withstood this test, demonstrating its stability and resilience. Also, the growth is closely related to the government's policy support.

5.2.3 Risks in the UK's P2P lending market

Although the UK P2P lending market has been praised for its efficient operation⁴⁶⁸, the risks that still exist in the market should not be overlooked. As discussed in Chapter 3, the features of the P2P lending business model inherently carry risks for consumers. For lenders, the main risks are defaults by borrowers or the platform; for borrowers, the primary risks involve misleading interest rates and abusive debt collection practices. Additionally, both parties face

⁴⁶⁶ Douglas J. Cumming and others, 'COVID-19 Bust, Policy Response, and Rebound: P2P vs. Banks' (2021) 47 *The Journal of Technology Transfer* 1825.

⁴⁶⁷ Jon Sindreu 'Why Covid-19 won't stop the new Shadow banks. Wall Street' (*The Wall Street Journal*, 13 July 2020) <<https://www.wsj.com/articles/why-covid-19-wont-stop-the-new-shadow-banks-11594639940>> accessed 12 July 2022.

⁴⁶⁸ Milne and Parboteeah (n 41).

risks related to information leakage, platform misuse of client accounts, and platform closures without proper wind-down arrangements.

Although the risks of abusive debt collection, personal information leakage, and over-indebtedness exist within the P2P lending sector, they are neither exclusive to it, nor possess distinctive features within the P2P lending field. In the UK, while these three types of risks are also present, there have been no notable events or cases demonstrating that they warrant regulation specifically tailored for the P2P lending area. Therefore, this section will focus on the main issues in the UK P2P lending market, which concern borrower defaults and platform failures. Also, the potential risk associated with the securitisation of P2P loans will be mentioned.

***α*. Borrowers' default**

Borrowers' default can be seen as the most significant risk faced by lenders in a legitimately operating P2P platform. When the borrower default rate is excessively high, the platform itself would also struggle to survive. In the UK market, some platforms had to close down due to overly high default rates among borrowers, a notable example of that situation is the crackdown of *Quakle* in 2011, due to a near 100% default rate.⁴⁶⁹ Another example is that *YES-Secure* (formerly *Encash*) closed down due to over 20% bad debt rates.⁴⁷⁰ As a comparison,

⁴⁶⁹ Moore and Moules (n 68).

⁴⁷⁰ Faulkner (n 443).

the default rates for a well-operating P2P lending platform, *Assetz Capital*, which were 7.7% in 2019 and 6.3% in 2020.⁴⁷¹

Given *Quakle's* astonishing default rate, the following section will review the underlying reasons. Unlike most P2P lending platforms that score borrowers by credit information provided by borrowers or purchases from the credit bureau, *Quakle* believed that “*normal credit risk assessment was unnecessary, and social media profiles and rankings were all you needed*”.⁴⁷²

Therefore, *Quakle* assessed its borrowers based on their individual behaviour and that of any group they may be part of within the site.⁴⁷³ *Quakle* employed a unique borrower ranking system, categorising borrowers into groups A to D based on their perceived repayment capacity.⁴⁷⁴ These rankings were intended to help lenders assess the risk associated with lending to different borrowers. The groups were ranked in descending order of repayment capacity, with Group A considered the most reliable and Group D the least.⁴⁷⁵ According to *Quakle's* expectations, borrowers in groups A and B were projected to have default rates of no more than 1%. This low expected default rate was based on the assumption that borrowers

⁴⁷¹ Marc Shoffman, ‘Understanding P2P Default Data’ (*P2Pfinance*, 12 August 2022) <<https://alternativecreditinvestor.com/2022/08/12/understanding-p2p-default-data/>> accessed 2 November 2023.

⁴⁷² Sam Dunn, ‘Fears Grow over Safety of ‘Peer-to-Peer’ Saving after Lender Quakle Goes Bust’ (*ThisisMoney*, 7 December 2011) <<https://www.thisismoney.co.uk/money/saving/article-2070817/Savings-fears-loan-firm-Quakle-goes-bust.html>> accessed 19 August 2023.

⁴⁷³ Wiseclerk, ‘Quakle-Exotic Newcomer in Britain’s P2P lending’ (*P2P-banking*, 2010) <<https://www.p2p-banking.com/countries/uk-quakle-exotic-newcomer-in-britains-p2p-lending/>> accessed 19 August 2022.

⁴⁷⁴ *Ibid.*

⁴⁷⁵ *Ibid.*

in these groups had strong social media profiles and positive rankings within the platform's community. Borrowers in groups C and D were expected to have slightly higher default rates, but still no more than 3%.⁴⁷⁶ However, those default rates were too good to be true and were proved to be far from the real default rate.⁴⁷⁷

Such high default rates can be seen as indicative of flaws in its business strategy, leading to the platform being eliminated by the market. However, despite the expected 1%-3% default rate being merely an estimate rather than a guarantee, P2P lenders based their investment decisions and expectations on this data. While default rates exceeded expectations to an extraordinary degree, the platform was not required to bear any responsibility for its almost completely inaccurate estimations; all default losses were borne by the lenders.

Quakle's collapse in 2011 served as a wake-up call for many other platforms, prompting them to adopt more cautious risk control methods and use more reliable data sources. Besides, since 2014, the FCA's regulatory rules have mandated information disclosure requirements for platforms, reducing the likelihood of misleading lenders. However, this case demonstrates that similar to what happened in China, P2P platforms in the UK also caused lenders to suffer far greater losses than expected due to high default rates before the implementation of specialised regulatory measures.

Additionally, although FCA regulations require platforms to disclose related information on loans, platforms are still not responsible for borrowers' defaults under any circumstances.

⁴⁷⁶ *Ibid.*

⁴⁷⁷ *Ibid.*

Therefore, despite excessively high default rates eventually leading to platform unsustainability, there remains a moral hazard: platforms may inflate borrower credit ratings to achieve higher short-term profits. This links to another type of risk for lenders, which is generated by the platform.

b. Risks generated by Platforms

As described in Chapter 3, the risks generated by platforms can be categorised into two scenarios. The first scenario involves the platform closing down. The collapse of a platform does not mean the lenders will incur an overall loss on outstanding loans moving forward, because the borrowers' obligation of repayment is not affected by the platform's closure. However, as explained in Chapter 3, a platform's closure increases the risk for lenders in that they may not receive some or all of the repayments, especially when a platform goes bust in apparent disgrace such as when many bad debts have been hidden or there are accusations of mis-selling, fraud, and negligence. The second scenario is the platform's default, with the most significant issue being the misappropriation of funds from client accounts. What happened to *Lendy* illustrates both of those two risks.

Lendy's collapse, which is the largest failure to date in the UK's P2P lending sector,⁴⁷⁸ serves as an example of harm to lenders. *Lendy* entered the P2P lending sector in 2013, focusing primarily on business loans for property developers to purchase sites. Those loans were

⁴⁷⁸ Nicholas Megaw, 'UK Property Finance Company Lendy Collapses' (*Financia ITimes*, 24 May 2019) < <https://www.ft.com/content/3ca77892-7e48-11e9-81d2-f785092ab560> > accessed 29 May 2024.

secured against property or land, with the loan-to-value ratios ranging from 11-70%. Most of the interest return was 1% per month and the loan durations were between 3-12 months.⁴⁷⁹

Secured loans backed by property or land led many people to believe that lending via *Lendy* was safe. However, this perception was misguided due to the very high risk associated with *Lendy's* operation and risk management. For example, many borrowers did not yet have planning permission when they applied for and received loans. *Lendy* charged high fees to these high-risk borrowers to make greater profits. The default rate of the loan book was 60%,⁴⁸⁰ indicating that the platform was not able to fulfil its asserted returns to many lenders.⁴⁸¹ This failure in risk management culminated in *Lendy* entering administration in 2019.⁴⁸² When it went into administration following an announcement by the FCA in May 2019, there were around 20,000 lenders with a total of £165 million invested via *Lendy*.⁴⁸³ In November 2020, £117 million was still outstanding and most of them were bad debts.⁴⁸⁴

Moreover, in the case, *Lendy v Brooke & Others*,⁴⁸⁵ former directors of *Lendy* were accused in a High Court civil claim of misappropriating £6.5 million through offshore accounts. The claim

⁴⁷⁹ *Ibid.*

⁴⁸⁰ Money&Co, 'Life After Lendy - Why Well-Managed P2P Really Works' (*Money&Co*, 12th June 2019) <<https://www.moneyandco.com/blog/10538/life-after-lendy-why-well-managed-p2p-really-works>> accessed 1 November 2023.

⁴⁸¹ *Ibid.*

⁴⁸² FCA (n 447).

⁴⁸³ Jean Galea, 'Lending Platform Lendy goes Bust-Lesson Learnt' (*Jean Galea*, 15 March 2022) <<https://jeangalea.com/lending-platform-lendy-goes-bust-lessons-learnt/#comments>> accessed 1 November 2023.

⁴⁸⁴ *Ibid.*

⁴⁸⁵ *Lendy Ltd v Brooke & Ors* [2020] EWHC 1475 (Ch).

was settled through a confidential agreement in October 2022, and it was later disclosed that the total amount repayable to *Lendy* was approximately £3.4 million.⁴⁸⁶ Also, the judge in the case stated that *Lendy* had misappropriated default interest for its own use.⁴⁸⁷

Lendy's issues with risk management and the misappropriation of customer funds not only harmed consumer interests but also highlighted the risks of the P2P industry in the UK market. It reflects the difficulty for consumers to detect flaws in a specific platform's operations and risk management methods before defaults occur. Moreover, although there were regulatory requirements for the management of customer accounts, these regulations could not prevent platforms from engaging in non-compliant activities.

Another example of platform failure is *Funding Secure*, which encountered internal issues in 2018, including missing funds from its client account.⁴⁸⁸ It went bust and entered administration in October 2019⁴⁸⁹, with around £80 million outstanding in 470 loans.⁴⁹⁰ As of May 2023, the realisations totalled nearly £50 million, including an administration fee of approximately £883K.⁴⁹¹

⁴⁸⁶ Mouse in the Court, 'Lendy v Brooke & Others – The Marshall Island Mystery' <<https://mouseinthecourtroom.wordpress.com/2021/05/29/lendy-ltd-v-brooke-others-the-case-so-far/>> accessed 29 November 2023.

⁴⁸⁷ *Lendy Ltd, Re* [2021] EWHC 2285 (Ch).

⁴⁸⁸ Cliff D'Arcy, 'P2P Site FundingSecure Collapse: 10 Thing You Need to Know Today', (*4thway*, 24 October 2019) <<https://www.4thway.co.uk/candid-opinion/funding-secure-collapse/>> accessed 1 November 2023.

⁴⁸⁹ FCA, *FundingSecure Ltd Enters Administration* (FCA, 23 October 2019) <<https://www.fca.org.uk/news/news-stories/fundingsecure-ltd-enters-administration>> accessed 1 November 2023.

⁴⁹⁰ D'Arcy (n 488).

⁴⁹¹ Alternative Credit Investor, 'FundingSecure Realisations Near £50m' (*ACI*, 26 May 2023) <<https://alternativecreditinvestor.com/2023/05/26/fundingsecure-realisations-near-50m/>> accessed 20 May 2024.

The cases demonstrate that losses resulting from platform failures or unauthorised misappropriation of client accounts also occur in the UK market. In response to these issues, the FCA has implemented new, stricter regulatory requirements for platforms since 2019, which provide a higher standard for protecting consumers although they were criticised as being too burdensome for platforms.⁴⁹²

c. Securitisation

Some UK P2P lending platforms, such as *Funding Circle*, have securitised P2P loans to expand their businesses and avenues.⁴⁹³ P2P loan securitisation, which originated in the US market⁴⁹⁴, involves pooling P2P loans into an SPV by P2P investors.⁴⁹⁵ As P2P platforms act as originators, this can accelerate market growth by increasing the volume of loans they originate.⁴⁹⁶ Also, this additional layer of intermediation takes place outside the platform and aligns, to some extent, with the concept of creating a secondary market for P2P loans; it has been promoted by some platforms.⁴⁹⁷

⁴⁹² FCA, PS19/14.

⁴⁹³ Thomas Hale, 'Funding Circle to Tap Securitisation Market' (Financial Times, 14 April 2016) <<https://www.ft.com/content/69f32f55-ce38-3fdf-8474-74cadc31f9>> accessed 17 July 2023.

⁴⁹⁴ John Timperio, 'The Emergence of P2P Loan Securitizations' (*Law360*, 22 September 2014) <<https://www.law360.com/articles/579749/the-emergence-of-p2p-loan-securitizations>> accessed 29 May 2024.

⁴⁹⁵ Wenjing He, 'Risk Mechanism and Supervision of P2P Lending Asset Securitization Under the Background of Big Data' in M Atiquzzaman, N Yen and Z Xu (eds), *2021 International Conference on Big Data Analytics for Cyber-Physical System in Smart City* (Springer, 2022) 53-63.

⁴⁹⁶ Bavoso (n 42).

⁴⁹⁷ *Ibid.*

However, as stated by Bavoso, securitising P2P loans raises questions of interconnectedness and systemic risk.⁴⁹⁸ All types of securitisations carry the risk of moral hazard, where the originator may seek to offload low-quality assets onto investors.⁴⁹⁹ Due to the low entry barriers of P2P lending, the average quality of loans and the risk management capabilities of platforms are inherently lower than those in the banking industry.⁵⁰⁰ Consequently, the risks associated with securitisation might be amplified in the P2P sector. Also, the repackaging of P2P loans further complicates the assessment of the credit risk of the underlying loans.⁵⁰¹

The securitisation of P2P loans also occurred in China's P2P market.⁵⁰² However, due to more severe issues with platforms in China's P2P lending market, the risks associated with securitisation were overshadowed by the default risks of the platforms and did not attract much attention. However, for any P2P market that aims to develop in a healthy and sustainable manner over the long term, the risks associated with securitisation should be noticed by the regulation.

⁴⁹⁸ *Ibid.*

⁴⁹⁹ Thierry Balzacq, 'Securitisation Theory: Past, Present, and Future' (2019) 51 *Polity* 331.

⁵⁰⁰ Bavoso (n 42).

⁵⁰¹ *Ibid.*

⁵⁰² Jin Ran and Hao Zhang, 'P2P 类资产证券化法律分析: 以 PPMONEY“安稳盈”为对象' [Legal Analysis of P2P Asset Securitisation: A Case Study of PPMONEY] (*Wusongyuedu*) <<http://victory.itslaw.cn/victory/api/v1/articles/article/b9516510-0f06-4377-953a-09b7e836023e>> accessed 3 May 2024.

5.3 Regulation of P2P Lending in the UK

P2P lending has been treated as a form of consumer credit by the UK government, so it was previously regulated under the consumer credit framework by the Office of Fair Trading. P2P platforms were required to obtain a consumer credit licence before they could operate.⁵⁰³ This differs from the approach in the US and China. In the US, P2P lending falls under securities regulation.⁵⁰⁴ In China, P2P lending was treated solely as innovative online lending and did not fit into any existing regulatory framework.

Although P2P lending is seen as consumer credit, P2P borrowers that are companies fall outside the scope of regulation under the Consumer Credit Act 1974.⁵⁰⁵ Thus, P2P lending could not simply be covered by the existing regulations at the time. The first specific regulation for P2P lending is that, since July 2013, P2P lending has been included in the regulated activities under article 36H, “operating an electronic system in relation to lending”, of the Regulatory Activities Order.⁵⁰⁶

On 1 April 2014, the regulatory body for consumer credit was transferred to FCA and all P2P lending platforms have needed full regulatory permissions from FCA since then.⁵⁰⁷ Within the

⁵⁰³ Office of Fair Trading, *Irresponsible Lending – OFT Guidance for Creditors*, OFT 1107 (March 2010) para 4.1

⁵⁰⁴ Jack R Magee, ‘Peer-to-Peer Lending in the United States: Surviving after Dodd-Frank’ (2011) 15NC Banking Inst.139.

⁵⁰⁵ HM Treasury ‘A New Approach to Financial Regulation: Transferring Consumer Credit Regulation to the Financial Conduct Authority’ (March 2013) 34.

⁵⁰⁶ FSMA 2000 (Regulated Activities) (Amendment) (No.2) Order 2013 (SI 2013/1881), article 36H.

⁵⁰⁷ FCA, ‘FCA Confirms New Rules for P2P Platforms’ (4 June 2019) <<https://www.fca.org.uk/news/press-releases/fca-confirms-new-rules-p2p-platforms>> accessed 6 October 2023.

most recent integrated regulatory framework spanning Supervision, Policy, and Competition at FCA in 2024, P2P lending is regulated by the Consumer Investments Directorate.⁵⁰⁸

As regulated firms by the FCA, P2P lending platforms must comply with the rules set out in the FCA Handbook.⁵⁰⁹ In addition, since 2014, the FCA has released three regulatory policy statements that introduced specific regulations for P2P lending by amending existing regulations within the Handbook. They regulate P2P lending platforms focusing on capital requirements, safeguarding client money, disclosures and promotions and wind down plans in the event of a platform's failure. The following sections will provide an overview of Article 36H and those three policy statements related to regulating P2P lending.

5.3.1 Article 36H

According to Article 36H, operating an electronic system in relation to lending is enabling two persons to become the lender and borrower under an article 36H agreement.⁵¹⁰ The operator's system is capable of deciding which agreements should be made available to lenders and borrowers, based on general instructions given to the operator by lenders or borrowers.⁵¹¹

⁵⁰⁸ FCA, 'Portfolio Letter: FCA Expectations for Loan-based Peer-to-Peer Lending Platforms' (FCA, 15 January 2024) <<https://www.fca.org.uk/publication/correspondence/expectations-loan-based-peer-to-peer-lending-portfolio-letter.pdf>> accessed 19 May 2024.

⁵⁰⁹ FCA, 'Handbook of Rules and Guidance' (20 July 2022) <<https://www.fca.org.uk/about/how-we-regulate/handbook>> accessed 19 May 2024.

⁵¹⁰ FSMA 2000, article 36H (1).

⁵¹¹ *Ibid.*

Article 36H specifies activities that are regulated, covering all stages of a P2P lending process. This includes presenting or offering 36H agreements to persons with the intention of them becoming borrowers or lenders;⁵¹² providing borrowers' relevant financial information to lenders⁵¹³; taking actions to collect a debt owed under a 36H agreement;⁵¹⁴ performing duties or enforcing rights on behalf of the lender under a 36H agreement;⁵¹⁵ determining whether a credit information agency holds information relevant to the financial status of an individual or related party;⁵¹⁶ determining the content of such information;⁵¹⁷ ensuring that any corrections, omissions, or modifications are made;⁵¹⁸ ensuring that the credit information agency stops holding such information/ does not provide it to others.⁵¹⁹

Article 36H formally acknowledges the P2P lending industry by designating it as a regulated activity. Then, in 2014, the FCA released the policy statement "The FCA's regulatory approach to crowdfunding over the Internet and the promotion of non-readily realisable securities by other media (PS14/4)" which outlines detailed rules for regulating P2P lending platforms.

⁵¹² *Ibid* (3)(a).

⁵¹³ *Ibid* (3)(b).

⁵¹⁴ *Ibid* (3)(c).

⁵¹⁵ *Ibid* (3)(d).

⁵¹⁶ *Ibid* (3)(e).

⁵¹⁷ *Ibid* (3)(f).

⁵¹⁸ *Ibid* (3)(g).

⁵¹⁹ *Ibid* (3)(h).

5.3.2 The FCA’s Regulatory Approach to Crowdfunding Over the Internet, and the Promotion of Non-readily Realisable Securities by Other Media (PS14/4)

PS14/4 introduced a regulatory framework for P2P lending (and equity crowdfunding) by amending existing financial regulation rules within the FCA’s handbook. It is the first regulatory framework for P2P lending in the UK, establishing several definitions regarding concepts in P2P lending and tailoring some rules according to the features of the P2P lending business model and its social impact.

(1) Glossary of definitions

Several new terms have been introduced, such as “P2P agreement,” “loaned funds,” and “operating an electronic system in relation to lending.”⁵²⁰ The most significant of these is the definition of a P2P agreement, which aligns with Article 36H of the Regulated Activities Order. The definition clarifies that participants in P2P lending can be either natural persons or bodies of persons. Therefore, it uses the term “person” rather than “individual”, as “person” is typically interpreted legally to include both corporations and individuals. Also, in the FCA’s handbook, a “person” encompasses a body of persons, whether corporate or incorporated, not just natural persons.⁵²¹

There is a £25,000 cap on the amount a lender can provide when the lender is not a natural person but the borrower is. This limitation is designed to prevent corporate lenders from using their larger financial resources to disadvantage individual lenders. By imposing this restriction,

⁵²⁰ PS14/4 Annex A.

⁵²¹ FCA, *Handbook*. S.12.2.

the definition ensures a level playing field between business and individual lenders, preserving the core principles of P2P lending.

However, since businesses can be both P2P borrowers and P2P lenders, and many platforms distribute a single investment across different borrowers, situations may arise that do not comply with the definition of a P2P agreement under Article 36H, namely, business-to-business lending. In the FCA's Consultation Paper 16/4, all non-Article 36H agreements in P2P lending are referred to as "B2B agreements" (as opposed to "P2P agreements").⁵²² Some regulations for P2P lending encompass B2B agreements facilitated by P2P lending platforms. For instance, regarding client asset management, the regulation pertains to "*money which was received or held in the course of or in connection with the operation of an electronic system in relation to lending*"⁵²³, rather than being limited solely to money related to P2P agreements.

(2) Senior management arrangements, systems and controls (SYSC)

Under section 4.1.8 of PS14/4, P2P lending platforms are required to take reasonable steps to ensure that there are arrangements in place to continue managing and administering P2P agreements according to the contract terms if the platform ceases to carry out the regulated activity.⁵²⁴

⁵²² FCA, *Loan-based Crowdfunding Platforms and Segregation of Client Money* (Consultation Paper, CP16/4, January 2016) 2.2.

⁵²³ *Ibid.*

⁵²⁴ PS14/4, 4.1.8

However, there are no standard requirements for the platforms to follow. This leaves platforms with the freedom to decide the level of protection they offer to users in case of insolvency. The benefit of this approach is that platforms can flexibly arrange their insolvency plans based on their specific circumstances. For market competition purposes, some platforms might adopt higher standards to attract more consumers. However, the absence of detailed standards may make it difficult to ensure that platforms have implemented reasonable insolvency arrangements. If a platform fails to comply with this regulation, it is highly likely that the FCA will not discover this until the platform has already entered insolvency proceedings, at which point it would be too late.

(3) Interim Prudential Sourcebook for Investment Business

The prudential requirements for P2P platforms are very detailed and demonstrate the process for calculating the total value of loaned funds, available financial resources, and any subordinate debt. These rules also consider the scenario where a platform engages in multiple regulated activity. Platforms are required to adhere to rigorous accounting standards when assessing their assets and liabilities in their annual financial statements. They must ensure they can meet their liabilities as they become due and maintain financial resources that are consistently above the required thresholds.⁵²⁵

The most significant requirement in this section is the capital adequacy requirement, which mandates P2P lending platforms to maintain mandatory regulatory capital to absorb potential financial shocks and offset operating losses. The required amount will be the higher of:

⁵²⁵ PS14/4, 3.6.

“a) A fixed minimum amount of £20,000 (between 1 April 2014 and 31 March 2017) or £50,000 (from 1 April 2017).

b) 0.2% of the first £50 million of the total value of loaned funds outstanding;

0.15% of the next £200 million of the total value of loaned funds outstanding;

0.1% of the next £250 million of the total value of loaned funds outstanding;

0.05% of any remaining balance of the total value of loaned funds outstanding

above £500 million.”⁵²⁶

The capital requirements for P2P lending platforms are much less stringent than those for banks and other deposit-taking financial institutions, which are required to hold a Common Equity Tier 1 capital ratio of 4.5%, a Tier 1 capital ratio of 6%, and a total capital ratio of 8%.⁵²⁷ This indicates a consideration of the distinctive features of P2P lending compared to the banking sector.

These requirements aim to ensure that platforms operate responsibly and consistently track their financial resources. They can help ensure adequate financial resources, cover operational and compliance shortcomings, address redress payments, reduce the risk of funding shortfall, and prevent instances of platform failure to some extent. Unlike insolvency arrangements, these requirements offer greater certainty to platforms by clearly defining the method for calculating capital requirements, instead of leaving it to the platforms’ discretion.

⁵²⁶ FCA, *Interim Prudential Sourcebook for Investment Businesses*, C12.2.4.

⁵²⁷ BoE, *Instructions for Reporting on Own Funds and Own Funds Requirements* (effect from 1 January 2022)1.4.1. Capital Requirements Regulation (575/2013), Article 92.

(4) Conduct of Business Sourcebook

The amendment in this module is that operating an electronic system in relation to lending is subject to the conduct of business rules. It provides platforms with examples of the types of information they should offer to lenders to clarify the particular characteristics and risks associated with P2P agreements, including expected and actual default rates; assumptions used in determining expected rates; loan risk assessment process; details of the creditworthiness assessment of the borrower; information on any security that benefits the P2P agreement; a fair description of the likely actual return, considering fees, default rates, and taxation; an explanation of how tax liability for lenders from P2P agreements is calculated; the firm's procedure for handling loans in a late payment or default; the procedure for lenders to access their money before the P2P agreement term expires; an explanation of what happens if the firm fails.⁵²⁸ This highlights the regulation's focus on protecting lenders by ensuring they receive clearer and more comprehensive information.

Information disclosure plays a critical role in protecting consumers in the P2P lending market. When platforms provide accurate, comprehensive, and transparent information, it enables consumers to make informed decisions. Effective information disclosure helps mitigate the inherent risks in P2P lending by ensuring that consumers understand the potential returns and associated risks, including default rates and the financial health of the borrowing entities. Although a transparent market and sufficient information do not necessarily guarantee that lenders will always make reasonable investment decisions, as discussed in Chapter 3, market

⁵²⁸ PS14/4, 14.3.7A.

transparency is essential for consumer protection, particularly in regulations that do not lean toward hard paternalism.

(5) Client Assets Sourcebook (CASS)

This section brings P2P lending under the regulatory framework of CASS 7 and 7A. Financial firms managing client funds related to investment activities are subject to the FCA's CASS client money rules. These regulations require that such firms ensure adequate safeguards are in place for the money they handle on behalf of their clients. Therefore, when designing their lending and repayment procedures, P2P lending platforms must comply with the CASS 7 and 7A rules. This includes the separation of client funds, the establishment of statutory trusts for client money, and the retrieval of relevant information in the event of insolvency to facilitate the prompt return of client funds.⁵²⁹

The inclusion of P2P lending under CASS 7 and 7A represents a significant step toward enhancing consumer protection in the P2P lending sector. The requirement for the segregation of client money and the establishment of statutory trusts provides a clear framework for safeguarding client funds and reducing the risk of mismanagement or misuse. Additionally, the provisions for insolvency benefit clients in that they can expect a timely return of their money, thereby increasing trust in the P2P lending market.

However, the *Lendy* case demonstrates that the effectiveness of these measures largely depends on the rigorous enforcement and compliance monitoring by the FCA, as well as the

⁵²⁹ CASS,1.

willingness of P2P platforms to adhere to these stringent regulations. It is difficult for consumers or others to detect non-compliant behaviour in this regard.

(6) Supervision Manual

This section includes requirements for P2P firms to submit information to the regulator, including annual reports and accounts, balance sheets, income statements, capital adequacy, client money and client assets, securitisation details, and information on P2P agreements.⁵³⁰

These rules assist the FCA in monitoring the operational status of platforms. They not only contribute to market stability but also facilitate the updating of regulations when necessary.

(7) Cancellation right

The lenders' cancellation rights are derived from the "right of withdrawal" in Distance Marketing Directive (2002/65) (DMD)⁵³¹. In this amendment of the FCA Handbook, P2P platforms without a secondary market must meet one of the following two requirements: *"a P2P firm may allow consumers to invest in loan agreements immediately but, when requested, it should repay consumers with their money within the first 14 days; or consumers will not be able to invest money in loan agreements within the first 14 days after they register with a P2P platform"*.⁵³²

⁵³⁰ PS14/4, Annex F.

⁵³¹ Directive 2002/65/EC of the European Parliament and of the Council of 23 September 2002 concerning the distance marketing of consumer financial services [2002] OJ L271/16.

⁵³² CONC11.2.3

The right to cancel provides consumers with the ability to reconsider their investment decisions in the early days of their registration on a platform, thereby alleviating potential negative effects for lenders caused by impulsive investments.

(8) Dispute resolution

The dispute resolution rules do not mandate a specific complaints procedure for platforms. Instead, they allow platforms to develop processes that are appropriate for their business model. Additionally, P2P lenders and borrowers can seek recourse through the Financial Ombudsman Service (FOS) for complaints about platform services.

However, there is no provision for P2P consumers to file complaints against each other, which differs from platforms facilitating C2C transactions, such as *eBay*. This indicates that the FCA does not treat P2P lending as a C2C business. As discussed in Chapter 2, although P2P lending is often referred to as the “*eBay* for money,”⁵³³ it plays a more significant role in consumers’ decisions, distinguishing it from typical C2C businesses. The absence of resolution rules for disputes among consumers implies that consumers must rely heavily on platforms to address this type of issue. This increases the dependence of consumers on the platforms.

5.3.3 Loan-based (‘peer-to-peer’) and Investment-based Crowdfunding Platforms:

Feedback to CP18/20 and Final Rules (PS19/14)

As the P2P industry developed, the inherent risks gradually became apparent. FCA observed some “poor business practices” that could harm consumers and then released new

⁵³³ Holf (n 49).

regulations based on consultations.⁵³⁴ To better protect consumers and address emerging market risks, the FCA introduced new regulatory rules in 2019 by releasing “Loan-based (‘peer-to-peer’) and investment-based crowdfunding platforms: Feedback to CP18/20 and final rules (PS19/14)”⁵³⁵. It amended and added rules to the PS14/4 regulation also by amending the FCA handbook. New rules in PS19/14 are stricter than PS14/4, focusing on issues relating to risk management framework; governance; wind-down arrangement; resolution manual; prudential requirements; disclosure requirements; contingency funds and commencement arrangements.⁵³⁶ In addition, as the FCA noticed the diversification of P2P lending models, with some platforms including residential mortgage loans in their business operations, the new regulations have incorporated specific rules for this sector, which had not been previously regulated specifically.⁵³⁷ Furthermore, the new rules specify that any non-P2P agreement facilitated by P2P lending platforms and included in a P2P portfolio is also subject to these requirements.

(1) Amendment to the glossary of definitions

Amendment in this module clarifies four key aspects related to P2P lending. Notably, the standardised definition of default provides clear guidance for the industry and establishes a clear understanding for consumers regarding what would be a default: for P2P agreements not secured by property, a default occurs when the borrower is more than 90 days past the

⁵³⁴ FCA, *Loan-based (‘peer-to-peer’) and investment-based crowdfunding platforms: Feedback on our post-implementation review and proposed changes to the regulatory framework* (Consultation Paper, CP18/20, 2018).

⁵³⁵ FCA, PS/19/14

⁵³⁶ *Ibid*, 2.

⁵³⁷ *Ibid*, S4.

contractual payment due date; for P2P agreements secured by property, a default occurs when the borrower is more than 180 days past the contractual payment due date.⁵³⁸

In addition, the definitions concerning price, management, and supervision reflect the FCA's more comprehensive approach to various aspects of the P2P industry, including consideration of the second market existing in P2P lending, thereby enhancing the clarity of the regulatory framework.⁵³⁹

(2) Risk management framework

The FCA finds that disclosure-based regulations are insufficient to ensure the fair pricing of loans. Therefore, platforms that price loans on behalf of lenders are required to conduct credit risk assessments on borrowers. The minimum standards for risk management are standardised, including obtaining sufficient information about the borrower, categorising borrowers by their credit risk, and setting the price of the agreement to reflect the borrower's risk profile.⁵⁴⁰

It also requires that a platform assesses the value of each P2P agreement at least in the following situations: when a P2P agreement is originated; when the platform believes the borrower is unlikely to fulfil their obligations under the P2P agreement without the platform

⁵³⁸ *Ibid.*

⁵³⁹ *Ibid.*

⁵⁴⁰ *Ibid*, S2.

having to take actions such as realising security; following a default and when the platform is facilitating a lender exit the P2P agreement before its maturity date.⁵⁴¹

The measures implemented aim to ensure the fair pricing of loans, thereby mitigating risks, particularly those arising from some platforms underestimating the risks when offering more competitive but unsustainable loan prices. By mandating reviews of loan valuations at key points, potential issues can be identified early, enabling timely corrective actions. However, these requirements may increase operational costs for P2P platforms and create a significant compliance burden. This additional cost could result in higher rates for borrowers and lower returns for lenders.

(3) Marketing Restrictions

Marketing restrictions help ensure that only consumers who can comprehend the risks and manage the potential outcomes invest in P2P agreements, thereby preventing the most vulnerable lenders from excessive risk exposure.

There are two restrictions. First, P2P platforms can only directly offer financial promotions to clients who are certified high-net-worth investors; certified or self-certified sophisticated investors and certified restricted investors.⁵⁴² Second, there is an investment cap for individuals classified as 'restricted investors', limiting them to investing a maximum of 10% of their net investable assets in P2P agreements during the initial 12 months.⁵⁴³ This restriction

⁵⁴¹ COBS 18.12.16.

⁵⁴² *Ibid*, 2.21.

⁵⁴³ *Ibid*, 2.26.

demonstrates that the regulation treats P2P lenders in a differentiated manner, based on their diverse levels of experience and assets, thereby yielding dissimilar degrees of investment freedom.

On one hand, this restriction can protect less experienced consumers from significant losses and can be viewed as a compromise between safeguarding consumers and preserving individuals' freedom in participating P2P lending. On the other hand, it raises concerns about limiting potential lenders' ability to familiarise themselves with the P2P asset class and investing in P2P loans. Also, this restriction could create an impression in lenders of heightened levels of risk in P2P lending and make it more difficult for P2P lending platforms to compete in the lending service market.

(4) Appropriateness assessment

The aim of the appropriateness assessment is similar to market restriction. It is to evaluate whether a consumer possesses the requisite knowledge and experience to comprehend the risks associated with the investment, thereby allowing the platform to determine if the proposed service or product is suitable for the client.⁵⁴⁴

The assessment is required to take place before any investment is made and there is a specific guidance on the risk factors to be covered in an appropriateness assessment. The amendment of COBS 10 mandates that P2P platforms evaluate whether retail customers have the required experience and understanding of the risks involved in the offered or requested product.⁵⁴⁵ It

⁵⁴⁴ *Ibid*, S2.

⁵⁴⁵ *Ibid*.

also requires P2P platforms to keep records of these appropriateness assessments.⁵⁴⁶ However, although the objective is to ensure that only consumers who are able to comprehend and bear risks should invest in P2P lending, it does not prevent P2P platforms from selling products to customers or executing customer transactions, even if the assessment indicates that the product may not be appropriate, provided the customer still wishes to proceed.⁵⁴⁷

This means that the regulation in this area aims to ensure that consumers are aware of the risks and understand whether the investment is suitable for them, but it does not force them to make specific decisions. In situations where a consumer is aware of the risks and recognises that the investment does not align with their risk preferences but still chooses to invest based on their personal decision, the regulation does not intervene in their choice. Thus, this remains an information disclosure-based approach, which differs from a paternalistic regulatory approach that limits a person's liberty or autonomy to promote their own good.

(5) Governance

P2P lending platforms are required to maintain independent risk management and internal audit functions.⁵⁴⁸ Additionally, they must have an independent compliance function unless they can demonstrate that such a function is disproportionate.⁵⁴⁹ These measures are intended to ensure that platforms operate in a more orderly and transparent manner, thereby

⁵⁴⁶ *Ibid.*

⁵⁴⁷ *Ibid.*

⁵⁴⁸ *Ibid.*, 2.1.2-2.2.4.

⁵⁴⁹ *Ibid.*

enhancing consumer confidence and reducing potential risks. However, implementing these requirements would significantly increase the operational costs of these platforms, which could affect their competitiveness and pricing strategies.

(6) Wind-down arrangements

P2P platforms are required to have a wind-down procedure in place and to disclose a summary of this procedure before any investment is made. They are required to demonstrate that, even if they cease providing P2P lending services, suitable arrangements are in place to manage all existing loans and investments they have provided.⁵⁵⁰

The insolvency of certain firms in any industry is inevitable in a highly competitive market, but not every financial service firm is required to have a wind-down plan. However, in the context of P2P lending, this requirement is important for protecting consumers. As P2P loan agreements are made between lenders and borrowers, with the platform not being a party to the contract, the collapse of a P2P lending platform does not directly result in financial losses for the lenders utilising that platform. However, individual lenders may face significant difficulties in managing their loans if their online platform ceases to exist. In most cases where contracts are made electronically, lenders do not even know the identity of the borrowers. Additionally, it is typical for a lender to hold just a small portion of a P2P loan, which may be crowdfunded by numerous other lenders. Therefore, the consumer protection requirements for the insolvency arrangements of P2P platforms should be quite different from those for other financial institutions and the wind-down plan is significant.

⁵⁵⁰ *Ibid*, 2.41-2.43.

However, a wind-down plan does not equate to a reassuring guarantee for post-insolvency arrangements. Even if a platform becomes insolvent due to normal business mismanagement and financial shortfalls, it may still face issues such as employee attrition, which could prevent it from executing the wind-down plan as intended. Furthermore, some platforms may engage in illegal operations before closing down, rendering the conditions necessary for the wind-up plan unattainable. Nevertheless, a detailed wind-down plan can provide consumers and regulators with more relevant information on a platform, ensuring that post-insolvency affairs are handled in a more orderly manner. It can be beneficial for consumers, the platforms, and the healthy development of the industry to a certain extent.

(7) Information disclosure

The minimum information and disclosures that platforms must provide to consumers are established, including information regarding *“the role of the platform, the practical impact of providing a direct loan(s) to borrower(s) under a P2P agreement, and the investment”*.⁵⁵¹

Information disclosure requirements have always been a significant factor in the FCA's regulation of P2P lending, as adequate information is the foundation for P2P lenders to make rational decisions. The requirements for information disclosure here are more specific and clearly define the content that needs to be disclosed, making it easier for consumers to access relevant information. However, there is no standardising of information disclosure because the diversity of the P2P lending model makes it difficult to develop.

⁵⁵¹ *Ibid*, 2.36.

(8) Regulation on P2P mortgage loans

P2P lending platforms that facilitate home financing agreements and where at least one of the investors is not an authorised home finance provider, are subject to the Mortgage and Home Finance Conduct of Business sourcebook (MCOB) regulatory requirements.⁵⁵² These include assessing consumers' affordability, managing arrears, payment shortfalls, and repossessions, adhering to disclosure rules, setting fees and charges, following calculation methods, conducting business appropriately and communicating financial promotions to consumers.⁵⁵³

Separating platforms that operate in home financing and placing them specifically under MCOB regulation reflects the FCA's comprehensive and practical consideration of different P2P models. However, the unique nature of P2P platforms, especially the special dependency that lenders have on these platforms, has not been considered by the regulations in MCOB.

5.3.4 Strengthening or Financial Promotion Rules for High-risk Investments and Firms

Approving Financial Promotions (PS22/10)

In 2022, FCA published “Strengthening or Financial Promotion Rules for High-risk Investments and Firms Approving Financial Promotions (PS22/10)”, which introduces stricter regulations for P2P lending as a high-risk investment and categorises it as a “restricted mass market investment”.⁵⁵⁴ There are three levels of the restrictions and P2P lending falls into the

⁵⁵² *Ibid*, S4.

⁵⁵³ *Ibid*.

⁵⁵⁴ PS22/10, C2.

middle⁵⁵⁵, meaning it is subject to a moderate level of market restrictions in financial promotions. The most significant restriction is risk warning. P2P lending platforms are required to provide consumers with specific risk warnings in a standardised format, as: *“Don’t invest unless you’re prepared to lose all your money invested. This is a high-risk investment. Take 2min to learn more.”*⁵⁵⁶

A shorter risk warning, comprising only the first sentence of the full version, is allowed exclusively when the full risk warning exceeds the word limits set by a third-party marketing provider.⁵⁵⁷ Moreover, the requirement of personalised risk warnings and associated risk summaries are also standardised.⁵⁵⁸

In essence, the approach of the risk warning is a form of information disclosure regulation designed to ensure consumers are informed about the worst-case scenarios that could occur with their investment. This approach does not constitute a stringent intervention in consumers' decision-making processes but rather encourages consumers to adopt a more rational and cautious attitude prior to making investment decisions.⁵⁵⁹ This is particularly advantageous for protecting novice lenders who lack extensive experience in P2P lending.

⁵⁵⁵ *Ibid*, C2.2.

⁵⁵⁶ *Ibid*, C3.2.

⁵⁵⁷ *Ibid*, C3.

⁵⁵⁸ *Ibid*, C3.35.

⁵⁵⁹ W.Kip Viscusi, 'Using Warnings to Extend the Boundaries of Consumer Sovereign' (1999) 23 Harvrd Journal of Law & Public Policy 211.

Other restrictions include:

- Cooling off period: first-time lenders must wait at least 24 hours before they receive a direct offer for financial promotion.⁵⁶⁰
- Banning financial promotions: this includes promotions for P2P lending that offer incentives such as refer-a-friend or new joiner bonuses, but it does not ban the dissemination of investment information.⁵⁶¹
- Helping clients better categorise themselves: consumers are required to state why they meet the relevant criteria.⁵⁶²

Therefore, if a consumer wants to be a P2P lender, they should follow these steps: 1) complete information checks; 2) receive personalised risk warning; 3) categorise themselves as a restricted investor, high net worth investor, self-certified sophisticated investor or certified sophisticated investor; and 4) have the platform assess the investment as appropriate for them. In addition, platforms are required to record various information throughout the consumer journey to assist the FCA in monitoring the regulatory effect.⁵⁶³

These regulations primarily aim to ensure that consumers possess adequate risk awareness and approach high-risk investments, such as P2P lending, with caution. However, this increases the threshold for becoming a P2P lender and may deter consumers with lower risk

⁵⁶⁰ FCA, PS22/10, C3.34.

⁵⁶¹ *Ibid*, C3.66.

⁵⁶² *Ibid*, C3.53.

⁵⁶³ *Ibid*, C3.

tolerance, which could adversely affect the P2P lending industry's ability to attract more participants (as a decrease in lenders naturally leads to fewer borrowers being served). Nevertheless, these rules have a significant impact on protecting more vulnerable consumers and ensuring they receive adequate information. Additionally, they can enhance consumers' knowledge and understanding of investment risks.

5.4 An evaluation of FCA Regulation: from a light-touch to a more interventionist approach

Research specifically focused on the regulation of P2P lending in the UK is not vast. Some of it provides affirming evaluations of the UK's P2P lending market and regulation. For example, Warren highlights that the UK's regulation on P2P lending is comprehensive.⁵⁶⁴ Also, a working paper from Asian Development Bank Institute (ADBI) concludes that the UK's regulatory framework appears to be well-balanced and suitable for the circumstances, presenting itself as an effective model to emulate.⁵⁶⁵ Although the rapid growth of the industry means that risks and issues often arise faster than new regulations can be implemented, the FCA's actions indicate a responsive approach to the industry's evolving dynamics.⁵⁶⁶

This should be attributed to the FCA's adaptive regulation, which is based on a consultative approach. Thus, it is responsive to emerging risks, capable of accommodating the evolving industry, and able to address gaps in existing regulations. For example, in PS14/4, most

⁵⁶⁴ Willam S. Warren, 'The Frontiers of Peer-to-Peer Lending: Thinking about a New Regulatory Approach' (2016) 14 *Duke Law & Technology Review* 298.

⁵⁶⁵ Naoko Memoto, David Storey and Bihong Huang, 'Optimal Regulation of P2P Lending for Small and Medium-Sized Enterprises' (2019) ADBI Working Paper 912 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3313999> accessed 2 December 2023.

⁵⁶⁶ *Ibid.*

consumer protection regulations are for the pre-contract stage, aiming to prevent issues that limit consumers' ability to make informed decisions. To address the post-contractual stage, PS19/14 introduces rules requiring platforms to establish wind-down plans and provide guidance for platforms to do so. Even though this effort does not constitute sufficient regulation for the post-contractual stage, it provides better protection for consumers and demonstrates the adaptability of the regulatory approach.

The regulatory response to the industry's development not only includes more comprehensive and detailed regulations but also demonstrates a shift from a light-touch to a stricter, more interventionist approach. As discussed in the previous section, this approach enhances the clarity and transparency of the industry in spite of increasing the operational burden and costs for platforms due to additional requirements such as risk management, governance, compliance, and appropriateness test arrangements. Also, these requirements assist regulators in monitoring the industry to detect wrongdoings by platforms at an early stage. Additionally, this approach provides better protection against unexpected and/or unaffordable losses by restricting the most vulnerable lenders from investing or investing more than a certain amount in P2P lending and likely discouraging hesitant lenders from investing through risk warnings.

In fact, the FCA's new approach to P2P lending demonstrates a consumerist narrative, which *"treats consumers as presumptively weaker parties and therefore fit for protection from abuses by stronger contracting parties"*.⁵⁶⁷ As explained in Chapter 3, P2P lenders are in a

⁵⁶⁷ *Director General of Fair Trading v First National Bank Plc* [2001] UKHL 52 [2002] 1 AC 481 [31] (Lord Steyn) discussing the Unfair Terms in Consumer Contracts Directive (93/13/EEC).

weaker position because they have to rely on the platform to acquire information, and make decisions and transactions, but bear default risks themselves. Therefore, P2P lenders, as weaker parties in P2P lending are fit for protection from unfair treatment of platforms. This is the rationale behind treating them as “incapable of informed consent to risk” as the consumerist narrative suggests.⁵⁶⁸

The previous regulation based on PS14/4 tends to reflect the arm's-length narrative, as that framework focuses on information disclosure to help consumers make informed decisions for their own interest and welfare. According to the arms-length narrative, each contractual party acts in its own interests and regulatory rules are appropriately confined to ensuring the conditions necessary for the market to function and self-regulate effectively.⁵⁶⁹ Thus, self-regulation is an important factor in the arm's length narrative.

Therefore, the dissolution of the UK's P2P lending self-regulation body can be seen as further evidence of the shift from an arm's-length narrative to a more interventionist approach. The self-regulatory body, Peer-to-Peer Finance Association (P2PFA), was founded by *Zopa*, *FundingCircle*, and *RateSetter* in 2011 with the aim of improving business conduct standards in the industry and enhancing the protection of investors using online platforms.⁵⁷⁰ By 2015, most UK platforms were P2PFA members, representing over 90% of the market share.⁵⁷¹ The

⁵⁶⁸ Benjamin (n 271).

⁵⁶⁹ *Ibid.*

⁵⁷⁰ P2PFA, 'What is the Peer-to-Peer Finance Association?' (*P2PFA*) <<http://www.p2pfa.org.uk>> accessed 5th July 2022.

⁵⁷¹ Money&Co, 'P2P Principles: Good News for Young Crowdfunding World' (*Money&Co*, 25 October 2015) <<https://moneyandco.com/news/5684/news/11318/blog/11328/platform-lending-in-review-ahead-of-ifisa-season-race-to-invest>> accessed 19 July 2022.

P2PFA had three main goals: securing favourable policy, regulation, and fiscal conditions; maintaining high standards of business conduct; and raising awareness and understanding of the benefits and risks of P2P finance. After the FCA introduced official regulatory rules in 2014, the P2PFA played a supplementary yet critical role in regulating P2P lending. However, in 2020, it announced its disbandment.⁵⁷² The reason is that with the establishment of more robust and mature regulatory rules by the end of 2019, members felt that the P2PFA had achieved its objectives as a self-regulatory body, and its relevance diminished due to the investment cap and the exit of major platforms.⁵⁷³

Then, another industry association, 36H group, was launched by *Innovate Finance* in 2020.⁵⁷⁴ However, it is not a self-regulation body but rather a “unified voice for lending platforms”.⁵⁷⁵ Membership of the 36H Group is open to all P2P lending platforms authorised and regulated by the FCA under Article 36H. The 36H group works closely with regulators, policymakers and other stakeholders as well as promoting the benefits the industry is delivering, including bringing choice, competition and transparency to the lending and investment markets.⁵⁷⁶

⁵⁷² Marc Shoffman and Suzie Neuwirth, ‘P2PFA Disbands as Platforms Establish New Group’ (*P2PFA*, 13 January 2020) <<https://alternativecreditinvestor.com/2020/01/13/p2pfa-disbands-as-platforms-establish-new-group/>> accessed 19 July 2022.

⁵⁷³ *Ibid.*

⁵⁷⁴ Innovate Finance, ‘36H Group Powdered by Innovate Finance’ (*Innovate Finance*) <<https://www.innovatefinance.com/36hgroup/>> accessed 19 July 2022.

⁵⁷⁵ Suzie Neuwirth, “Innovate Finance’s 36H Group Absorbed into Trade body” (*Alternative Credit Investor*, 2 May 2023) <<https://alternativecreditinvestor.com/2023/05/02/innovate-finances-36h-group-absorbed-into-trade-body/>> assess 1 June 2024.

⁵⁷⁶ *Ibid.*

This shift is inevitable because, with the establishment of a strict and detailed regulatory framework, self-regulation has become less necessary. Therefore, the role of the industry association moved to protecting industry interests, promoting industry development, and cooperating with the regulator.

The updated stringent regulatory measures and the dissolution of self-regulatory bodies indicate a shift in the narrative of regulating P2P lending. The arms-length narrative focuses on equality and democracy.⁵⁷⁷ However, the regulatory challenges of the P2P lending business model do not stem from issues of improving equality and democracy, but rather from how to reasonably alleviate the risk of unfair losses to P2P lenders. Due to the inclusive nature of P2P, many lenders are individuals without professional expertise or financial strength. Thus, a paternalistic approach, as included in the consumerist narrative, can be seen in the updated regulation which is more suited to the circumstances of P2P lending.

As explained by Benjamin, the ethical ambition in the consumerist narrative in financial law is to ensure fairness to consumers in the process, not the outcome.⁵⁷⁸ It prevents the possibility of unfairness, not the substantive unfair harms.⁵⁷⁹ This can explain why the P2P lenders are not protected by FSCS. In fact, from the consultation document in 2013 to the present, there has been ongoing debate and discussion about whether to include P2P loans within the scope

⁵⁷⁷ *Ibid.*

⁵⁷⁸ Benjamin (n 271).

⁵⁷⁹ *Ibid.*

of the FSCS. The FCA has consistently stated that including P2P loans in the FSCS is not appropriate, as it would significantly increase regulatory costs.⁵⁸⁰

It has been argued that FCA should focus more on the welfare outcomes for consumers rather than just procedural matters like market access and the tools for navigating choices.⁵⁸¹ This is due to the significant personal welfare losses investors may face compared to the benefits financial services firms gain.⁵⁸² This issue is also relevant in P2P lending. Although lenders' losses are not directly caused by the platforms - since defaults are made by borrowers when the platform is operating legally and not facing insolvency - platforms may encourage riskier, more expensive loans to make more profits.

However, including P2P lending in the FSCS to compensate lenders would encourage "free riders" who underestimate risks and exercise less discretion in their investment decisions, as they could shift the risk onto regulators. Although the risk of "free riders" exists in any investment, it is aggravated in P2P lending due to the lower and more inclusive threshold for lenders, who often exhibit typical herding behaviour as discussed in Chapters 2 and 3.

Since FCA cannot afford the costs to compensate for P2P lenders' losses, it chooses to focus on preventing losses rather than providing compensation. This reflects the consumerist

⁵⁸⁰ PS19/14.

⁵⁸¹ Iris H-Y Chiu, 'More Paternalism in the Regulation of Consumer Financial Investments? Private Sector Duties and Public Goods Analysis' (2021) 41 *Legal Studies* 657.

⁵⁸² *Ibid.*

narrative that the aim of regulatory protection for consumers is preventing unfair harm rather than ensuring absolutely no harm or compensating for their losses from harm.⁵⁸³

However, while the consumerist narrative does not include guaranteeing the outcome of investments, it aims to ensure that fairness extends beyond the pre-contractual stage and covers the entire investment journey of consumers. The regulatory framework, however, primarily focuses on the pre-contractual stage and the point of sale, such as warning consumers, restricting certain actions, and requiring the platform to take additional steps to reduce default risks. Although there are some post-contractual rules regarding wind-down arrangements and complaints through Financial Ombudsman Service (FOS), these pertain to the platform-customer relationship and focus on platforms' wrongdoings or closures, without sufficient consideration of the fairness among the platform, lender and borrower in the tripartite relationship. First, there is a gap in dispute resolution between lenders and borrowers. Second, the measures for information disclosure, personalised risk warnings, and suitability tests are primarily focused on the pre-contractual stage. These measures aim to help lenders enter the market with an understanding of the risks and make informed decisions. However, they do not address the need for updates on circumstances during the investment journey or the potential changes in the lenders' situations over time. In addition, although there are some regulatory concerns relating to the secondary market and the securitisation of P2P loans, there is a gap in specific regulations addressing this area⁵⁸⁴.

⁵⁸³ Benjamin (n 271).

⁵⁸⁴ Bavoso (n 42).

Another concern is whether the information for potential lenders carries too much warning thus discouraging or preventing them from P2P lending. Many empirical studies on the impact of risk warnings focus on areas related to eating habits, confirming that risk warnings can reduce consumers' consumption of unhealthy foods and increase their consumption of healthy foods. For example, Viscusi et.al. discovered the use of hazard warnings prompts consumers to take precautions.⁵⁸⁵ Machin *et al.* found that nutritional warnings led participants to choose unhealthy products less frequently.⁵⁸⁶ Adasme-Berrios found that warning labels boost the intention to avoid processed foods.⁵⁸⁷ The results of these studies highlight the effectiveness of risk warnings in modifying consumer behaviour. When consumers are presented with potentially negative consequences, they are more likely to adjust their behaviour to avoid such outcomes. However, there is little dispute that unhealthy eating negatively impacts consumers' physical health and well-being. In contrast, being a P2P lender is not inherently detrimental to any individual, especially since the investment cap has already limited the maximum loss for the most vulnerable lenders.

Last but not least, it is questionable the extent to which the FCA's regulation balances protecting consumers and promoting industry progression. Since the implementation of regulation PS19/14, there has been a reduction in the potential consumer base and an increase in the operating costs for platforms, and many players in the P2P lending industry are

⁵⁸⁵ W.Kip Viscusi, Wesley A. Magat and Joel Huber, 'Information Regulation of Consumer Health Risk: an Empirical Evaluation of Hazard Warnings' (1986)17 *Rand Journal of Economics* 351.

⁵⁸⁶ Leandro Machin and others, 'Do Nutritional Warnings do Their Work? Results from a Choice Experiment Involving Snack Products' (2019) 77 *Food Quality and Preference* 159.

⁵⁸⁷ Cristian Adasme-Berrios and others, 'Effect of Warning Labels on Consumer Motivation and Intention to Avoid Consuming Processed Foods' (2022) 14 *Nutrients* 1547.

inevitably dissatisfied.⁵⁸⁸ Some believe that financial service providers should allow customers to take risks as long as they understand them.⁵⁸⁹ For example, the chief executive of *RateSetter* described the rule as “patronizing normal people”.⁵⁹⁰ Also, *Zopa*'s announcement of its exit from the P2P industry mentioned that one of the reasons for leaving was the increased costs due to strict regulation.⁵⁹¹ However, the continuous growth of the P2P market and its performance during the pandemic indicate that industry development has not been halted by regulatory measures, although these measures have reshaped the industry.

It is arguable that the new regulations may not have effectively promoted the development of the industry, but they have not significantly impeded it either. Despite the increased costs for platforms and consequently higher prices for services, the primary advantages of P2P lending, such as low cost and financial inclusivity, have been somewhat compromised.

In summary, the key points of the evaluation encompass several aspects of the FCA's regulation on P2P lending. First, the FCA's regulation is adaptive and flexible, grounded in a consultative approach. Second, the shift from a light-touch to a more interventionist regulatory approach reflects the FCA's commitment to ensuring a transparent market and fair protection for individual lenders, as articulated by the consumerist narrative in financial law. Third, the current regulation embodies a soft paternalistic approach, yet it lacks sufficient

⁵⁸⁸ Michael Lloyd, 'Regulation: Too Much is Never Enough' (*P2P Finance News*, 14 April 2022) <<https://p2pfinancenews.co.uk/2022/04/14/regulation-too-much-is-never-enough/>> accessed 16 July 2022.

⁵⁸⁹ *Ibid*

⁵⁹⁰ Ashley Daniells, 'FCA Announces New Rules on Peer-to-Peer Lending' (*RPC*, 8 July 2019) <<https://www.rpc.co.uk/perspectives/financial-services-regulatory-and-risk/fca-announces-new-rules-on-peer-to-peer-lending/>> accessed 19 July 2022.

⁵⁹¹ *Zopa* (n 445).

measures in the post-contractual stage, highlighting areas that require further attention. Last, the regulatory challenges lie in balancing industry development with consumer protection. Under the current measures, regulation is more inclined towards protecting consumers. Although platforms are bearing an increased burden on development, the industry has not yet been significantly hindered.

5.5 Conclusion

The UK P2P lending market has demonstrated steady growth despite inherent risks and harms for lenders and the adverse impact of the COVID-19 pandemic on P2P loan liquidity. It provides an important funding source for SMEs, especially in alleviating the negative effects of Brexit on these businesses. This resilience underscores the advantages of the P2P lending model in addressing market gaps left by traditional financial institutions. Such growth is also attributed to supportive policy measures.

Despite the increased risks and the implementation of stricter regulations in 2019, which led to the exit of many platforms, the industry has shown remarkable adaptability with new and existing platforms stepping in to fill the void. However, the increasing dominance of P2P property lending raises critical concerns regarding the potential limitations on the social value of P2P lending, particularly in its role in enhancing financial inclusion.

Although the P2P lending sector has experienced significant growth, the risks for P2P lenders remain excessive, underscoring their weaker position in the lending process. To better protect lenders from unexpected and unaffordable losses, the FCA has shifted its regulatory approach from a neoliberal to a more paternalistic model. This involves applying restrictions and risk

warnings for P2P lenders and imposing additional requirements on platforms. However, this chapter finds that post-contractual protection for lenders remains insufficient. Moreover, the restrictions and enhanced risk warnings, along with the increased operational costs for platforms, could reduce the potential consumer base for P2P lending. This challenges the balance between consumer protection and industry progress.

Chapter 6 Comparison of P2P Lending Regulation Between the UK and China:

A Functional Analysis

6.1 Introduction

Based on the discussions in Chapters 4 and 5 regarding the P2P lending markets in China and the UK and their respective regulatory pathways, two key insights can be drawn. First, they experienced a similar change in regulatory ideology. Both regulators initially did not intend to intervene heavily in the development of P2P lending, valuing its role in promoting financial inclusion as an innovative financial tool. The UK regulator had adopted a light-touch approach as the regulatory framework and implemented several supportive measures, while China's regulators indirectly promoted the industry's development by leaving it unregulated during the initial years. Then, as the industry developed and the flaws in its business model became apparent, stricter regulatory measures were implemented in both countries.

Second, in these two P2P lending markets, the primary risk is the credit risk for lenders due to a borrower's defaulting or the platform not meeting customer agreement obligations. The consequences of this risk were strikingly evident in China's market and also appeared in the UK market. Accordingly, it can be observed from the regulatory frameworks that both China and the UK focus on protecting lenders from excessive credit risk. Other objectives of financial regulation, such as promoting effective market competition⁵⁹², have not been given the same importance as lender protection.

⁵⁹² John Armour and others, 'The Goals and Strategies of Financial Regulation', in *Principles of Financial Regulation* (online edn, Oxford Academic, 2016) 51.

These commonalities indicate that the overarching regulatory focus of the P2P lending markets in China and the UK is similar. However, as shown in previous chapters, the consequences of market development and consumer protection differ significantly between these two countries. China's P2P lending market was terminated after significant harm had been done to numerous individual lenders, while the UK market has been growing relatively steadily despite certain excessive risks to lenders. Given this, the chapter will examine the extent to which the regulatory strategies of China and the UK have led to these differing outcomes, and whether they can address regulatory challenges and achieve the primary regulatory focus of consumer protection. While Chapters 4 and 5 provide some analysis of these questions by discussing specific rules, this chapter will further explore the answer through a comparative approach.

Comparative law is underscored by its inherent ability to transcend the confines of a single legal landscape, enabling the incorporation of diverse perspectives through the examination of legislative and regulatory strategies from various countries.⁵⁹³ Guided by this, the main objective of the comparative study in this chapter is to examine solutions to regulatory challenges in P2P lending by employing the analytical lens of comparative law to unveil insights that might otherwise remain obscured within the scope of a single legal system. By embracing the insights derived from various legal landscapes of both countries, it aspires to contribute to the potential evolution of regulatory frameworks that are not only adaptable and forward-looking but also adept at addressing the challenges presented by the dynamic P2P lending landscape.

⁵⁹³ Uwe Kischel, *Comparative Law* (online edn, Oxford Academic 2019).

Considering the distinct differences between the legal systems of China and the UK, as well as the unique characteristics of their financial market features, this study applies the functional method to facilitate the comparative analysis. This approach places greater emphasis on the effects of law rather than doctrinal structures and strives to provide practical judicial responses to real-life situations.⁵⁹⁴ As stated in Chapter 1, the functional method is particularly well-suited in the context of P2P lending regulation because the issues inherent in P2P lending predominantly stem from the features of the P2P lending business model itself, giving rise to similar regulatory challenges that are pervasive across jurisdictions with P2P lending markets. By employing the functional method, a targeted evaluation becomes possible to determine whether regulations effectively address the specific issues arising within the P2P lending landscape and how adeptly they fulfil their designated objectives.

The justification for selecting China and the UK as comparative case studies in this thesis is threefold. First, prior to the termination of its P2P lending industry, China and the UK, together with the US, were the three largest P2P lending markets globally in terms of trading volume.⁵⁹⁵ This prominence demonstrates that these markets were notably prosperous, thereby providing richer and more comprehensive insights compared to other markets.

However, this thesis deliberately excludes the US from its comparison because the US regulatory framework treats P2P lending platforms as intermediary issuers of securities,

⁵⁹⁴ Michaels (n 18).

⁵⁹⁵ Majid Bazarbash and Kimberly Beaton, 'Filling the Gap: Digital Credit and Financial Inclusion' (2020) IMF Working Paper.

regulated under the Securities Act of 1933.⁵⁹⁶ While this model contributes to a certain degree of market stability, it departs from the approach justified in Chapters 2 and 3, which argue that P2P lending, due to its unique structure and the nature of participant relationships, requires a tailored regulatory framework rather than one originally designed for traditional financial instruments. Although securities regulation may offer valuable insights for the design of P2P lending regulation—such as in areas like prudential requirements, transparency, and licensing—it may not be optimal for achieving a balanced approach between industry development and consumer protection. Therefore, the U.S. regulatory model is considered less relevant to the objectives of this thesis, and China and the UK are regarded as more appropriate jurisdictions for comparative analysis.

Second, as stated in Chapter 1, China serves as a quintessential example of market and regulatory failure, while the UK illustrates a relatively successful and stable regulatory environment. Since P2P lending emerged as an innovative financial service without an existing regulatory structure, the initial and ongoing regulatory frameworks significantly influenced market outcomes. Therefore, the contrasting results of these two markets present an important analytical opportunity to evaluate how differing regulatory approaches can shape market performance and outcomes. The stark divergence in their trajectories—one towards failure and the other towards stability and continued growth—highlights the critical importance of regulatory design tailored specifically for P2P lending.

⁵⁹⁶ Chaffee and Rapp (n 221).

Third, the dynamic evolution of P2P lending regulations in China and the UK mirrors a broader global trend, as many countries have adapted their regulatory frameworks in response to the rapid growth of this sector. For example, in Indonesia, the financial regulator has introduced stricter provisions on lending limits and governance requirements to address the risks associated with the rapid expansion of the P2P lending market.⁵⁹⁷ In France, an initial regulatory framework was established in 2014, followed by a reform in 2016 to expand the scope and strengthen oversight.⁵⁹⁸ In addition, in 2021, the EU implemented Regulation (EU) 2020/1503, which creating a harmonised regulatory framework for crowdfunding service providers, including P2P lending platforms, across all member states.⁵⁹⁹

Therefore, the selection of China and the UK provides a compelling basis for comparative analysis, not only because of their prominence in the global P2P lending landscape, but also due to the regulatory diversity and outcomes they represent. These jurisdictions serve as illustrative case studies for examining how regulatory design shapes market behaviour and consumer welfare.

The meaning of regulation, as outlined by Baldwin *et al.*, encompasses targeted rules, all forms of state intervention in the economy, and all mechanisms of social control.⁶⁰⁰ This

⁵⁹⁷ Ashurst, 'New OJK Regulation on P2P Lending: Does it Address the Crux of the Matter' (*Ashurst*, 04 August 2022) <https://www.ashurst.com/en/insights/new-ojk-regulation-on-p2p-lending-does-it-address-the-crux-of-the-matter/?utm_source=chatgpt.com> accessed 01 March 2025.

⁵⁹⁸ Therese Torris, 'France's 2nd Regulatory Reform Enlarges the Scope of Crowdfunding & Crowdlending' (*Crowdfundinsider*, 31 October 2016) < https://www.crowdfundinsider.com/2016/10/91855-frances-2nd-regulatory-reform-enlarges-scope-crowdfunding-crowdlending/?utm_source=chatgpt.com> accessed 01 March 2025.

⁵⁹⁹ Regulation (EU) 2020/1503 of the European Parliament and of the Council of 7 October 2020 on European crowdfunding service providers for business [2020] OJ L347/1.

⁶⁰⁰ Robert Baldwin, Colin Scott and Christopher Hood, 'Introduction', in *A Reader on Regulation* (Oxford University Press 1998).

comparative study focuses specifically on regulatory rules, thus adopting the first definition: targeted rules. Although this is the narrowest of the three definitions, it is more practical for comparison purposes because the other two broader definitions are influenced much more by factors such as state ideology, economic development, culture and so forth, making them less feasible for this functional comparative analysis.

As the regulation of P2P lending in both China and the UK has undergone a series of dynamic updates and transformations, the rules used for comparison are determined as follows: for China's regulation, the main reference is the "1+3" regulatory framework. This framework is not only the most representative of China's P2P lending regulation but also governed the industry during its most prosperous era. Moreover, other regulations from different phases are considered where relevant. Additionally, consumer protection laws are discussed to illustrate the state of consumer protection for P2P users in China. In terms of UK regulation, the comparisons in this chapter focus on the most recently introduced rules from PS19/14 and PS22/10, as these constitute the current regulatory framework in force within the UK.

The structure of this chapter is organised as follows: Section 6.2 identifies transparency, clarity and fairness as fundamental functions of P2P lending regulation. Sections 6.3 to 6.5 delve into the definitions and significance of these functions, providing a comparative analysis of how the UK and China address and implement these regulatory objectives. Finally, Section 6.6 presents the conclusion, synthesising the insights and findings discussed in the chapter.

6.2 Identifying the functions of P2P lending regulation

The analysis in previous chapters of the inherent issues in P2P lending and the regulatory frameworks in the UK and China demonstrates that consumer protection, particularly for lenders, is the central focus of P2P lending regulation. Consumer protection is essential in ensuring a financial service operates in a manner that is economically sustainable and ethically responsible.⁶⁰¹ This is especially true in P2P lending, where consumer protection through regulation fosters trust and confidence in the market. When consumers feel assured that their interests are safeguarded and their rights are upheld, this sense of security encourages more individuals to participate in the market, thereby driving the expansion and prosperity of the industry. Therefore, this comparative study focuses on functions from the perspective of consumer protection.

The previous chapters also reveal that regulatory measures to protect P2P lending consumers encompass both *ex ante* and *ex post* regulations. In *ex ante* regulation, the emphasis is on information disclosure and the lenders' decision-making processes. The primary focus is to ensure that lenders have access to transparent and comprehensive information, enabling them to make informed decisions regarding their investments. *Ex post* measures, on the other hand, aim to prevent or mitigate harm to consumers. Although risk is inevitable in almost all financial-return investments, P2P lenders are in a vulnerable position due to their dependence on the platform and limited financial literacy, thus the underlying principle for preventing harm is whether the service from the platform is fair for consumers.

⁶⁰¹ Benston (n 11).

Additionally, in both *ex ante* and *ex post* stages of contracting, the clarity of rules from the regulator, along with the information and terms provided by the platform, play a pivotal role. This is essential for helping and guiding consumers to correctly understand the various risks involved in P2P lending activities as it reduces the possibility of misunderstanding and confusion. Consequently, consumers can make decisions that align with their risk tolerance and financial goals. Furthermore, it ensures a coherent and consistent regulatory framework. Given these considerations, this chapter identifies three key functional elements that regulators use to achieve the objective of consumer protection for the comparison: ensuring transparency, clarity and fairness.

6.3 Transparency

6.3.1 The meaning and significance of embracing transparency

Transparency is a prerequisite for effective and robust financial regulation, and its importance has been emphasised by financial regulators, especially in the wake of the 2008 financial crisis.⁶⁰² It is identified by economists as essential for efficient markets.⁶⁰³ A study in behavioural science finds that in the digital world, transparency benefits not only consumers but also platforms, which can expect to see business growth as a result of increased consumer trust.⁶⁰⁴

⁶⁰² Christine Kaufmann and Rolf H. Weber, 'The Role of Transparency in Financial Regulation' (2010) 13 *Journal of International Economic Law* 779.

⁶⁰³ John H. Jackson, 'Sovereignty-Modern: A New Approach to an Outdated Concept', 97 *American Journal of International Law* 782 (2003) 797.

⁶⁰⁴ Giuseppe A. Veltri and others, 'The Impact of Online Platform Transparency of Information on Consumers' Choice' (2023) 7 *Behavioural Public Policy* 82.

For P2P consumers, transparency is crucial as it enables informed decision-making and provides insights into the status and performance of their lending activities. It serves as a cornerstone for building trust and confidence in the P2P lending industry. Lenders are more likely to participate in P2P lending platforms if they perceive transparency as a safeguard against hidden risks or predatory lending practices. By demonstrating a commitment to transparency, P2P platforms can attract a wider pool of lenders, contributing to the growth and sustainability of the industry. In addition, transparency can deter adverse selection in the market by providing lenders with accurate and comprehensive information about borrowers and the platform's operating status. This contributes to a more balanced and sustainable lending ecosystem. Moreover, transparency enables lenders to allocate their capital effectively, while borrowers can compare offers and select the most suitable terms. A transparent marketplace promotes healthy competition, leading to improved pricing, better terms and overall market efficiency.

To examine whether the UK and China embrace transparency in P2P lending through their regulatory measures, it is essential to understand what transparency is. The literal dictionary definition of transparency in the context of financial activities is "*a situation in which business and financial activities are done in an open way without secrets, so that people can trust that they are fair and honest*"⁶⁰⁵ Also, some scholars identify the meaning of transparency within the scope of financial regulation. For example, Tara and Kaufmann define transparency as the timely and trustworthy sharing of certain information. Conversely, a lack of transparency occurs when individuals or entities intentionally withhold or misrepresent information or

⁶⁰⁵ Cambridge Dictionary, 'Meaning of Transparency in English'
<<https://dictionary.cambridge.org/dictionary/english/transparency#>> accessed 2 July 2024.

provide inadequate and irrelevant information.⁶⁰⁶ They also state that transparency encompasses access, comprehensiveness, relevance, quality and reliability.⁶⁰⁷

Similar to other areas of regulation, the dimensions of transparency in P2P lending regulation include transparency of the regulator and transparency of the regulated.⁶⁰⁸ The transparency of the regulator is always related to the incentives of the regulator and sometimes refers to the issue of “regulatory capture.”⁶⁰⁹ It does not have distinctive features in the context of P2P lending compared to other forms of financial services. More importantly, since this comparative study focuses on consumer protection, it assumes that the regulator's incentives prioritise safeguarding consumers, as evidenced by regulatory practices in the UK and China. Therefore, the transparency of the regulated, meaning the P2P lending platform in this context, becomes the central focus.

Based on the above definitions and considerations, transparency in P2P lending can be understood as users having access to accurate and comprehensive information about their prospective or active lending transactions. Drawing upon the insights provided in Chapter 2, the issue of inadequate transparency within the P2P lending sector primarily revolves around the presence of information asymmetry regarding the precision of borrowers' creditworthiness and the operational dynamics of the platform. This issue emerges from the

⁶⁰⁶ Tara Vishwanath and Daniel Kaufmann, ‘Towards transparency in finance and governance’ *Available at SSRN 258978* (1999) < https://papers.ssrn.com/sol3/papers.cfm?abstract_id=258978 > accessed 11 August 2023.

⁶⁰⁷ *Ibid.*

⁶⁰⁸ James R. Barth, Apanard Penny Prabha and Clas Wihlborg, ‘Transparency of financial regulation’ in Jens Forssbaeck and Lars Oxelheim (eds) *The Oxford Handbook of Economic and Institutional Transparency* (OUP 2015).

⁶⁰⁹ *Ibid.*

potential divergence of incentives between the platform and its participants. There is a moral hazard that platforms may prioritise expanding the volume of loans processed, potentially at the expense of ensuring the quality and creditworthiness of borrowers. This misalignment of interests can result in a lack of transparency concerning the allocation and monitoring of loans. This is the reason transparency cannot be ensured without regulation.

6.3.2 Comparative analysis

- **Information disclosure**

Transparency is often achieved through proactive and comprehensive information disclosure.⁶¹⁰ In both the UK and China, regulators recognise the importance of transparency in P2P lending. They implemented regulations to enhance transparency comprising two key types of requirements: (1) mandating platforms to disclose the required relevant, comprehensive and timely information to consumers and report to regulators; and (2) prohibiting platforms from engaging in activities that obstruct transparency.

However, from a results-oriented perspective, the transparency of P2P platforms in China is notably deficient; otherwise, the prevalence of problematic platforms and Ponzi schemes would not have been so widespread, leading to a large number of lenders becoming victims before the eventual termination of the P2P industry in China. Chapter 4 mentioned that the lack of regulation before 2016 exacerbated the information asymmetry in China's P2P lending market. Therefore, the subsequent "1+3" regulatory framework includes a specific regulatory statement on information disclosure designed to address this issue. While these rules

⁶¹⁰ Caroline Bradley, 'Transparency is the New Opacity: Constructing Financial Regulation after the Crisis' (2011) 1 Am U Bus L Rev 7.

contributed to enhancing transparency to some extent, they did not fully achieve the objective of ensuring a sufficiently transparent P2P lending market, as there remained a large number of problematic platforms until the termination of P2P lending in China.⁶¹¹

In fact, this disclosure regulation sets similar requirements to those in the UK, including details about the platform's registration, role, specifics of the loan, expected returns, default rates, remedies for defaults, risk management practices, and risk warnings.⁶¹² These information disclosure requirements cover a comprehensive range of P2P lending activities. In principle, if all platforms fully complied with these requirements, transparency would be assured to a high standard. However, the Chinese market has shown that most platforms have failed to meet these requirements. This is evident in the subsequent rectification activities, where regulatory authorities conducted case-by-case reviews of platforms to identify non-compliance with regulatory rules⁶¹³, revealing that a large number of platforms did not meet the information disclosure requirements.⁶¹⁴

Nevertheless, the review is another measure that can enhance the transparency of the platforms by mandating non-compliant platforms to undergo rectification or, in some cases, cease operations entirely.⁶¹⁵ However, it is part of the regulatory response to the occurrence of widespread fraudulent activities in China. The lack of proactive measures had already

⁶¹¹ China News (n 364).

⁶¹² Guideline on Information Disclosure 2017.

⁶¹³ Interim Measures 2016, article 4.

⁶¹⁴ Gao, Yen and Liu (n 361).

⁶¹⁵ Rectification Campaign (n 376).

created an environment ripe for fraud and mismanagement, leading to a loss of confidence among participants and undermining the foundation of the P2P lending market. In such circumstances, although the regulatory rules for disclosure and this rectification review measure can improve transparency, they struggle to restore the already damaged market trust and confidence. Consequently, the beneficial effects of transparency for consumers in the market could not be fully realised.

This underscores a critical lesson for regulating P2P lending: transparency must be proactively ensured before confidence and trust in the market are eroded. Rather than relying on reactive interventions, regulatory bodies should prioritise the establishment of effective information disclosure rules from the outset to prevent the loss of market reputation and confidence.

In comparison, such a type of large-scale, case-by-case review has not been implemented in UK regulation. As this thorough review process inevitably led to a significant increase in regulatory costs, it is neither necessary nor feasible in a relatively stable P2P lending market from a cost-benefit efficiency perspective.

Another difference between regulations in the UK and China is that, although the aspects cover similar areas, the disclosure in China is more standardised, while in the UK, it is more discretionary, allowing for more flexibility. For example, China's regulation mandates that platforms proactively provide certain information to consumers within a fixed number of days or hours.⁶¹⁶ In contrast, UK regulations do not specify exact timeframes, instead requiring

⁶¹⁶ Guideline on Information Disclosure 2017.

that information be provided in a timely manner.⁶¹⁷ The FCA explains that its primary concern is ensuring clear descriptions on the platforms, thereby allowing them the flexibility to disclose the necessary content according to the characteristics of their business model.⁶¹⁸

It is true that a standardised form of information disclosure requirements cannot guarantee the same level of transparency due to the diversity of operational models and loan types of each platform. For example, in China's regulations, for loan terms of less than six months, platforms must disclose information to the lender on a monthly basis within the first five working days of each month.⁶¹⁹ Although this can ensure continuous updates, lenders who enter into a loan agreement within the first five working days of a month and whose contract term is only one month might not have the opportunity to receive updated information disclosures.

However, can a discretionary disclosure work better? A discretion on the format of disclosure offers greater potential effectiveness by allowing the platform to apply a tailored format for information disclosure. It helps in achieving better outcomes based on disclosure incentives⁶²⁰ in terms of adaptability, fairness in disclosing various loan agreements and possibly cost control. However, discretionary disclosure also implies that platforms may employ certain tactics to avoid disclosing information that could be detrimental to their

⁶¹⁷ PS19/14.

⁶¹⁸ *Ibid.*

⁶¹⁹ Guideline on Information Disclosure 2017, article 9.

⁶²⁰ Michael Dobler, 'Incentives for risk reporting — A discretionary disclosure and cheap talk approach' (2008) 43 *The International Journal of Accounting* 184.

reputation and competitiveness, which means the minimum standard of transparency could be lower than with a standardised format.

Therefore, a better way to address this issue may be to combine the advantages of both approaches. For important information or details that platforms might otherwise disclose perfunctorily, especially regarding ongoing updates of loans and the platforms' operational conditions, standardised disclosure requirements should be implemented, taking into account the diverse types of agreements. For information that is difficult to standardise, varies significantly between models, or has distinct disclosure costs among models, platforms can be given the discretion to choose how to disclose it, based on compliance.

Another critical aspect of transparency is that, while pre-contractual information disclosure requirements have been emphasised, maintaining transparency post-contract is equally crucial, particularly in cases of default or when the platform encounters operational difficulties. Ensuring that lenders have the opportunity to recover certain losses and the right to be informed about how these losses occurred is essential for maintaining trust and stability in the market. Both China and the UK have regulations that include rules about ongoing disclosure; however, the UK requirement for platforms to establish wind-down plans in advance provides a more robust framework for ensuring transparency. This forward-thinking approach helps reduce the uncertainty and disorder that may arise from unexpected operational difficulties, thereby ensuring transparency is upheld even during the wind-down period.

- **Self-financing**

Self-financing in P2P lending refers to a P2P platform or its affiliated companies acting as the borrowers and transacting with lenders on the platform. China's regulation emphasises the prohibition of self-financing, disguised self-financing, and self-guarantees.⁶²¹ In contrast, the UK regulation does not prohibit P2P platforms or affiliates of the platform from acting as borrowers on the platform. Instead, it requires platforms to take "appropriate steps to identify, prevent or manage conflicts of interest between itself (or any person directly or indirectly linked to it by control) and a client of the platform."⁶²²

China's prohibition of self-financing is primarily due to the large number of illegal fundraising activities that exploited P2P platforms using self-financing as a method.⁶²³ These criminal activities mainly occurred during the unregulated period.⁶²⁴ In a well-regulated P2P lending market, illegal fundraising can be more easily detected by regulators or consumers through disclosure and reporting requirements. Thus, a specific prohibition of self-financing may not be necessary in a well-regulated P2P lending market and could be considered unfair to platforms and their affiliates regarding their right to engage in transactions.

However, the additional risks associated with self-financing cannot be overlooked. First, there is a potential conflict of interest between the platforms' own financing needs and other borrowers' loan requests. Second, there is a moral hazard that platforms may favour or over-

⁶²¹ Interim Measures 2016.

⁶²² SYSC, 10.1.3R

⁶²³ Weiming Wu, 'P2P 非法集资案件的成因与预防' [Causes and Prevention of Illegal Fundraising Cases in P2P Lending] (*Allbrightlaw*, 7 August 2018) <<https://www.allbrightlaw.com/CN/10475/ebfe1c1f4e240eb5.aspx>> accessed 2 August 2024.

⁶²⁴ *Ibid.*

rate their self-finance loan projects. Since platforms are not required to undertake a fiduciary duty of acting in the best interests of their users, self-financing increases risks for lenders in P2P lending.

Although lenders can in fact find information about platforms' disguised self-financing from publicly available company information and the platform's compliance disclosure, this requires lenders to have specific literacy and the motivation to search for it. Since they are not professional investors, they may inevitably overlook this type of information. Also, the complexity of corporate relationships implies that P2P lenders cannot be assumed to easily obtain or understand this information.

Thus, requiring platforms to specifically label or highlight instances of self-financing in their information disclosures is crucial for ensuring transparency. The UK approach focuses on managing conflicts of interest but lacks emphasis on this aspect through specific information disclosure requirements.

- **Summary and insights from the comparison**

Both the UK and China prioritise transparency in P2P lending, with regulations requiring platforms to disclose comprehensive information and prohibiting activities that hinder transparency. A key difference is that China's rules include more standardised forms of disclosure, while the UK allows more flexibility for platforms in their disclosures. Based on the comparison, it can be concluded that a combination of both approaches might be more effective. Standardised disclosure for critical information ensures a baseline of transparency,

while discretionary disclosure for aspects that vary between models or have high disclosure costs can accommodate different operational needs and enhance overall transparency.

Second, ensuring transparency proactively before market reputation erodes is more effective in realising the benefits of a transparent market than using it as a rectification measure. Additionally, regulatory costs are significantly higher when aimed at effective rectification after market confidence erodes, and the compliance costs for platforms are also greater.

Third, self-financing of platforms poses additional risks, including conflicts of interest and moral hazards. Effective transparency requires platforms to specifically label instances of self-financing, making it easier for regulators and consumers to identify and assess these activities.

Regarding transparency, another issue is evident from the disclosure regulations concerning penalties for non-compliance and relevant cases. Should the information disseminated by platforms contain significant inaccuracies, these inaccuracies may remain obscured until their repercussions become substantial and severe, prompting regulatory intervention. This situation has occurred in both the UK and China, though the severity levels differ. When platforms inundate the public domain with extensive information, assessing the veracity of such data becomes a formidable challenge. From a regulatory standpoint, attempting to authenticate this deluge of data could lead to increased regulatory costs and is not feasible. In addition, in cases where a minor portion of the disclosed data is found to be unreliable, the ramifications might be confined to a limited number of consumers who happen to focus solely on that particular segment of information. Consequently, the absence of widespread serious repercussions might elude the regulator's attention.

Although avenues exist for individuals to report suspicious activities to the regulator in both the UK and China, for an ordinary consumer to identify problems remains demanding as many P2P users may be ill-equipped to discern underlying issues. Therefore, this issue necessitates a multi-faceted approach that encompasses not only regulatory intervention but also enhancing the responsibility and accountability of the platforms themselves.

As the intricate nature of information disclosure requires continuous monitoring, analysis, and interpretation of vast amounts of data, AI-driven algorithms and computational tools can be deployed to automate these processes, enabling regulators to swiftly identify discrepancies, inaccuracies, or potential irregularities in the disclosed information.⁶²⁵ AI-powered algorithms can perform real-time data analysis, comparing the information disclosed by P2P platforms against industry standards and regulatory requirements. This proactive approach can instantly flag inconsistencies or deviations, allowing regulators to take prompt action before any detrimental consequences occur. Moreover, AI can also assist in identifying patterns and trends that might be indicative of misleading practices or fraudulent activities.⁶²⁶ However, it is important to note that while the AI-based approach to regulation offers immense potential, it also comes with its own set of challenges. These challenges include algorithmic biases, data privacy concerns, and the need for skilled professionals to manage and interpret the technology effectively.

⁶²⁵ Treleaven Philip and Bogdan Batrinca, 'Algorithmic regulation: automating financial compliance monitoring and regulation using AI and blockchain' (2017) 45 *Journal of Financial Transformation* 14.

⁶²⁶ Larry D Wall, 'Some financial regulatory implications of artificial intelligence' (2018) 100 *Journal of Economics and Business* 55.

6.4 Clarity

6.4.1 The meaning and significance of clarity

In addition to transparency, whether consumers can correctly understand the information provided to them is crucial for effective consumer protection. Therefore, ensuring clarity in P2P lending is also a vital function of consumer protection. Clarity means ‘the quality of being expressed clearly’.⁶²⁷ In the context of consumer protection, clarity within P2P lending encompasses a two-fold perspective. The first is the clarity of the platform, which pertains to the clear and comprehensible presentation of information by platforms concerning loans and the platform’s services. The second is clarity in regulation, which refers to the quality of regulatory guidelines, rules, and requirements being expressed in a clear, concise, and easily understandable manner. This involves ensuring that the language, terminology, and structure of regulatory documents are designed in a way that is accessible to the intended audience.⁶²⁸

Clarity in P2P lending regulations is important for fostering a fair and transparent lending environment that benefits both borrowers and lenders. First, clear regulations provide legal certainty for all parties involved. Participants can have confidence that their rights are protected and that their contractual obligations are clearly defined. This confidence can contribute to the growth and sustainability of the industry.

⁶²⁷ *Oxford English Dictionary Online*, Second Edition 1989 (Oxford University Press, 2010).

⁶²⁸ Jack Solowey and Jennifer J. Schulp. ‘We Need Regulatory Clarity to Keep Crypto Exchanges Onshore and DeFi Permissionless.’ (*Cato Institute*, 10 May 2023) <<https://policycommons.net/artifacts/3812813/we-need-regulatory-clarity-to-keep-crypto-exchanges-onshore-and-defi-permissionless/4618732/>> accessed 18 August 2023.

Second, when regulations are easily understandable, participants in the P2P lending market can better comprehend their rights, responsibilities, and the potential risks involved. When potential lenders have a clear understanding of the risks, benefits, and legal framework surrounding P2P lending, they are more likely to invest their money with confidence. When borrowers understand the terms of their loans and lenders understand the potential risks associated with their investments, the likelihood of default or disputes decreases. This is especially important for borrowers who may have limited financial literacy or lack the resources to fully understand complex terms.

Third, clear regulations discourage misleading practices and promote fair competition. When regulations are unambiguous, and expectations/requirements are clearly defined, P2P lending platforms are less likely to engage in deceptive advertising, hidden fees, or unfavourable contract terms. Clear regulations provide a basis for regulatory authorities to enforce compliance and take action against platforms that fail to meet the specified standards. These foster trust among participants and contribute to the integrity of the market.

6.4.2 Comparative analysis

- **Clarity on regulatory rules**

The manner in which a concept is formulated profoundly influences the writing of laws and regulations associated with it.⁶²⁹ A vague or ambiguous concept can result in legal gaps, inconsistent interpretations and even unintended consequences. This is particularly true in the context of P2P lending, as it is innovative finance without an extensive regulatory history

⁶²⁹ Onyeka Osuji, 'Fluidity of Regulation-CSR Nexus: The Multinational Corporate Corruption Example' (2011), 103 *Journal of Business Ethics* 31.

and established experience. The phrasing used in regulations must be precise, succinct, and all-encompassing in conveying the intended significance. This aids in diminishing the possibility of misinterpretation and guarantees consistent application of the regulation in all scenarios.⁶³⁰ Generally speaking, the regulations in both China and the UK are relatively clear in presenting rules. However, the main issue lies in the terminology used, as discussed in Chapter 2. China's regulation uses the term 'online loan' to refer to P2P lending, which might cause confusion in distinguishing P2P lending from other forms of online lending. The UK regulation also faced a similar issue, as the FCA initially referred to P2P lending as "loan-based crowdfunding" in a consultation paper⁶³¹, potentially overlooking the C2C relationship inherent in P2P lending. However, in PS14/4, the term P2P lending appears in the rules. This has been further clarified in PS19/14, where "P2P lending" is included in brackets in the title, and by PS22/10, the term "P2P lending" is used exclusively. This demonstrates the UK's adaptability and improvement in the clarity of its regulatory language.

- **The nature of the platform**

Compared to the UK, a distinct feature of China's regulation is the restriction that platforms operate strictly as information intermediaries, mandating that they only facilitate connections between borrowers and lenders by providing a venue for information.⁶³² It prohibits platforms from offering financial services like guarantees or credit enhancement, and they are not

⁶³⁰ *Ibid.*

⁶³¹ FCA, *The FCA's regulatory approach to crowdfunding (and similar activities)* (Consultation Paper, CP13/13, October 2013).

⁶³² Interim Measures 2016, article 5.

allowed to maintain a capital pool.⁶³³ In contrast, the UK regulation does not include similar restrictions, allowing platforms to engage more broadly in the financial aspects of P2P lending.

China's restriction provides a clearer definition of the platforms' nature under regulation. However, this also means that P2P consumers are not protected by China's Financial Consumer Protection Law because the law defines a financial consumer as a natural person who purchases or uses financial products and services provided by financial institutions.⁶³⁴ Although P2P users are protected by the Consumer Protection Law, this legislation is primarily designed for ordinary consumers of products and traditional services rather than alternative finance services, emphasising core principles such as 'equality, voluntariness, fairness, and good faith.'⁶³⁵ While these principles are applicable to protect P2P consumers to some extent, the Financial Consumer Protection Law is more suited to address the specific needs of P2P consumers because this law includes more pertinent provisions for resolving issues related to information asymmetry, contract protections, and information security, which are crucial for protecting P2P consumers. Therefore, there is a lack of coherence in the broader legal framework for P2P consumer protection in China.

Moreover, China's experience showed that many platforms cannot operate purely as information intermediaries, as this would result in a higher rate of financial losses for lenders,

⁶³³ *Ibid.*

⁶³⁴ Implementation Measures of the People's Bank of China for Protecting Financial Consumers' Rights and Interests, article 2.

⁶³⁵ Consumer Protection Law (China), article 4.

thus making them less attractive to potential lenders.⁶³⁶ Therefore, restricting P2P lending platforms to functioning solely as information intermediaries may hinder the industry's development.

UK regulation treats P2P lending as a financial service and P2P consumers as financial consumers. Unlike China, there is no restriction preventing P2P platforms from operating as more than just information intermediaries. Consequently, some UK platforms offer additional services beyond merely facilitating loan information. For example, certain platforms, such as *Kuflink*, provide bridging loans secured by property.⁶³⁷ These platforms typically maintain a capital pool, offer a certain level of guarantee and provide house collection services.⁶³⁸

As the original intention of P2P lending is to facilitate loans by providing lenders and borrowers with opportunities to assess their information and facilitate loan transactions, the difference between the UK and China's regulations raises the question of whether P2P lending platforms should be limited to acting purely as information intermediaries, or if they should be allowed operational diversity as long as detailed and tailored regulations are applied. This question pertains to the type of responsibility that platforms should bear. If a platform is restricted to acting solely as an information intermediary, its responsibilities would inevitably be relatively limited. By analogy to other information intermediaries, such as real estate agents, the responsibilities are primarily confined to whether they operate within the scope

⁶³⁶ Qing He and Xiaoyang Li, 'The Failure of Chinese Peer-to-Peer Lending Platforms: Finance and Politics' (2021) 66 *Journal of Corporate Finance* 101852.

⁶³⁷ Kuflink < <https://www.kuflink.com/peer-to-peer-lending/> > accessed 1 August 2024

⁶³⁸ *Ibid.*

of approved business activities and whether there is any fault in the provision of information.⁶³⁹ Given this, identifying the true nature of P2P lending platforms is an important question for regulating them. Chapter 7 will explore answers to this question.

- **Non-misleading**

As discussed in Chapter 3, consumer behaviour biases in P2P lending can be exploited by platforms, primarily through misleading promotion and advertising. These practices are intended to attract more consumers. However, misleading information not only harms consumers by guiding them to make decisions that might not align with their risk preferences, but it also erodes trust in the source of the information and reduces consumers' willingness to buy.⁶⁴⁰ Over time, this can damage the industry's reputation and sustainability. Therefore, it is essential to ensure that platforms promote their services responsibly by regulation, avoiding mis-selling or misleading consumers. This helps protect consumers from making biased decisions and fosters a fair and trustworthy lending environment.

China's P2P market exemplifies the detrimental impact of deceptive advertising and promotion. Chapter 4 illustrates that misleading information and advertisements played a significant role in influencing a substantial number of lenders during the P2P lending crisis in China. This underscores the importance of ensuring that platforms promote their services responsibly to protect consumers and maintain market integrity. Therefore, China's regulation includes restrictions on this issue: it is prohibited to fabricate or exaggerate the authenticity

⁶³⁹ J Benjamin, G Jud and G Sirmans, 'What do We Know about Real Estate Brokerage' (2000) 20 *Journal of Real Estate Research* 5.

⁶⁴⁰ Romani Simona, 'Price Misleading Advertising: Effects on Trustworthiness Toward the Source of Information and Willingness to Buy' (2006) 15(2) *Journal of Product & Brand Management* 130.

and profitability of P2P financing projects, conceal defects and risks associated with P2P financing projects, or use ambiguous language or other deceptive means to engage in false or misleading advertising or promotions.⁶⁴¹

However, this is just a reiteration of relevant rules in China's advertising law and lacks a specific standard for defining “fabrication or exaggeration of profitability” in P2P lending. For instance, some advertisements for P2P platforms were integrated into web dramas. One such example is an advertisement for the P2P platform *IQianjin*, which promoted P2P lending as “a good way to make money,” though it was accompanied by a small risk warning caption.⁶⁴² This type of advertisement was not deemed non-compliant with regulatory standards as it did not use obviously fabricated or overtly exaggerated language. However, the statement “a good way to make money” is misleading because of omitting critical risk information. Although there was a risk warning, it was a small-sized caption that might not capture the viewers’ attention as effectively as the engaging visual content presented within the video. Consequently, the risk warning may be overshadowed, leading viewers to focus primarily on the “making money” aspects of the investment.

The belief that P2P lending is a “good way to make money” aligns with the platforms' incentive to attract more lenders by promoting the idea that P2P lending is beneficial while failing to equally emphasise the associated risks. This kind of advertisement fits Russo *et al.*'s definition

⁶⁴¹ Interim Measures 2016, Article 10.

⁶⁴² Huangxi, ‘P2P 广告强势植入网剧，违不违规’ [Placement of P2P Lending Advertisements in Web Series: Are They Compliant with Regulations?] (*People.cn*, 16 Oct 2017) <<http://money.people.com.cn/n1/2017/1016/c42877-29588464.html>> accessed 29 July 2024.

of "misleadingly false" in advertising.⁶⁴³ In other words, China's regulation fails to prevent misleadingness in the P2P market.

By contrast, the UK has more standardised regulations under "the fair, clear and not misleading rule".⁶⁴⁴ Misleading information is strictly prohibited, and firms are obligated to provide potential investors with a clear and transparent portrayal of the investment opportunities. To ensure compliance, firms are also tasked with continuous monitoring of their promotional materials, guaranteeing that they align with the established regulatory standards.⁶⁴⁵ Additionally, PS22/10 introduced enhanced and specific restrictions on P2P lending promotion by classifying it as a high-risk investment and restricting it to mass market investments.⁶⁴⁶ The implementation of clear and robust promotion rules, combined with efficient monitoring processes and an accountability system, can protect consumers from deceptive or false advertisements. This helps prevent situations similar to what happened in China's market and fosters consumer confidence in the P2P lending sector.

- **Risk warning**

To avoid misleading consumers, it is crucial to mandate clear risk warnings through regulation, as platforms might downplay the associated risks in their communications and promotions. In fact, a key feature of safeguarding lenders in the UK compared to China is the emphasis on

⁶⁴³ J. Edward Russo, Barbara L. Metcalf and Debra Stephen, 'Identifying Misleading Advertising' (1981) 8 *Journal of Consumer Research* 119.

⁶⁴⁴ COBS, 4.2.

⁶⁴⁵ FCA, 'Approving Financial Promotions' (FCA, 15 March 2023) <<https://www.fca.org.uk/firms/financial-promotions-and-adverts/approving-financial-promotions>> accessed 10 August 2023.

⁶⁴⁶ PS22/10.

risk warnings. Risk warning improves clarity (and also transparency) by informing and alerting lenders that their capital is at risk: they may lose part, or all of their invested funds. The UK's regulation mandates that a clear, standardised warning sentence be prominently displayed on P2P platform websites to inform lenders of the potential worst-case investment outcomes. Although China's regulations also include risk warnings, they are not standardised, which makes it possible for platforms to place them inconspicuously and even use relatively mild language for these warnings.

However, due to China's regulatory framework comprising both central and local levels, more stringent standardised risk-warning requirements were implemented at the local level in Guangdong province in 2019. These rules required platforms to set standardised risk warnings that should appear when lenders log into the platform's website, app, or WeChat mini-program, as well as during the registration process and when clicking the bid button.⁶⁴⁷ However, this is only a local-level regulation in one province, not throughout China's P2P lending market. This means that if a platform did not want to comply with the additional risk warning requirements, it could potentially engage in regulatory arbitrage by changing its registration, provided that the cost of doing so is less than the cost of compliance. Furthermore, the content of the risk warning is relatively mild, "be cautious and keep risk awareness in mind; losses are borne by yourself."⁶⁴⁸ Comparatively, the UK's risk warning:

⁶⁴⁷ Guangdong Internet Finance Association and Guangzhou Internet Finance Association, '关于加强网络借贷出借人风险提示的通知'[Notice on Strengthening Risk Warnings for Lenders of Online Lending] (2019).

⁶⁴⁸ *Ibid.*

"Don't invest unless you're prepared to lose all your money invested,"⁶⁴⁹ is more impactful and emphasises the potential for complete financial loss.

Thus, the question arises whether a standardised, strong risk warning is necessary. This can be explored from the perspective of the regulatory intention of requiring risk-warning. Before releasing the standardised risk warning requirement in 2022, the FCA found that there was an inadequate explanation of risks in P2P lending, even though there were existing risk warning requirements.⁶⁵⁰ The standard of risk warnings set by the regulator is essential because, without standardised risk warnings, there is no guarantee that platforms will design risk warnings that align with regulatory purposes for encouraging cautious behaviour among lenders and informing them of the level of risk involved in P2P lending. If platforms only mention risk without emphasising what it means, consumers may overlook the worst possibilities. Although consumers can obtain information on the risks, particularly the risk of losing their investment, through platforms' regular disclosures or industry news, the regulator cannot rely on this as a consumer responsibility. Not all consumers have the motivation or capability to research all relevant information as they are not professional investors. Some consumers may maintain overly optimistic expectations regarding earnings. Moreover, historical data from well-performing platforms may not show substantial investment losses, but this does not guarantee future performance. Therefore, it is crucial to ensure that risk warnings are clearly communicated and easily accessible to all consumers. In this way standardised strong risk warnings enhance the clarity of risks beyond the limitations of a single platform's existing information.

⁶⁴⁹ PS22/10 3.2.

⁶⁵⁰ CP18/20.

There are numerous studies across various fields regarding the use of fear language in warnings. Almost all of them have found that strong language is more effective. For example, Whitmer and Sims conclude that using language which creates fear is effective in hurricane warnings.⁶⁵¹ Ruiters and Kok's research on cigarette warning labels indicates that smokers exhibit a stronger intention to quit after exposure to fear-arousing messages compared to non-fear-arousing messages. However, they question the overall effectiveness and necessity of fear-based warnings due to psychological immunity, where repeated exposure to fear-based messages can reduce their impact over time.⁶⁵²

However, P2P lenders are less susceptible to “psychological immunity” caused by strong risk warnings because the purpose of warnings in P2P lending is not to persuade consumers to cease their activities but rather to inform them about the financial risk of losing their invested money. This type of warning aims to ensure that consumers are aware of the risks and can make informed decisions that align with their risk preferences, thereby enhancing both emotional awareness and cognitive caution.⁶⁵³ Additionally, repeated exposure to risk warnings in P2P lending typically corresponds to more engagement, which helps consumers gain experience and make better decisions.

⁶⁵¹ D. E. Whitmer and V. K. Sims, 'Fear Language in a Warning Is Beneficial to Risk Perception in Lower-Risk Situations' (2023) 65 *Human Factors* 618.

⁶⁵² R.A.C. Ruiters and G. Kok, 'Saying is not (Always) Doing: Cigarette Warning Labels are Useless' (2005) 15 *European Journal of Public Health* 329.

⁶⁵³ R.A.C. Ruiters, C. Abraham and G. Kok, 'Scary Warnings and Rational Precautions: A Review of the Psychology of Fear Appeals' (2001) 16 *Psychology & Health* 613.

Although the primary purpose of strong risk warnings is not to discourage lenders, they inevitably lead some lenders, including those with a certain risk tolerance but conservative risk preferences, to withdraw or decide not to engage in P2P lending. As mentioned in Chapter 5, these risk warnings have been questioned for potentially overemphasising the risk. However, platforms often prominently display positive information about their expected returns to balance the potential discouraging effect of risk warnings. This approach boosts consumer confidence and attracts more users. Thus, consumers are presented with both potential returns and worst-case investment outcomes simultaneously, creating a balanced disclosure. This approach effectively enhances the clarity of both the positive and negative aspects of P2P lending, providing financial consumers with a comprehensive understanding of the investment product. By highlighting both sides, the disclosure helps ensure that consumers can make informed decisions that align with their risk preferences and financial goals.

- **Educating consumers**

Compared to China, another distinctive feature of UK regulation is the inclusion of a detailed and tailored educational element for P2P lenders by mandating platforms to conduct an appropriateness test for new lenders. This test consists of a series of multiple-choice questions designed to determine whether potential lenders possess the relevant knowledge and experience in P2P lending and can understand the associated risks.⁶⁵⁴ If a consumer fails to demonstrate the necessary investment knowledge, platforms may provide educational

⁶⁵⁴ PS19/14.

materials to help them better understand the investment. Depending on the platform's rules, the customer may then be permitted to retake the test.⁶⁵⁵

This approach also helps improve clarity in P2P lending. In addition to non-misleading communication and risk warnings that contribute to the clarity of the platform, whether the information is understandable depends not only on the extent of disclosure but also on the consumers' literacy and ability to comprehend the information. In other words, ensuring clarity for consumers requires both objective and subjective measures. Objectively, this involves clear legal provisions and comprehensive, transparent information from platforms.

Subjectively, it necessitates that consumers can access and correctly understand the relevant information. Because financial consumers often lack the same level of expertise as professional investors,⁶⁵⁶ their ability to access, interpret and use information is limited.⁶⁵⁷ Therefore, regulation should not only ensure that platforms use non-misleading, clear, and comprehensive language but also implement measures to enhance consumers' literacy on P2P lending.

⁶⁵⁵ Intelligent Partnership, 'Behaving Appropriately Under the FCA's New P2P Regime' (*Intelligent Partnership*, 6 August 2019) <<https://intelligent-partnership.com/behaving-appropriately-under-the-fcas-new-p2p-regime/>> assessed 1 August 2024.

⁶⁵⁶ Peter Cartwright, 'Understanding and Protecting Vulnerable Financial Consumers' (2015) 38 *Journal of Consumer Policy* 119.

⁶⁵⁷ Vishwanath and Kaufmann (n 606).

In fact, financial Consumer education as an approach to protecting consumers has been adopted by regulators across diverse economies.⁶⁵⁸ In China, regulators took steps to educate financial consumers during the rise of P2P lending. However, these efforts were inadequate, as the emphasis was more on assessing consumers' financial literacy and risk warning rather than actively providing education.⁶⁵⁹ More importantly, there was a lack of specific focus on educating P2P consumers.

Individuals who are interested in or newly joining P2P lending, inevitably go through a process of learning and understanding (unless they possess certain professional knowledge regarding investment). While the sources of information can be quite broad, such as social media and forums, the most crucial source is the introductory information provided by the platform. Therefore, when regulators do not mandate how platforms should provide educational guidance to consumers, it leaves platforms with the autonomy to guide consumers as they see fit. At this point, it becomes difficult to gauge the accuracy of the guidance and whether it contains a risk of misdirection: platforms may emphasise profitability and downplay risks to attract more consumers to participate. Even if a platform complies with information disclosure and risk warning regulations, there is freedom for it to explain the relevant information that prioritises the platform's profitability over the consumers' interests.

Therefore, it is necessary to transfer the task of improving consumer literacy on P2P lending from platforms to regulators. Requiring platforms to implement educational content

⁶⁵⁸ Toni Williams, 'Empowerment of Whom and for What? Financial Literacy Education and the New Regulation of Consumer Financial Services' (2007) 29 *Law & Policy* 226.

⁶⁵⁹ Huaiyong Wang and Ruohan Deng, '互联网金融消费者教育制度研究' [A Study on the System of Financial Consumer Education in Internet Finance] (2017) 1 *South China Finance* 77

according to standardised regulatory rules can better protect consumers from a precautionary standpoint. This approach ensures that the educational materials are unbiased, comprehensive, and designed to enhance consumer understanding of the risks and benefits associated with P2P lending. By standardising the educational content, regulators can mitigate the risk of platforms prioritising their profitability over consumer interests, thereby improving clarity in P2P lending.

Another advantage of regulatory standardised consumer education content is that it makes it easier for regulators to identify non-compliance by platforms compared to prohibitive regulations banning misleading communications. For instance, it becomes straightforward to detect if platforms fail to conduct required tests or if the test content does not meet the standards.

Educating financial consumers can contribute to the democratisation of financial knowledge and the increased responsibility placed on consumers.⁶⁶⁰ In P2P lending, educating financial consumers helps bridge the knowledge gap, enabling them to engage with the platform with a sufficient understanding of the processes, associated information and risks. This education enhances the effectiveness of information disclosure, achieving greater clarity and transparency. Consequently, this mitigates unaffordable and excessive risk exposure for P2P lenders and thus contributes to consumer protection in a self-directed manner.

- **Summary and insights from the comparison**

⁶⁶⁰ Asta Zokaityte, *Financial Literacy Education: Edu-Regulating Our Saving and Spending Habits* (Springer 2017).

Clarity in the context of P2P lending regulation involves two aspects: the clarity of the platform's communication and the clarity of regulatory rules. Both the UK and China have relatively clear regulatory rules, but UK regulation is more effective in ensuring platform communication clarity. The UK achieves this through more specific and standardised non-misleading rules and stricter risk warning requirements using strong, impactful language. Additionally, the UK appropriateness test educates consumers, enhancing their understanding of disclosed information and enabling them to make informed decisions that align with their risk preferences. These further safeguard consumers and promote a transparent and responsible lending environment.

UK regulatory rules mean greater regulatory intervention in platform operations. Although China's regulation also addresses some issues of clarity, it lacks specificity and standardisation, giving platforms a certain degree of freedom to determine how to comply. This leads to less effectiveness in ensuring clarity, as evidenced by numerous misleading cases after the implementation of the regulatory rules.⁶⁶¹

Therefore, the more specific and detailed the rules are, the less likely it is that platforms can provide misleading information, and the more effectively the goal of clarity can be achieved. However, specific and detailed rules need to take into account the differences in the operational methods of various platforms and the specific characteristics of the industry. They may also need to be updated as the industry develops, which results in higher costs in drafting

⁶⁶¹ R.H Huang, 'Online P2P Lending and Regulatory Responses in China: Opportunities and Challenges' (2018) 19 European Business Organization Law Review 63.

regulatory rules. Nonetheless, detailed rules can, in turn, increase the risk of non-compliant platforms being detected and reduce the enforcement costs for addressing violations.

Furthermore, a distinctive difference between the UK and China is whether the nature of the platform should be limited to an information intermediary role. This distinction determines the diversity of operational models and the level of responsibility the platforms should bear. However, regulations should also consider the feasibility of the industry's sustainability. In other words, it is essential to balance the survival of the industry with consumer protection objectives.

6.5 Fairness

6.5.1 The meaning and significance of fairness

Although ensuring transparency and clarity enables consumers to make informed decisions and access all relevant information throughout their engagement in P2P lending, these measures alone are not sufficient for protecting consumers from excessive risks. This is due to the vulnerable position of P2P lenders and their reliance on the platform, as discussed in Chapter 2. Therefore, ensuring fairness is essential as a regulatory function for comprehensive consumer protection.

The dictionary definition of “fairness” is “the quality of treating people equally or in a way that is right or reasonable.”⁶⁶² The concept of fairness is rooted in the theory of justice.⁶⁶³ It

⁶⁶² Cambridge dictionary <<https://dictionary.cambridge.org/dictionary/english/fairness>> accessed 28 July 2024.

⁶⁶³ S Worthington and J Devlin, ‘Fairness and Financial Services in Australia and the United Kingdom’ (2013) 31 *Journal of Bank Marketing* 289.

is a substantive standard in consumer protection law.⁶⁶⁴ Fairness includes procedural fairness, distributive fairness, and interactional fairness.⁶⁶⁵ Procedural fairness is the justice of the processes involved in an exchange, encompassing elements such as impartiality, the opportunity to challenge decisions, clear explanations, and familiarity with the procedures.⁶⁶⁶ Distributive fairness pertains to the equity of the outcomes of an exchange, specifically how the benefits and resources are divided among the parties involved.⁶⁶⁷ Interactional fairness concerns the courtesy, respect, and consideration shown during an exchange, as well as the degree of communication between the parties involved.⁶⁶⁸⁶⁶⁹ Thus, in the context of regulating P2P lending, ensuring fairness can be understood as the extent to which regulatory rules have prevented, alleviated, or remedied the harms that P2P consumers might encounter in procedural aspects, distributive outcomes, and interactions with the platform and other consumers. The comparison in the next section will examine which law better achieves these three elements of fairness for P2P consumers. Moreover, regulatory measures for protecting lenders from criminal offences related to their investments in P2P lending will also be compared. Based on China's experience, the criminal harm to P2P lenders can be severe, as

⁶⁶⁴ Inge Graef, 'Fairness and Enforcement: Bridging Competition, Data protection, and Consumer Law' (2018) 3 International Data Privacy Law 200.

⁶⁶⁵ *Ibid.*

⁶⁶⁶ R Duffy, A Fearne and S Hornibrook, 'Measuring Distributive and Procedural Justice' (2003) 105 British Food Journal 682.

⁶⁶⁷ P.G Patterson, E Cowley and K Prasongsukam, 'Service Failure Recovery: The Moderating Impact of Individual-Level Cultural Value Orientation on Perceptions of Justice' (2006) 21(3) International Journal of Research in Marketing 263.

⁶⁶⁸ S.S Tax, S.W Brown and M Chandrasekaran, 'Customer Evaluations of Service Complaint Experiences: Implications for Relationship Marketing' (1998) 54 Journal of Marketing 60.

⁶⁶⁹ Cathy Goodwin and Ivan Ross, 'Consumer Responses to Service Failure Influence of Procedural and Interactional Fairness Perceptions' (1992) Journal of Business Research 149.

the P2P lending model can be exploited by criminal activities. Therefore, ensuring security for P2P lenders in this regard is essential to achieving fairness.

6.5.2 Comparative analysis

Fairness is a crucial principle in both the UK and China's financial regulation and consumer protection law. The definition of fairness in financial services, provided by the FCA, is that "A term is unfair if, contrary to the requirement of good faith, it causes a significant imbalance in the parties' rights and obligations under the contract to the detriment of the consumer".⁶⁷⁰ In China, fairness in consumer protection law refers to the right of consumers to engage in fair and reasonable market exchanges when purchasing goods or receiving services.⁶⁷¹ This principle ensures that consumers are treated justly and engage in market transactions fairly. However, there are certain differences between the two countries in terms of how fairness is specifically achieved in the P2P regulatory system and the effectiveness of its implementation.

- **Procedural fairness: cooling-off period and right to cancel**

Regarding procedural fairness, two rules of the UK's regulation contribute to ensuring better fairness for consumers. The first is the 24-hour cooling-off period for financial promotion to P2P lenders, while the second is the 14-day right to cancel for borrowers. On one hand, it protects lenders from impulsive financial decisions; on the other hand, it allows borrowers to have adequate time to review and reconsider their commitments.

⁶⁷⁰ FCA, *Fairness of Variation Terms in Financial Services Consumer Contracts Under the Consumer Rights Act 2015* (Finalised Guidance, FG18/7, December 2018).

⁶⁷¹ Consumer Protection Law (China), art.10.1

China's regulation lacks these considerations within the "3+1 framework". In addition, the "right to cancel" in China's Consumer Law does not apply to P2P consumers. It grants consumers the right to cancel purchases within seven days from the date of receipt of goods purchased online, through television, telephone, or mail order, but excludes custom-made products, perishable and easily spoilable items, digital goods, and delivered newspapers and periodicals.⁶⁷² Clearly, this regulation was designed without consideration for alternative finance consumers, as it was established before the emergence of P2P lending. Furthermore, despite P2P consumers not being covered by China's Financial Consumer Protection Law, it is notable that there are no provisions regarding cooling-off periods or right-to-withdraw rules even as a reference.

- **Distributive fairness: market restriction and wind-down plan**

In terms of distributive fairness, a notable rule is regarding market restriction. Market restrictions can take various forms and help maintain stability in the market.⁶⁷³ The UK's market restriction is based on the classification of lenders and then restricting less experienced lenders. Individuals who are classified as "restricted investors" can invest a maximum of 10% of their net investable assets in P2P agreements during the initial 12 months.⁶⁷⁴ This measure is intended to protect new and less-experienced P2P lenders, who are the most vulnerable group in P2P lending practices, from unexpected and unaffordable financial losses. This restriction consequently results in the regulation treating P2P lenders in

⁶⁷² Consumer Protection Law (China), article 25.

⁶⁷³ Jonathan Zinman, 'Restricting Consumer Credit Access: Household Survey Evidence on Effects around the Oregon Rate Cap' (2010) 34 *Journal of Banking & Finance* 546.

⁶⁷⁴ *Ibid.*

a differentiated manner, based on their diverse levels of experience and assets, thereby yielding dissimilar degrees of investment freedom.

In comparison, China's market restriction was through the implementation of investment caps for P2P loans. Individual lenders were constrained to a maximum investment balance of CNY 200,000 (USD 29,400) on a single platform, along with a total investing balance of CNY 1 million (USD 0.15 million) across all platforms.⁶⁷⁵ This restriction was uniformly applied to all lenders, irrespective of their investment knowledge, experience, or net investable funds. The intention behind this limitation was to contain investment amounts within a defined range, consequently curbing potential losses within those boundaries. However, this restriction falls short in accounting for two critical factors: 1) lenders with varying levels of knowledge and experience possess differing probabilities of encountering investment failures, and 2) the impact of the same loss from P2P loans substantially varies among individuals with different financial resilience.

In fact, the investment cap was set at a high level for the majority of individual lenders. As a reference, the average disposable income in China was CNY 23,821 (USD 3,500) in 2016⁶⁷⁶ when the aforementioned investment cap was instituted. This average yearly income equates to approximately 1/8.4 of the limit for investing in a single platform, and 1/42.8 of the overall

⁶⁷⁵ Meanwhile, the maximum investing balance for a legal person or other institution on a single platform is capped at RMB 1 million, with a total investment balance across all platforms not exceeding RMB 5 million. Interim Measures 2016.

⁶⁷⁶ National Bureau of Statistics, '2016 年全国居民收入进一步增长, 居民消费进一步改善' [Further Growth in National Income and Improved Household Consumption in 2016] <http://www.stats.gov.cn/tjsj/sjjd/201701/t20170120_1456174.html> accessed 11 February 2023.

investment cap. Consequently, a significant portion of individual lenders possessing limited investable funds below CNY 200,000 find the investment cap inconsequential. However, these lenders are more vulnerable to the repercussions of investment losses compared to those with the ability to invest beyond the cap, as the former are less resilient in withstanding the consequences of a failed investment decision.

This underscores the fact that the market restriction primarily curtails those who have the means and intention to invest more than CNY 200,000, safeguarding them from excessive risk exposure. While this restriction is equally applied to all individual lenders, it fails to offer fair protection due to its neglect of varying financial situations and vulnerabilities among different lenders, each of whom warrants a distinct level of safeguarding.

Another UK rule that contributes to distributive fairness is the requirement for platforms to have a wind-down plan. Pre-arranging a wind-down plan allows for the organisation of the administration and risk mitigation strategies in the event of a closure. This can help alleviate potential consumer harm caused by the platform abandoning its responsibilities or being unable to manage the situation effectively during the shutdown. The reason for the lack of similar considerations in China's regulations might be that the primary goal was to correct the chaotic market and enable the industry to operate healthily. However, before this goal could be fully achieved, the industry was terminated in China.

- **Interactional fairness: dispute settlement**

Interactional fairness in P2P lending can be achieved through measures aimed at reducing information asymmetry, preventing misleading information, and improving consumer literacy

by ensuring transparency and clarity. An additional area of focus is dispute settlement. Disputes in P2P lending fall into two categories: disputes between platforms and consumers, and disputes between consumers.

Disputes between platforms and consumers primarily arise from consumer dissatisfaction with platform services or from suffering harm due to the platform's wrongdoings. Both China and the UK P2P regulation and consumer protection laws provide relevant complaint channels for addressing these issues. Additionally, consumers have the option to protect their rights through litigation.

For disputes between consumers, there is a regulatory gap in both China and the UK. Despite P2P consumers having civil rights to address any disputes, it is challenging for them to directly resolve conflicts with one another. The dependence of consumers on the platform makes it difficult to negotiate directly with the opposing party through civil legal means. Unlike platforms such as *eBay*, which offer solutions for resolving consumers' disputes in C2C commerce⁶⁷⁷, P2P platforms do not have mechanisms in place to assist consumers in resolving their disputes. Since P2P platforms are in the best position to resolve consumer disputes but may lack the motivation to engage in this, regulatory intervention is necessary to ensure fairness for consumers. Regulatory measures can incentivise or mandate platforms to actively participate in dispute resolution, thereby protecting consumer interests and maintaining trust in P2P lending.

⁶⁷⁷ Colin Rule, 'Designing a Global Online Dispute Resolution System: Lessons Learned from eBay' (2016) 13 U St Thomas LJ 354.

- **Security: Preventing illegal fundraising and fraud**

Chapter 4 illustrates that a key factor in the downfall of China's P2P industry was the pervasive prevalence of fraud scandals, with Ponzi schemes standing as a glaring example of the unscrupulous activities that plagued the industry and inflicted substantial harm on a wide swath of individual consumers. As a comparison, the UK P2P market is not rife with a number of fraudulent platforms. While instances of failures and management issues also have resulted in unforeseen losses for lenders in the UK, there is no substantial evidence to indicate that these platforms have been established with the intention of unlawfully soliciting funds.

There are multi-faceted reasons for this difference, and the absence of comprehensive regulations prior to 2016 played a pivotal role in creating an environment conducive to fraudulent activities and unscrupulous players entering the market. Although the subsequent regulatory efforts initiated in 2016 failed to effectively rectify the situation and restore the industry's integrity, they significantly reduced the phenomenon of criminals using platforms for illegal fundraising. Regulation forms the bedrock for ensuring security in P2P lending. Thus, how can regulatory measures effectively thwart the establishment of platforms with fraudulent intentions? By comparing with UK regulations, it can be found that similar measures conducive to preventing the use of platforms for illegal fundraising mainly include the following aspects.

First, both countries' regulations include specific rules designed to prevent the establishment of P2P platforms for illegal fundraising purposes. These measures include registration requirements, information disclosure, filing mandates, and the obligation for platforms to regularly report relevant data to regulatory authorities. Such regulations enable regulators to

have comprehensive access to platform information, facilitating the early detection of non-compliant activities. Although there are differences in specific rules, they contribute to preventing and detecting illegal activities that could harm lenders.

Second, both countries' regulations require segregating P2P client accounts within financial institutions that meet certain standards, which is crucial for reducing the risk of platform misappropriation of client funds or absconding with them. UK rules are more detailed, as they are included in the existing CASS framework (with some amendments), covering comprehensive aspects of account regulation.⁶⁷⁸ Even when a firm retains funds that have not yet been invested on behalf of a client, these funds should be managed as client money in accordance with the CASS regulations, unless it is unequivocally clear that these funds will never be connected to a P2P agreement.⁶⁷⁹

In comparison, China's rules, in line with the mandate that P2P platforms operate solely as information intermediaries, focus on ensuring platforms cannot access their clients' accounts. Financial institutions holding client deposits are required to perform formal checks to verify that each transaction instruction aligns with the P2P agreement's terms.⁶⁸⁰ However, this approach cannot ensure the detection of fraudulent loan projects because financial institutions cannot verify the authenticity of the projects, they only ensure that the flow of funds is relatively transparent and that platforms do not directly handle the money.

⁶⁷⁸ PS19/10.

⁶⁷⁹ *Ibid.*

⁶⁸⁰ General Office of CBRC, '网络借贷资金存管业务指引' [Guidelines for the Custody of Funds in Online Lending] (No.21, 2017).

Therefore, there are two differences between the UK and China's regulations in terms of separating client accounts. First, UK regulations require platforms to follow specific operational rules, whereas China's regulations not only involve the platforms but also require cooperation and supervision by third-party financial institutions. Second, the specific operational requirements for client accounts are not as detailed in China as they are in the UK. Even though neither approach can completely prevent the misappropriation of funds by platforms, as highlighted by the misuse cases discussed in Chapters 4 and 5, they can still significantly deter platforms from being established for the purpose of illegal fundraising and from absconding with funds entirely to a certain extent.

Another type of crime related to P2P lending that should be noted is when fraudsters induce victims to take out online loans without their knowledge or while under a misconception, and then transfer the funds to the fraudsters' accounts. This type of crime primarily occurs in telecom/app fraud. Although preventing this kind of fraud is mainly addressed in other areas of law, the rapid disbursement of loans by some P2P platforms, sometimes within minutes, has made them a significant tool in such scams.⁶⁸¹ In this regard, the roles of P2P platforms are similar to those of banks. Therefore, if regulatory measures require platforms to issue cautionary reminders about scams and to perform duties akin to the *Quincecare* Duty (where banks refuse to comply with payment instructions when there is a suspicion of fraud)⁶⁸², it will

⁶⁸¹ D.K Harjono, 'Regulations of Lending Business Activities via Online Applications (Peer-to-Peer Lending): Financial Technology Activities in Legal Terms' (2022) 1 OPSearch: American Journal of Open Research 95.

⁶⁸² *Barclays Bank Plc v Quincecare Ltd* [1992] 4 All ER 363.

help prevent this type of criminal activity. However, neither China nor UK regulations include consideration of this issue.

- **Summary and insights from the comparison**

While both the UK and China have made strides in regulating the P2P lending industry, the UK's regulatory framework offers more detailed and effective measures. In terms of procedural fairness, UK regulations concerning the cooling-off period for financial promotions and the cancellation rights for borrowers, offer significant protection against impulsive decisions and allow for adequate reconsideration. Regarding distributive fairness, the UK approach to market restrictions differentiates between lenders based on their experience, limiting less experienced investors to protect them from substantial losses, while China's uniform investment caps do not account for the varying financial resilience among investors, leading to less effective risk mitigation. Additionally, the UK requirement for platforms to have a wind-down plan further protects consumers by ensuring an orderly process in the event of a platform's closure. For interactional fairness, both the UK and China provide complaint channels and litigation options for disputes between platforms and consumers. However, there is a regulatory gap in addressing disputes between consumers, as neither country's framework includes mechanisms to facilitate C2C conflict resolution. Regulatory intervention is necessary to motivate platforms to assist in these disputes, thereby enhancing fairness.

In terms of security against illegal fundraising and fraud, the UK's regulations include comprehensive measures such as registration requirements, information disclosure, and regular reporting, which help detect and prevent fraudulent activities. China's regulations also

aim to segregate client accounts and prevent platform access to funds, but the approach lacks the detailed operational requirements found in the UK's CASS framework.

Overall, the UK's regulatory framework is more conducive to achieving the function of fairness. This is primarily because its P2P industry has enjoyed relatively healthy and mature development for a longer period in the UK, which has enabled regulators to adjust the rules and stay up-to-date with evolving market conditions. However, there are still regulatory gaps in resolving disputes between P2P consumers and assisting in anti-fraud measures. Moreover, as evidenced in the FCA's letters, platform responsibility is fault-based, and various harms persist in the P2P market.⁶⁸³ Thus, it is worth rethinking the regulatory approach, particularly regarding the responsibilities that platforms should bear.

6.6 Conclusion

This chapter employs a functional approach to compare P2P lending regulations in the UK and China, with a particular focus on consumer protection. It identifies transparency, clarity, and fairness as fundamental functions of P2P lending consumer protection regulation. While China's regulatory rules are effective to some extent, UK regulations are notably more comprehensive and detailed, demonstrating a more robust mechanism for ensuring these key functions, highlighting the benefits of a more meticulous and encompassing approach to regulation in the P2P lending sector. This difference can be attributed in part to the timing of the regulatory measures. The UK's more effective rules were largely implemented in the 2019

⁶⁸³ For example, the FCA 'Dear Board of Directors' letter (2021) <<https://www.fca.org.uk/publication/correspondence/portfolio-letter-loan-based-p2p-crowdfunding-platforms.pdf>>; 'Portfolio letter: FCA Expectations for Loan-based Peer-to-Peer Lending Platforms' (2024) <<https://www.fca.org.uk/publication/correspondence/expectations-loan-based-peer-to-peer-lending-portfolio-letter.pdf>> accessed 5 August 2024.

regulations, reflecting a response informed by a longer accumulation of market research and regulatory experience.

Since P2P lending regulations in both China and the UK are rules backed by sanctions and enforced by regulatory authorities, they fall within the scope of command-and-control regulation, which primarily aims to restrict and constrain activities.⁶⁸⁴ ⁶⁸⁵China's regulation highlights the shortcomings of this type of regulation, which includes high regulatory costs, challenges in effective enforcement, and hindrance to innovation.⁶⁸⁶ This was evidenced by China's regulation utilising a one-size-fits-all approach for addressing most issues, which neglected the different business models of P2P lending platforms. Also, the rectification campaign increased regulatory costs.

Compared to China's regulation, UK regulation is more adaptive and responsive. Responsive regulation suggests that regulatory procedures and determinations should consider the characteristics of various business models.⁶⁸⁷ This is represented by a consultative approach to updating regulation and also other forms (such as 'Dear CEO' letters) of collaborative interactions between regulators and P2P lending firms.⁶⁸⁸

⁶⁸⁴ Alan Moran, 'Tools of Environmental Policy: Market Instruments Versus Command-and- Control' in Robyn Eckersley (ed) *Markets, the State, and the Environment: Towards Integration* (Macmillan Education AU 1995).

⁶⁸⁵ Janis D Bernstein, 'Alternative Approaches to Pollution Control and Waste Management: Regulatory and Economic Instruments' (1993) The World Bank Discussion Paper 11711.

⁶⁸⁶ *Ibid.*

⁶⁸⁷ Christine Parker, 'The "compliance" Trap: The Moral Message in Responsive Regulatory Enforcement' (2006) 40 *Law & Society Review* 591.

⁶⁸⁸ Lauren A. Fahy, 'Fostering Regulator, Innovator Collaboration at the Frontline: A Case Study of the UK's Regulatory Sandbox of Fintech' (2022) 44 *Law Policy* 162.

Responsive regulation considers how businesses perceive the ethical aspects of the regulated activity but faces challenges in addressing the inherent flaws and ethical or practical issues within the approach.⁶⁸⁹ Therefore, it is not suitable to apply it solely as a regulatory approach for achieving the consumer protection goal. From the UK experience, responsive regulation can be used as a method of implementing existing regulation. Therefore, it can serve as a supplement to the shortcomings of command-and-control regulation and provide a useful analysis of the potential practical implications or usefulness of P2P lending regulation.⁶⁹⁰

Based on the comparison in this chapter, it can be concluded that P2P lending platforms hold a central position in this practice and should be the primary focus of regulation. Therefore, the core consideration in P2P lending regulation is determining the responsibilities that platforms should bear. Both the UK and China's regulations impose fault-based responsibility on the platforms, but the differences in regulatory requirements lead to varying levels of responsibility regarding "fault." Since P2P platforms possess the resources and authority to monitor the activities on their platforms, and lenders rely on the platform's information to trust borrowers and make investment decisions, fault-based liability might be insufficient for P2P consumer protection and the long-term development of the industry. To address this issue, Chapter 7 will explore an enhanced liability approach aimed at more effectively protecting P2P consumers.

⁶⁸⁹ *Ibid.*

⁶⁹⁰ *Ibid.*

Chapter 7: Exploring a New Regulatory Paradigm for P2P Lending

7.1 Introduction

Chapter 6 revealed that although UK regulations are generally more effective at regulating P2P lending and addressing the excessive risks for P2P consumers, questions remain about the specific responsibilities that platforms should hold. This chapter will explore these issues by first analysing the nature of P2P platforms and then rethinking the regulatory paradigm.

The nature of platforms is crucial when considering the necessary regulations, as financial intermediaries take on more roles in lending than information intermediaries and therefore should bear greater responsibility accordingly. By identifying P2P lending platforms as neither pure financial intermediaries nor merely information intermediaries, but rather as a new type of online lending intermediary, this chapter proposes applying gatekeeper liability to these platforms and adopting a look-through regulation approach in response to the increasing emergence of P2P loan securitisation. Moreover, as a whole regulatory framework, this chapter also highlights the necessity for prudential regulation of the platform. It also discusses the relationship between civil liability and regulation, highlighting the difficulties P2P consumers encounter when pursuing private enforcement. It emphasises the need for regulatory advocacy to encourage platforms to facilitate dispute resolution between consumers.

The chapter is structured as follows: section 7.2 identifies P2P platforms as active intermediaries, functioning as digital lending intermediaries that incorporate elements of both information and financial intermediaries, yet do not fully align with either category.

Section 7.3 rethinks the regulatory framework, proposing that enhancing platform responsibility through gatekeeper liability would be more effective in improving regulatory efficiency. It also underscores the importance of prudential liability, discusses civil liability in P2P lending, and suggests implementing look-through regulation for the secondary market and P2P loan securitisation. Finally, Section 7.5 presents the conclusion.

7.2 Identifying the nature of the P2P lending platforms

Chapter 2 outlines how the P2P platform facilitates loans between individual lenders and borrowers, highlighting its innovation in transforming the traditional method of financial intermediation into a new P2P intermediation in loans. It concludes that the P2P platform does not eliminate intermediation from its lending process but instead introduces P2P platform intermediation to replace traditional bank methods. Given the distinctive qualities of P2P intermediation, there arises a significant question regarding whether and how P2P lending intermediaries can be categorised within existing types of intermediaries and then be fitted to apply, or at least referenced to, a relative intermediary regulation approach.

This question is crucial because the categorisation of the P2P platform reflects its attributes and positioning, thereby determining the necessary regulation; then, the regulatory framework, in turn, plays a pivotal role in shaping the trajectory of the P2P lending industry. This had been evidenced by the P2P lending regulation in China because the regulatory measures prohibited platforms from acting as financial intermediaries, leading all platforms to relinquish their capital pool and loan guarantee services and refocus on services related to matching information between loan demanders and loan providers.

Therefore, a comprehensive understanding of the nature of P2P intermediaries is important for developing effective regulation that fosters the growth and stability of the P2P lending sector. While various forms of intermediaries exist depending on the context, industry, and specific roles they play—such as retail intermediaries, travel intermediaries, and others—the central issue in delineating categories for P2P regulation is determining whether P2P platforms should be classified as financial intermediaries or information intermediaries.

An information intermediary is only a provider of information and a transaction aggregator.⁶⁹¹ Information intermediaries primarily focus on facilitating the exchange of information between parties involved in a transaction. They connect individuals or businesses seeking specific information with those who possess it by providing access to relevant data, expertise or knowledge.⁶⁹² This means that an online lending information platform does not bear the credit risk and is not obligated to ensure the repayment of the principal and interest to the lender, as the loan exists between the lender and the borrower without involving the platform. In contrast, the financial intermediary must bear the credit risk and handle underwriting.⁶⁹³ Financial intermediaries are entities that facilitate the flow of funds between borrowers and lenders, often offering services such as loan origination, credit evaluation, and

⁶⁹¹ Nic Schaub, 'The Role of Data Providers as Information Intermediaries' (2018) 53 *Journal of Financial and Quantitative Analysis* 1805.

⁶⁹² *Ibid.*

⁶⁹³ Manthos D. Delis, Hasan Iftekhar and Efthymios G. Tsionas, 'The Risk of Financial Intermediaries' (2014) 44 *Journal of Banking & Finance* 1.

risk assessment.⁶⁹⁴ These intermediaries typically hold and manage funds on behalf of the lenders, ensuring their proper allocation to borrowers.⁶⁹⁵

P2P platforms seem to fit some features of both categories, but the regulation for financial intermediaries could be quite distinct from that of information intermediaries, making this identification crucial. If P2P platforms are classified as financial intermediaries, they would be subject to stricter regulations and oversight, similar to traditional financial institutions. This can include considerations such as capital requirements, liquidation coverage ratios, net stable funding ratios and so forth.

However, if P2P platforms are considered information intermediaries, the regulatory framework may be less stringent. In such cases, the focus would primarily be on ensuring fairness and adequate disclosure of relevant information to users of the platform. The emphasis would be on fostering a trustworthy environment to facilitate efficient information exchange and enabling informed decision-making. For example, the EU Digital Services Act (DSA) outlines exemptions from liability for online (information) platforms regarding illegal content posted by their users, although these platforms still bear certain responsibility for countering such content.⁶⁹⁶

⁶⁹⁴ Sebastian Di Tella, 'Optimal regulation of financial intermediaries', (2019) 109 American Economic Review 271.

⁶⁹⁵ *Ibid.*

⁶⁹⁶ Regulation (EU) 2022/2065 of the European Parliament and of the Council of 19 October 2022 on a Single Market for Digital Services and amending Directive 2000/31/EC (Digital Services Act) [2022] OJ L277/1.

Therefore, the determination of whether P2P platforms should be classified as financial intermediaries or information intermediaries has far-reaching implications for both the platforms themselves and the overall regulatory framework governing their operations. It requires careful consideration of the specific activities and functions performed by these platforms, as well as their potential impact on financial markets, consumer welfare and systemic stability.

7.2.1 Information intermediaries

Information intermediaries are entities that are designed to assist consumers in the processing of information.⁶⁹⁷ They collect, organise, and distribute information to clients.⁶⁹⁸ In the context of P2P lending, being an information intermediary implies that the platform should collect and distribute curated and reliable information to empower consumers to make informed choices. This means that the regulation should be focused on the platforms being faultless in providing information and ensuring that information is transparent and clear.

The initial business idea and operating model of P2P lending were more aligned with positioning as an information intermediary. Throughout the inaugural decade of its existence, literature and news consistently referenced the concept of 'cutting out the middleman' when discussing or introducing P2P lending.⁶⁹⁹ During this stage, P2P lending was seen as a part of

⁶⁹⁷ Jinkook Lee and Jinsook Cho, 'Consumers' Use of Information Intermediaries and the Impact on Their Information Search Behavior in the Financial Market' (2005) 39 *The Journal of Consumer Affairs* 95.

⁶⁹⁸ Ryan Womack, 'Information Intermediaries and Optimal Information Distribution' (2002) 24 *Library & Information Science Research* 129.

⁶⁹⁹ For example, Roula Khalaf, 'P2P lending: Cutting Out the Middle Man' (*Financial Times*, 15 April 2012) < <https://www.ft.com/content/51d67b98-8588-11e1-90cd-00144feab49a> > accessed 29 March 2024.

a broader trend in innovative practices moving towards disintermediation, which represents a shift in focus from B2B to C2C.

There are two features of P2P platforms that function similarly to those of information intermediaries. First, they play a role distinct from traditional financial institutions because they act as connectors linking individuals without becoming direct parties to the loan contract. Second, during the initial stage, the business model predominantly involves the straightforward matching of potential lenders with borrowers for unsecured loans, with most platforms neither engaging in credit enhancement nor owning capital pools.

However, the initial business model of P2P lending, primarily serving as a pure information matching facilitator, faced challenges in sustainability, primarily attributable to the remarkably high default rate. This issue was not confined to China's market which lacked a unified social credit rating system, but was also evident in the UK market, exemplified by a nearly 100% default rate in platforms like *Quakle*⁷⁰⁰, despite having a relatively mature social credit rating system. P2P platforms are profit-oriented rather than welfare-driven. When default rates become excessively high, the platform, though not directly responsible for the consequences of defaults, still suffers from an indirect impact on its business reputation. This reputational damage can deter new lenders from joining, ultimately threatening the platform's long-term viability.

⁷⁰⁰ Moore and Moules (n 68).

Recognising the need for adjustment, P2P lending practitioners responded by modifying the business model (for example, by requiring collateral from borrowers) and incorporating guarantee methods to mitigate default rates and bolster lenders' confidence. This strategic adjustment has contributed to ensuring the continued growth and development of their business. Consequently, P2P platforms have undergone a noteworthy transformation, evolving from their initial role as pure information intermediaries towards adopting qualities akin to financial intermediaries.

Additionally, to attract more lenders and enhance their competitive edge in the market, an increasing number of P2P platforms have begun offering credit enhancement services. These services include conducting thorough investigations of borrowers, retaining a portion of the borrower's deposit, collaborating with guarantee agencies, and providing assurances of capital preservation to lenders.

In this scenario, P2P platforms differ significantly from information intermediaries and more closely resemble financial intermediaries. However, as explained in Chapter 2, the risk for lenders in P2P lending is significantly higher than in institutional lending due to weaker risk management capabilities and the moral hazard associated with encouraging riskier loans. This is the reason China's regulator limits P2P platforms to their initial business model and prohibits them from engaging in financial intermediation by the regulation. As explained by Shen, the Director of the Survey and Statistics Department of China's Central Bank, P2P platforms lack the capability to meet the qualifications and conditions required for credit

intermediation, such as maintaining appropriate capital adequacy ratios, non-performing loan provisioning ratios, deposit reserves and so on.⁷⁰¹

However, limiting P2P platforms to the role of pure information intermediaries requires a key prerequisite: the price of a P2P loan, that is, the interest rate, must be determined by the market (or by consumers) rather than by the platform. Otherwise, the platform is not merely facilitating the communication of information but is also playing a central role in the loan transaction. In the early days of P2P lending, some platforms operated under a bidding model that adhered to this principle, but these platforms were eventually eliminated by market competition. Since then, and continuing to the present day, interest rates have either been set or significantly influenced by the platform, although the platform's decisions are always affected by prevailing market interest rates. It should be noted that in China's regulation in which P2P lending platforms are restricted to being information intermediaries, there is no prohibition on platforms offering pricing or credit rating services for loans, which is essential for the viability of the P2P lending business.⁷⁰²

However, this is markedly different from that of other information platforms, such as *eBay* and *Amazon*, where product prices are determined by the sellers. This means the level of involvement that P2P lending platforms have in P2P lending differs significantly from that of information intermediaries.

⁷⁰¹ Songcheng Sheng, 'P2P 暴雷之根本在于信息中介和信用中介的混淆' [The Cause of the P2P Crisis Lies in the Confusion Between Information Intermediaries and Credit Intermediaries] (*Sina*, 12 Dec 2020) <https://finance.sina.cn/zl/2020-12-14/zl-iiznctke6175116.d.html?vt=4&cid=79615&node_id=79615> accessed 2 November 2023.

⁷⁰² Po-Chin Wu, Shiao-Yen Liu and Ming-Fang Yang, 'Estimation of P2P Lending Rates and Lending Strategies' (2022) 11 *Review of Integrative Business and Economics Research* 61.

In addition, the inherent characteristics of P2P lending determine platforms having a greater influence on lenders' decision-making. For instance, when compared to information intermediaries like real estate agencies, a buyer generally relies more on other factors rather than on the information and evaluations provided by the agency. Typically, buyers conduct an in-depth site inspection and personal evaluation of the property to ensure it meets their requirements and expectations. While the quality of information and level of service provided by an agent may speed up or slow down a property transaction, it cannot have a substantial impact on a buyer's decision to purchase a property. One reason for this difference is that real estate clients typically have diverse preferences. For example, Koklic and Vida found that idiosyncratic characteristics of consumers, including their personal situation, experience, and environmental factors, significantly influence their decision-making when purchasing a house.⁷⁰³ These consumers are less likely to make the decision to buy a property primarily based on their trust in the agency that recommended it.

The situation in P2P lending is quite different. P2P lenders are primarily concerned with two factors: returns and risk. Since information related to these factors largely depends on what is provided by the platform, trust in the P2P platform becomes crucial for lenders when making decisions. P2P lenders are often unfamiliar with the borrowers and do not have direct contact with them. Additionally, lenders may lack the professional financial knowledge needed to assess a borrower's repayment ability, making them heavily reliant on the credit ratings and information supplied by the platform for their decision-making.

⁷⁰³ Mateja Kos Koklic and Irena Vida, 'A Strategic Household Purchase: Consumer House Buying Behaviour' (2009) 7 *Managing Global Transitions* 75.

Therefore, P2P platforms assume responsibilities similar to those of financial intermediaries and leverage their own credibility when facilitating transactions, which fundamentally distinguishes them from pure information intermediaries.

Another difference is that, even in the initial business model, P2P platforms demonstrate a higher level of proactivity compared to information intermediaries. Online information intermediaries, such as search engines or online marketplaces, mostly do not create content or engage with their users' online activities. However, they can still engage in certain non-passive activities and should therefore be held liable for those aspects. For example, in a UK case, *Tamiz v Google*, Richards LJ emphasises that *Google's* involvement with the blogs on Blogger.com was not entirely passive because *Google* offered search services on its own terms and had the ability to remove or block any blog, thereby demonstrating a more active involvement.⁷⁰⁴ This indicates that merely lacking direct involvement or awareness of the wrongful behaviour does not automatically allow an intermediary to invoke the defence of passivity.

In comparison, the P2P platforms' role is even more active. They can not only provide lending services on their own terms and have the ability to accept or reject a consumer but also rate P2P borrowers' creditworthiness and present relevant information essential for lenders' decision-making and securing loan repayment.

⁷⁰⁴ *Tamiz v Google Inc* [2013] 1 WLR 2151 [23].

In addition, while P2P platforms were defined as information intermediaries, the focus of regulation would be on platforms being faultless in providing information and ensuring that information is transparent and clear. This is indeed what Chinese regulators have done after defining P2P platforms as information intermediaries. Whilst the UK does not define P2P platforms as information intermediaries, it is also true that the focus of the 2014 regulation is on information disclosure.⁷⁰⁵ However, this type of regulation overlooks the platform's responsibility to provide a relatively fair assessment of value and risk, as well as to ensure clear and accurate loan pricing. Thus, it cannot mitigate the moral hazard where the platform promotes expensive but risky loans.

Overall, there are four key reasons why P2P platforms cannot function as pure information intermediaries. First, the pure information intermediary model does not align with the industry's sustainability under real market conditions. Second, the fact that loan pricing is largely determined by the platform indicates a high level of involvement in the lending process. Third, P2P platforms exhibit a higher level of activity and play a more determinative role in influencing users' decision-making and the lending process compared to traditional information intermediaries. Finally, regulations focused solely on information intermediaries may ensure information accuracy and transparency, but they fall short in adequately protecting consumers and ensuring fairness in P2P loan transactions. Since P2P platforms cannot operate purely as information intermediaries, could they be classified as financial intermediaries and mitigate excessive risks through financial intermediary regulations?

⁷⁰⁵ Chris Rogers and Chris Clarke, 'Mainstreaming social finance: The regulation of the peer-to-peer lending marketplace in the United Kingdom' (2016) 18 *The British Journal of Politics and International Relations* 930.

7.2.2 Financial intermediaries

Greenbaum and others define financial intermediaries as entities that act as an intermediation between suppliers and users of financial capital.⁷⁰⁶ Among the various types of financial intermediaries, banks stand out as the most common ones. Banks function as intermediaries by accepting deposits from savers, pooling and transforming those funds into long-term loans, while also absorbing the credit risk associated with lending.⁷⁰⁷ Bank depositors are not exposed to the risk of loss, except in extreme cases such as a bank failure or when a depositor's losses exceed the coverage limit of the government protection scheme.⁷⁰⁸

In contrast, in P2P lending, the platform signs a service contract ("terms and conditions") with users but does not participate in the lending agreement itself nor assumes responsibility for ensuring repayment (except in cases where guarantee services or provision funds are offered). This is the fundamental difference between the two. In short, financial institutions typically make their own investment decisions and bear the associated risks. In contrast, P2P lenders bear the risks themselves rather than the platform, despite heavily relying on the platform for their investment decisions. This indicates that P2P lending platforms cannot be classified as pure financial intermediaries, as doing so would fail to capture the innovative nature of the P2P lending business model and overlook the heightened risks faced by P2P lenders.

⁷⁰⁶ Stuart I. Greenbaum, Anjan V. Thakor and Arnoud W.A.Boot, *Contemporary Financial Intermediation* (4th edn, Elsevier 2019).

⁷⁰⁷ K.E Davis and A Gelpern, 'Peer-to-Peer Financing for Development: Regulating the Intermediaries' (2010) 42 *Journal of International Law and Politics* 1209.

⁷⁰⁸ For example, in the UK, the Financial Services Compensation Scheme covers up to £85,000 per person for deposits held in a failed bank or building society. FSCS, Deposit protection Q&As-Banks & Building Societies <<https://www.fscs.org.uk/industry-resources/deposit-protection-banks/>> assessed 1 September 2024.

In addition, defining and regulating P2P platforms as financial institutions implies downplaying their differences from traditional financial institutions, which would contradict the social and economic objectives for which the concept of P2P lending was developed. P2P platforms play a socially valuable role by contributing to the efficient distribution of resources between savers and those seeking lending in the market, fostering better resource allocation and smoother financial flows. Treating P2P platforms solely as financial intermediaries overlooks the fundamental purpose of the P2P industry and its significant impact on inclusive finance. This impact includes providing alternative fundraising opportunities for those who struggle to obtain credit from traditional institutions and offering ordinary financial consumers an accessible way to invest their idle money with a low minimum investment requirement. Thus, reducing them to mere financial intermediaries is inconsistent with society's expectations and the social value attributed to the alternative finance industry.

However, since P2P platforms exhibit some characteristics similar to financial intermediaries, it is worth considering the regulatory experience of financial intermediaries, particularly that of brokers.⁷⁰⁹ Brokers act as agents who facilitate trade agreements and transactions, executing the buying and selling of shares on behalf of investors in exchange for a fee.⁷¹⁰ They may also provide financial advice and other services for an additional charge. The main

⁷⁰⁹ 'Financial intermediary', *Oxford Dictionary* <<https://www.oxfordreference.com/display/10.1093/oi/authority.20110803095818405#:~:text=2%20In%20the%20Financial%20Services,See%20also%20independent%20intermediary.>> assessed 11 August 2024.

⁷¹⁰ Tamar Frankel, 'The Regulation of Brokers, Dealers, Advisers and Financial Planners' (2010) 30 Rev. Banking & Fin. L 123.

similarity between brokers and P2P lending platforms is that neither typically holds ownership rights to the assets being traded.⁷¹¹

Brokers are not part of the transaction contract, but they can still be held accountable under specific circumstances when issues arise.⁷¹² This suggests that similar accountability measures could be applied to P2P lending platforms, given their comparable role as facilitators and their position as non-parties to the loan contracts. However, it is important to note that while brokers act as agents for lenders, P2P platforms function as neutral intermediaries in facilitating loan transactions. Additionally, while a broker typically withdraws from the process after assisting lenders and borrowers in negotiating terms, P2P platforms continue to play a crucial and active role even after the loan has been agreed upon and initiated. These distinctions should be considered in examining their liabilities to parties involved in the transactions they intermediate.

7.2.3 Digital Lending Intermediaries

In light of these facts, P2P platforms cannot be simply classified as information intermediaries or financial intermediaries and there should be a specialised definition of the nature of P2P platforms in line with their idiosyncrasies. The P2P lending platforms are digital lending intermediaries which intermediate loans mainly through matching information, but also include various credit enhancement services. It incorporates some characteristics of both information intermediaries and financial intermediaries. This identification may contribute to

⁷¹¹ Donald C Langevoort, 'Brokers as Fiduciaries' (2009) 71U. Pitt. L. Rev. 439.

⁷¹² David Unseth, 'What Level of Fiduciary Duty Should Mortgage Brokers Owe Their Borrowers?' (1997) 75 Washington University Law Review 1737.

a more comprehensive understanding of the platform's function within the financial landscape, thereby guiding regulatory authorities in formulating policies that align with the distinctive features of P2P lending.

7.3 Rethinking the regulatory framework for P2P lending platforms

Building on the insight that P2P lending platforms operate as active intermediaries, blending characteristics of both information intermediaries and financial intermediaries, this section rethinks which regulatory paradigm is best suited to address the associated challenges. Regulation paradigm encompasses a collection of shared models, practices, rules and standards.⁷¹³ Taylor identifies three major elements of the regulatory paradigm: the public policy objectives set for the regulatory system; institutional arrangements; and specific techniques and methods.⁷¹⁴ This section analyses core considerations for the redesign of regulation through the lens of these three elements.

7.3.1 Platform-customer relationship

The relationship between P2P platforms and their customers, like that of other intermediaries, is contractual in nature. As such, P2P consumers can seek remedies under contract law and tort law if the platform commits a fault. The platform owes a duty of care in both tort and contract law, but this duty generally applies only to clear instances of wrongdoing.⁷¹⁵ In cases

⁷¹³ Michael Taylor, 'The Search for a New Regulatory Paradigm' (1998) 49 Mercer Law Review 793.

⁷¹⁴ *Ibid.*

⁷¹⁵ Despite distinct legal systems and traditions, the principles of duty of care in contract law and tort law are similar in both the UK and China.

where the platform has not committed any direct wrongdoing, consumers cannot hold the platform responsible for negligence.

To mitigate the moral hazard associated with the platform, promoting good faith in the relationship between the platform and its customers is essential. Good faith is sometimes associated with fiduciary obligations, particularly in situations where one party relies on the trust of another to act on their behalf. Although P2P platforms facilitate and even manage users' funds, they are not held to fiduciary obligations. While it has been argued that fiduciary duties could extend to more relationships to protect against abuse, such as between doctors and patients, parents and children and so on,⁷¹⁶ the primary challenge is that P2P platforms cannot fulfil the duty of loyalty. As neutral intermediaries, P2P platforms cannot serve the best interests of both parties simultaneously, which inherently contradicts the duty of loyalty which is one of the main principles of fiduciary relationships.

Thus, what relationship best describes the P2P platform-customer relationship beyond its contractual nature? Drawing insights from discussions on the gatekeeper's role in the public function of banking⁷¹⁷ and the designation of six major information platforms as gatekeepers by the Digital Market Act (DMA)⁷¹⁸, this thesis proposes understanding P2P platforms as gatekeepers for P2P users. However, the scope of this gatekeeping role extends beyond public interest to encompass the specific characteristics unique to P2P lending.

⁷¹⁶ Sarah Worthington, *Equity* (OUP 2006).

⁷¹⁷ Anna Keller, 'The Public Role of Banks: A New Narrative Born?' (2022) *Journal of International Banking Law Review*.

⁷¹⁸ EU Commission, *Digital Markets Act: Commission Designates Six Gatekeepers* (6 September 2023) <https://ec.europa.eu/commission/presscorner/detail/en/ip_23_4328> assessed 11 August 2024.

In fact, the gatekeeper narrative has already existed in P2P lending practices. At the pre-contractual stage, the platform acts as a gatekeeper in selecting borrowers: platforms have the discretion to set thresholds for customers to access their services and must inform consumers about these thresholds, particularly regarding the platform's minimum creditworthiness requirements for borrowers. After the loan transaction, some platforms undertake certain debt collection actions in response to borrower defaults, which, in a sense, also serves as a gatekeeper function by helping to prevent lenders from incurring losses. Additionally, as service providers, platforms are typically bound by legal obligations related to anti-money laundering and anti-terrorist financing regulations, further highlighting their gatekeeper role, not only for their users but also for the broader financial system and society. However, the gatekeeper narrative has not been fully integrated into P2P lending regulation in either the UK or China. Therefore, the next section will explore the theoretical background and examine how to adopt gatekeeper liability for P2P platforms.

7.3.2 Gatekeeper liability: enhancing the platforms' responsibility

7.3.2.1 Definition of Gatekeeper liability

The gatekeeper theory formally originated in 1943 with Kurt Lewin, a social psychologist.⁷¹⁹ During World War II, Kurt Lewin studied how Midwestern housewives influenced family food consumption, identifying them as gatekeepers in the decision-making process from purchase

⁷¹⁹ Kurt Lewin, 'Forces behind food habits and methods of change' (1943) 108 Bulletin of the National Research Council 35.

to table.⁷²⁰ Since then, the gatekeeper concept has been explored across various fields, such as journalism, social media, politics “gatewatching” and also financial markets.

Although there is no academic consensus on the definition of gatekeeper liability, it is possible to identify common elements regarding what constitutes the "gate" and the corresponding responsibilities of a gatekeeper. These aspects can also be examined for their applicability to P2P platforms.

An early definition of gatekeeper, provided by Kraakman in the 1980s, describes them as "*private parties who can prevent misconduct by refusing to cooperate with wrongdoers.*"⁷²¹

According to his perspective, the role of the "gate" is to prevent wrongdoings by withholding essential support from intermediaries.⁷²² The primary function of gatekeeper liability is to discourage gatekeepers from turning a blind eye to fraudulent activities. The liability system is structured with the intention of encouraging gatekeepers to actively monitor their clients.⁷²³

According to this definition, when P2P lending platforms bear gatekeeper liability, they are obligated to prevent misconduct by refusing to engage in or condone misleading behaviours or wrongdoing once detected. However, this means that the gatekeeper only performs a post hoc action that occurs only after the wrongdoing has taken place. Also, in the context of P2P

⁷²⁰ *Ibid.*

⁷²¹ Reinier H Kraakman, 'Gatekeepers: The Anatomy of a Third-Party Enforcement Strategy' (1986) 2 *Journal of Law, Economics, & Organization* 53.

⁷²² *Ibid.*

⁷²³ *Ibid.*

lending, it requires further determination of what wrongdoings a P2P platform should and could prevent to be held liable.

Another definition, from Coffee, interprets a gatekeeper as a "reputational intermediary" who offers verification or certification services to investors.⁷²⁴ Also, Coffee identified four situations that could weaken gatekeeper liability: "Poor Observability" due to vague standards or unclear certifications; "Implicit Collusion" where gatekeepers align with corporate interests; "Economic Coercion" exerted by corporate managers; and "High Agency Costs," where individuals within the firm remain undeterred by potential liabilities.⁷²⁵ This provides a framework for defining the gatekeeper liability paradigm for P2P platforms. Issues such as poor observability pertain to clarity, while implicit collusion relates to moral hazard. Economic coercion is evident in some of China's offline P2P platform services but is commonly present in the generally insignificant roles of P2P lending managers. Additionally, high agency costs are not significant, as P2P platforms rely more on technology and overall management rather than the behaviour of individual staff members.

Gerner-Buerle's definition of gatekeepers is "*agents that ensure compliance of the primary market actor with the applicable rules by reviewing its disclosures and withholding their participation in transactions if violations occur.*"⁷²⁶ This is grounded in the viewpoint of

⁷²⁴ John C Coffee, 'Understanding Enron: "It's About the Gatekeepers, Stupid"' (2002) 57 The Business Lawyer 1403.

⁷²⁵ John C Coffee, 'The Acquiescent Gatekeeper: Reputational Intermediaries, Auditor Independence and the Governance of Accounting' < https://papers.ssrn.com/sol3/papers.cfm?abstract_id=270944> accessed 29 March 2024.

⁷²⁶ Carsten Gerner-Beuerle, 'The Market for Securities and its Regulation Through Gatekeepers' (2009) 23 Temple International & Comparative Law Journal 2.

securities law, as evidenced by the mention of the disclosure obligations imposed on issuers.⁷²⁷ Based on this definition, the gatekeeper role of platforms will focus on promoting transparency and preventing harm.

In addition, Hamdani defines gatekeepers as, “*parties who sell a product or provide a service that is necessary for clients wishing to enter a particular market or engage in certain activities*”.⁷²⁸ He classifies gatekeepers as third parties and asserts that they are better positioned than their clients to oversee and manage the activities occurring.⁷²⁹ This is particularly true in the realm of P2P lending. The P2P platform is better equipped to acquire information, control transactions and detect and prevent harm. It has superior access to data and analytical tools that enable effective oversight of activities. Compared to individual P2P users, who may lack the resources or expertise to monitor for irregularities, the platform can implement comprehensive safeguards and enforce standards that mitigate risks for all parties involved.

In light of these definitions, it becomes evident that the main aspects of gatekeeper liability include preventing wrongdoings and ensuring transparency and clarity. As preventing wrongdoing is essential for ensuring fairness, these elements are consistent with the regulatory functions of P2P lending outlined in Chapter 6.

⁷²⁷ *Ibid.*

⁷²⁸ Assaf Hamdani, ‘Gatekeeper Liability’ (2003) 77 Southern California Law Review 53.

⁷²⁹ *Ibid.*

7.3.2.2 Justifying Gatekeeper Liability for P2P Platforms

P2P platforms can serve as gatekeepers by embodying the core aspects of gatekeeper liability. These platforms act as a 'gate' for lenders and borrowers to access the P2P lending market, and they control this gate mainly by conducting verification procedures to assess the creditworthiness of borrowers seeking to use the platform for lending. Specifically, the justifications for adopting gatekeeper liability for platforms are fivefold. First, as explained in the previous section, the gatekeeper narrative is present to some extent in the relationship between P2P platforms and their customers.

Second, as discussed in Chapter 6, fault-based liability has proven inadequate for protecting consumers in the UK and China. Fault-based liability often presumes that intermediaries are passive entities, making it appear unjust to hold them responsible for the actions of primary actors.⁷³⁰ However, as outlined in Section 7.2, P2P platforms are not passive intermediaries; they play a more active role than some information intermediaries, which themselves are not entirely passive in the activities occurring on their platforms. A key factor in assigning liability for wrongdoing is awareness. If an intermediary is aware of wrongful actions and fails to prevent them despite having the opportunity and capability to do so, there is no valid reason why they should not be held liable.⁷³¹

This is also reflected in the EU Electronic Commerce Regulations 2002 (ECR 2002), which indicate that a service provider is not liable for damages if they do not select or alter the

⁷³⁰ R.J. Mann and Seth R. Belzley, 'The Promise of Internet Intermediary Liability' (2005) 47 *William & Mary Law Review* 239.

⁷³¹ *Bunt v Tilley and others* [2007] 1 WLR [21].

information in the transmission.⁷³² The key implication here is that the lack of control over the transmission indicates an absence of responsibility or fault, thereby justifying the exclusion or limitation of the service provider's liability. Conversely, if a service provider exercises control over the transmission, they could be held liable for certain damages, as their involvement suggests a greater degree of responsibility for the content and its consequences. This underscores the importance of control in determining liability within the context of electronic commerce.

P2P platforms typically perform a range of activities including: 1) collecting borrowers' information; 2) analysing or rating borrowers' creditworthiness; 3) matching one or more borrowers' loan requests with one or more lenders (sometimes using financial strategies to set up loan portfolios); 4) collecting funds from lenders and transferring them to borrowers; 5) collecting repayments from borrowers and paying them back to lenders; 6) debt collection in cases of default, if the platform offers such a service. Additionally, platforms that intermediate secured loans engage in further activities related to the management and administration of collateral.

It can be seen that the platform is clearly fully aware of all these activities and maintains control throughout the process, from the initial collection of information to the final repayment and even debt recovery. Given this level of control and active participation, it is evident that fault-based liability is insufficient to address the potential risks and harms associated with P2P lending. The platform's deep involvement in every stage of the

⁷³² The Electronic Commerce (EC Directive) Regulations 2002, SI 2002/2013, 17(1).

transaction process means it bears a certain degree of responsibility for any resulting harm. Therefore, a more robust liability framework is necessary to ensure that P2P platforms are held accountable for their role in managing and facilitating these financial transactions. This would better align the regulatory framework with the actual operational realities of P2P platforms, where their central role in the process has a significant impact on both borrowers and lenders. Given that the platform is in the best position to prevent harm or mitigate risks for users, applying gatekeeper liability presents a feasible approach to redesigning the regulatory framework.

Third, the P2P platform occupies the most advantageous position in the loan transaction. As Mann and Belzley highlighted, the internet's influence indicates that intermediaries can prevent misconduct in the most cost-effective way.⁷³³ Among the three key participants—lender, borrower, and the platform itself—the platform is the only entity that engages in every transaction it facilitates. It emerges as the most easily identifiable party in any deal. Both lenders and borrowers see the platform as the primary facilitator in their interactions, rather than their contractual counterpart. This is because a single loan can be financed by several P2P lenders, and a lender's investment may be spread across various borrowers on the platform, making direct communication challenging. Consequently, the P2P platform maintains a central role despite the vast number of transactions. In situations where some type of harm arises, pursuing the platform itself rather than individual users may be more practical.

⁷³³ Mann and Belzley (n 730).

Fourth, enhancing the platform's liability through the adoption of gatekeeper liability aligns with the concept of soft paternalism discussed in Chapter 3, which is well-suited for P2P consumer protection. Soft paternalism holds that it is justifiable to prevent individuals from harming themselves if their actions are involuntary or if there is significant reason to believe they might be misguided.⁷³⁴ Regulating platforms to intervene in consumer behaviours that could bring harm to themselves, such as making erroneous decisions based on misunderstandings, and holding platforms accountable for the standards and effectiveness of their interventions, precisely embodies the soft paternalism approach. For instance, the mandate in the UK that requires inexperienced lenders to undergo an appropriateness test exemplifies this approach.

Fifth, direct liability often fails to provide adequate deterrence, as wrongdoers may perceive a minimal chance of being held accountable.⁷³⁵ This issue becomes particularly acute in situations where platforms close down without adequate contingency plans. Borrowers might find it costly and challenging to pursue independently their loan contract counterparties—the lenders—for debt collection. Therefore, applying gatekeeper liability to platforms requires that they proactively undertake comprehensive measures to minimise default risks. This involves not just precautionary interventions but also strengthens deterrence against potential misconduct through the establishment of rigorous risk management protocols.

⁷³⁴ Jason Hanna, 'Hard and Soft Paternalism' in *The Routledge Handbook of the Philosophy of Paternalism* (Routledge 2018) 24-34.

⁷³⁵ Ke Steven Wan, 'Gatekeeper Liability Versus Regulation of Wrongdoers' (2008) 34 *Ohio Northern University Law Review* 483.

In consideration of the aforementioned factors, it becomes imperative to reevaluate and enhance the liability mechanisms applied to platforms. Adopting a gatekeeper liability paradigm could serve as a strategic approach to regulating the behaviours and interactions that occur within platform services. Gatekeeper liability would position platforms not merely as facilitators but as active regulators responsible for maintaining oversight and enforcing norms within their domains. Such liability could potentially lead to more robust governance structures on platforms, ensuring they play a pivotal role in mitigating risks and addressing misconduct effectively. This approach would not only align with the evolving dynamics of internet-based transactions but also reinforce the accountability mechanisms necessary for sustaining trust and security in digital marketplaces.

A limitation of gatekeeper liability is that it has the potential to increase the conflict of interest between the gatekeeper firm and its employees.⁷³⁶ However, these concerns are less significant in the context of P2P lending. As online fintech firms utilising information technology to facilitate loans, P2P platforms employ significantly fewer staff than traditional financial institutions, and client relationship management plays a less prominent role in their operations.

7.3.2.3 Adopting gatekeeper liability for P2P Platforms: defining the boundaries

Adopting gatekeeper liability for P2P platforms means requiring P2P platforms to hold liability for preventing wrongdoings happening on the platform. It is questionable which kinds of wrongdoings subject platforms to gatekeeper liability and to what extent these platforms

⁷³⁶ Stavros Gadinis and Colby Mangels, 'Collaborative Gatekeepers' (2016) 73 Washington and Lee Law Review 797.

should be held liable. To explore this, this section will analyse key factors influencing the desired implementation of gatekeeper liability as identified by Shavell, including *a.* the flow of information about illegal activities between private parties and regulators; *b.* the capacity to compensate for damages; *c.* the costs incurred by private entities and the public in enforcing gatekeeper liability; and *d.* the likelihood that parties might avoid litigation for damages caused.⁷³⁷

***a.* Inaccurate Information**

Regarding the flow of information, Shavell demonstrates that private parties generally possess more comprehensive knowledge about the risks when discussing the differences in awareness of illicit activities between parties and the regulatory authority.⁷³⁸ In the context of P2P lending, the platform serves as the "private party" that possesses superior information concerning risk. Compared to regulators, the platform has direct and comprehensive access to transactional data, user behaviour, and financial interactions. Although regulation may include reporting requirements, these are typically not as timely as the data access that platforms have. This access provides the platform with a deeper, more nuanced understanding of the inherent risks, enabling it to detect subtle patterns and potentially inaccurate information at an early stage. Compared to P2P borrowers who provide their own information, the platform, overall, is in the best position to understand the associated risks, as it manages many loan portfolios consisting of various loan requests. Within P2P lending, the most at-risk party is the lender, who often possesses the least information, contrary to having the most at stake.

⁷³⁷ Steven Shavell, 'Liability for Harm Versus Regulation of Safety' (1984) 13 *Journal of Legal Studies* 357.

⁷³⁸ *Ibid.*

Unlike individual lenders or borrowers who may only see a fraction of the overall interactions and data, the platform has comprehensive access to and control over all transactional data and risk assessments. This unique position allows the platform to analyse trends, identify inaccurate information more effectively and implement strategies to mitigate those risks. Consequently, the platform's enhanced understanding of the intricacies of each transaction positions it as a crucial gatekeeper for the accuracy of information.

Adopting gatekeeper liability necessitates that platforms effectively screen for and eliminate any wrongful or misleading information listed on their platforms and hold them accountable for any inaccuracies. This implies that platforms are liable not only for ensuring sufficient disclosure but also for maintaining a certain level of accuracy in the information disclosed. Consequently, this form of liability imposes a dual responsibility on platforms to both regulate the content they host and guarantee its veracity, enhancing transparency and trust among users.

Therefore, what is a "certain level" of accuracy? The DSA, which exempts digital platforms from liability for illegal activities and content when they lack actual knowledge of these, or when they are unaware of facts or circumstances that would make such activities and content evident, can serve as a reference.⁷³⁹ It aligns with the reasons why P2P platforms should be accountable for their users' behaviour. The crux of the matter lies in the platform's awareness and its capacity to discern such behaviours with the requisite knowledge. Therefore, the platform's responsibility for the accuracy of information is predicated on standard due

⁷³⁹ DSA, article 6.

diligence and reasonable knowledge or capabilities. This suggests that the extent of gatekeeper liability is defined by the platform's good faith efforts; if, despite employing all reasonable verification and investigative measures, the platform fails to uncover erroneous information, it should not be held liable for these inaccuracies. Essentially, while the platform is required to implement comprehensive verification processes, it is not expected to detect errors that are undetectable through such diligent efforts.

b. Compensation

Gatekeepers and wrongdoers can be jointly liable when harm occurs, which benefits victims since gatekeepers' assets are more susceptible to liens compared to those of other wrongdoers.⁷⁴⁰ However, in terms of compensation, strict liability is often superior to negligence or knowledge-based liability for gatekeepers.⁷⁴¹ This is due to the fact that the wrongdoer may deem it profitable to commit fraud, while the gatekeeper would find it expensive to transfer the cost to the primary wrongdoers.⁷⁴²

Shavell mentions some factors regarding evaluating a gatekeeper's ability to compensate for harm, such as the size of the party's assets and liability insurance.⁷⁴³ In P2P lending, the primary concern regarding compensation is identifying the type of harm. The predominant issue in P2P lending is the unexpected excessive losses incurred by lenders. In terms of assets,

⁷⁴⁰ Jeffrey Manns, 'Private Monitoring of Gatekeepers: The Case of Immigration Enforcement' (2006) University of Illinois Law Review 887.

⁷⁴¹ Hamdani (n 728).

⁷⁴² *Ibid.*

⁷⁴³ The factor also includes "employee decision-maker's assets", but this is not relevant to P2P lending. Shavell (n 737).

unlike some gatekeepers who have “deep pockets”,⁷⁴⁴ P2P platforms in general are not capable of covering all the lenders' losses. As mentioned in Chapter 2, P2P platforms typically charge a relatively low percentage fee on transactions; therefore, the volume of transactions is often many times greater than the platform's profits. If the default rate is significant, it becomes infeasible for platforms to absorb the associated losses.

More importantly, as discussed in Chapter 3, using others' funds to compensate for such losses (akin to a bank's deposit guarantee scheme) would lead to lenders becoming "free riders," investing without discretionary and due diligence. This issue would also arise if regulations required platforms to cover these losses. Moreover, it is impractical because it would place a substantial financial burden on the platform. To remain viable, platforms would have to significantly raise the criteria for qualifying as P2P borrowers, such as requiring substantial collateral or only accepting borrowers with high creditworthiness. This contradicts the objectives and social values of the P2P lending business model.

Another approach for compensating loss is through gatekeeper liability insurance. This is based on the assumption that P2P platforms assume compensation liability jointly with defaulted borrowers. In discussing liability insurance, Winter states that joint liability would not actually expand the range of liable parties in the absence of insurance.⁷⁴⁵

⁷⁴⁴ Wan (n 735).

⁷⁴⁵ Ralph A. Winter, 'Liability Insurance, Joint Tortfeasors and Limited Wealth' (2006) 26 *International Review of Law and Economics* 1.

However, liability insurance seems inapplicable in the context of P2P lending. As Wan noted, as wrongdoing is committed by users, it would be very difficult for insurers to assess the risk of gatekeeper liability.⁷⁴⁶ In P2P lending, although insurers can calculate risks based on historical data of default rates, the varied business models and credit rating standards operated by platforms bring uncertainty that challenges the insurance model. Given the complexities and unpredictable nature of loan defaults, insurers may find it challenging to accurately assess the risk and set appropriate premiums, making it difficult for platforms to secure affordable and effective coverage.

Moreover, in cases where the borrower has already defaulted, the probability that they will assume the debt is exceedingly low. This implies that within this joint liability, the platform will primarily bear the responsibility for compensation. Kehne points out that when net assets, rather than causal contributions to accidents, are the primary factor in determining liability, insurance markets fail to provide effective incentives for preventing losses.⁷⁴⁷ In addition, liability insurance could diminish the gatekeepers' precautionary measures.⁷⁴⁸ Thus, this type of insurance would be less feasible for P2P platforms undertaking gatekeeper liability for loan default compensation.

It follows that platforms should not be held liable for compensating defaulted loans. However, the provision fund schemes some platforms offer, which provide certain compensation for

⁷⁴⁶ *Ibid.*

⁷⁴⁷ Jeffrey Kehne, 'Encouraging Safety Through Insurance-Based Incentives: Financial Responsibility for Hazardous Wastes' (1986) 96 Yale Law Journal 403.

⁷⁴⁸ *Ibid.*

defaults, form an integral part of their business strategy and are not subject to regulatory oversight—provided that all related information is disclosed accurately and transparently, without any misleading details.

Furthermore, whether the platform should assume responsibility for compensating other types of damages that arise from users' activities is contingent upon the contractual obligations established between the platform and its users, as well as principles in other legal domains, such as tort and data protection regulation. These areas of law assess how directly a platform's actions contribute to user harm and whether adequate measures were taken to prevent such outcomes. However, these aspects are generally less pertinent to the platform's gatekeeper liability, which primarily focuses on proactive oversight and preventive measures.

c. Costs

Wan identifies that a key factor in determining the desirability of gatekeeper liability and regulation is whether parties can effectively deter misconduct at acceptable costs through legal or structural means.⁷⁴⁹ Cost is a significant consideration in any regulatory measure, encompassing both the expenses incurred by regulators and the financial impact on the regulated entities, which in this case are P2P platforms. According to Kraakman, the expenses associated with gatekeeping encompass administrative costs from monitoring gatekeepers, private costs affecting transactions between gatekeepers and clients, and tertiary costs incurred by third parties.⁷⁵⁰

⁷⁴⁹ *Ibid.*

⁷⁵⁰ Kraakman (n 702).

Looking first at administrative costs, these include regulatory expenses that arise regardless of whether harm occurs, due to the fixed costs of monitoring a gatekeeper's compliance.⁷⁵¹ The costs associated with gatekeeping can vary depending on the specific context.⁷⁵² In P2P lending, the administrative costs for the regulator may not be as significant compared to regulating other gatekeepers. This is because, unlike other forms of gatekeeping where there are no private victims or where the harm done is difficult to detect and requires regulatory or governmental intervention, P2P users can typically identify harm that has occurred to them on their own.⁷⁵³ However, the monitoring costs for regulating P2P gatekeeping are not significantly lower than those for other gatekeepers. As with regulating other forms of gatekeeping, a certain minimum level of verification is necessary to meet regulatory objectives.⁷⁵⁴

Second, private costs are made up of residual liability risks, expenses to mitigate these risks, and risks related to performance.⁷⁵⁵ Wan states when the gatekeeper is required to continuously monitor a client's behaviour to ensure legal compliance, the costs associated with this ongoing oversight can become excessively high.⁷⁵⁶ This applies to P2P lending as well. As a gatekeeper, the platform must monitor and prevent misconduct, but it may still face legal risks in its efforts to do so. These costs obviously increase the platform's operational costs and

⁷⁵¹ Shavell (n 737).

⁷⁵² Wan (n 735).

⁷⁵³ Shavell (n 737).

⁷⁵⁴ *Ibid.*

⁷⁵⁵ Kraakman (n 702).

⁷⁵⁶ Wan (n 735).

would significantly influence the platform's operational decisions and pricing strategies, ultimately affecting both lenders and borrowers who use the service.

Third, tertiary costs impact third parties rather than the gatekeepers.⁷⁵⁷ Since gatekeepers typically pass these costs onto their clients or customers, high gatekeeping expenses may deter clients or customers from using gatekeepers.⁷⁵⁸ In P2P lending, when the platforms' operational costs significantly increase, they may charge higher fees, which could lead clients, particularly lenders, to conclude that participating in P2P lending is not a worthwhile deal. Some borrowers may have limited alternatives for lending, which further complicates the situation.

Moreover, when faced with significant residual liability risks, a gatekeeper might feel compelled to alter its contracting practices in ways that are more restrictive, potentially leading to discrimination against clients who, although perceived as risky, are actually innocent.⁷⁵⁹ This heightened caution could prompt the platform to implement stricter credit requirements for borrowers, thereby excluding individuals who would have previously met the platform's standards. As a result, a segment of borrowers who might have successfully secured loans under less stringent conditions could find themselves unable to access the platform's services, limiting their financial opportunities and potentially undermining the inclusivity that P2P lending originally sought to provide.

⁷⁵⁷ *Ibid.*

⁷⁵⁸ *Ibid.*

⁷⁵⁹ *Ibid.*

The costs raise the question of whether it is feasible to implement stricter credit requirements, given the additional expenses involved, and whether platforms are willing to actively assume and undertake gatekeeper liability. To address this issue, the thesis suggests applying the collaborative gatekeeper theory to improve efficiency and balance the costs and liabilities for platforms, which will be explored in the next section.

d. avoiding litigation

The last determinant identified by Shavell is that wrongdoers would avoid litigation for harm done. He suggests that if a lawsuit against a firm involving gatekeeper liability fails to deter a decision-maker, government intervention is necessary to regulate the decision-maker directly.⁷⁶⁰ However, Wan argues that assessing the desirability of gatekeeper liability and regulation should not be about whether wrongdoers are likely to face legal action. Instead, the focus should be on whether the gatekeeper can effectively deter misconduct at a reasonable cost, whether through legal means or system design.⁷⁶¹ Adopting gatekeeper liability in P2P lending aligns more closely with Wan's argument. In the context of P2P lending, it is often impractical for regulators to take legal action against wrongdoers when platforms fail to prevent misconduct. Instead, the focus should be on establishing the gatekeeper as a proactive mechanism for preventing wrongdoing, particularly because victims in P2P lending may find it difficult or costly to pursue legal action on their own.

Collaborate gatekeeper

⁷⁶⁰ Shavell (n 737).

⁷⁶¹ Wan (n 735).

Gatekeepers might avoid liability when wrongdoing goes undetected by victims or the government, or when victims decide against pursuing legal action due to factors like the high cost of litigation.⁷⁶² This is because their actions are frequently driven by their own private interests.⁷⁶³ As discussed by Gadinis, in reality, neither reputational incentives nor the deterrent effect of severe penalties have successfully kept gatekeepers in check.⁷⁶⁴ Thus, he developed the gatekeeper theory into a collaborative gatekeeper model which requires gatekeepers to collaborate with regulators by reporting any client conduct they suspect involves potential wrongdoing, without alerting the client. Gatekeepers who fulfil their reporting duty gain immunity from subsequent actions, provided they continue to act in good faith. Meantime, gatekeepers who fail to report suspicions may face potential sanctions.⁷⁶⁵

This framework can help gatekeepers navigate conflicts of interest by encouraging them to report as soon as they detect any irregularities, rather than delaying action or potentially ignoring signs of misconduct.⁷⁶⁶ Therefore, this approach reduces the likelihood that platforms will overlook or conceal client wrongdoing. For P2P platforms, close collaboration with regulators can mitigate the risks associated with gatekeeper liability. This collaboration not only encourages platforms to proactively fulfil their regulatory obligations but also provides them with an additional layer of protection against legal repercussions. For

⁷⁶² Amanda Cohen Leiter, 'Environmental Insurance: Does It Defy the Rules?' (2001) 25 Harvard Environmental Law Review 259.

⁷⁶³ Sugata Roychowdhury and Suraj Srinivasan, 'The Role of Gatekeepers in Capital Market' (2019) 57 Journal of Accounting Research 295.

⁷⁶⁴ Gadinis and Mangels (n 736).

⁷⁶⁵ *Ibid.*

⁷⁶⁶ *Ibid.*

regulators, this collaboration improves efficiency, potentially alleviating the increased costs associated with gatekeeping. Furthermore, this strategy reinforces trust among users, who can be confident that the platform is actively engaged in preventing and addressing misconduct.

However, the challenge of accurately calibrating immunity should be noted.⁷⁶⁷ The level of immunity needs to be established based on a comprehensive assessment of the specific circumstances of different models. This should primarily take into account the cost differences between reporting and directly preventing illegal activities, as well as the actual capabilities of the platform.

7.3.2.4 Conclusion and reflection on adopting gatekeeper liability

Gatekeepers in financial markets have the capacity to provide the institutional stability, resilience, and guidance necessary for the growth and smooth operation of capital markets.⁷⁶⁸

Adopting gatekeeper liability in P2P lending offers a more effective solution to regulatory challenges, but it is essential to strike a balance between business interests and consumer rights. Regulation and monitoring must be proportional to participants' conduct, ensuring the protection of users and the enforcement of their rights.

However, adopting gatekeeper liability can increase costs, leading to a potential trade-off between curbing misconduct and the market distortions it may cause. Additionally,

⁷⁶⁷ Andrew F. Tuch, 'The Limits of Gatekeeper Liability' (*Harvard Law School Forum on Corporate Governance*, 5 June 2024) < <https://corpgov.law.harvard.edu/2017/06/05/the-limits-of-gatekeeper-liability/>> accessed 20 August 2024.

⁷⁶⁸ Roychowdhury and Srinivasan (n 763).

gatekeeper liability could result in the strict censorship of services offered by platforms. On P2P platforms, this might manifest as more stringent checks, potentially restricting market access for certain segments of society, such as economically disadvantaged borrowers with poor credit ratings.

Despite these challenges, gatekeeper liability eventually presents more advantages than disadvantages. It offers P2P lenders another defendant. This liability framework enables the injured party, and potentially the regulator or court, to address not only causality but also a more precise allocation of responsibility, taking into account all parties involved, the quality of the platform's services, and its standard of care. This approach discourages platforms from shifting liability away from themselves.

In addition to its relevance in regulating P2P lending, gatekeeper liability offers a valuable lens through which to understand and address risks associated with the rapid evolution of other FinTech sectors, such as blockchain technology and decentralised finance (DeFi). DeFi platforms, which often operate without centralised control or clearly identifiable responsible entities, pose significant regulatory challenges due to their potential misuse for illicit activities, including money laundering, terrorist financing, fraud, and market manipulation.⁷⁶⁹

Decentralisation does not necessarily preclude accountability. For instance, the Financial Action Task Force (FATF) has stated that individuals or entities exercising control, influence,

⁷⁶⁹ Gagandeep Kaur, Amir H. Lashkari, Iman Sharafaldin and Zahra H. Lashkari, *DeFi Platforms*, in *Understanding Cybersecurity Management in Decentralized Finance: Challenges, Strategies, and Trends* (Springer International Publishing 2023) 57–70.

or substantial involvement in the operation of a platform may be classified as Virtual Asset Service Providers (VASPs), even in the absence of formal centralisation.⁷⁷⁰ Nonetheless, DeFi platforms with no identifiable owner or central authority often operate in legal grey areas or actively evade regulatory oversight, thereby hampering enforcement efforts.

Gatekeeper liability presents a promising avenue for addressing these gaps by expanding the conceptual boundaries of accountability. Under this model, responsibility could extend beyond traditional intermediaries to include governance token holders, smart contract developers, and other actors involved in the design and functioning of decentralised systems.

Moreover, the concept of gatekeeper liability may also be applicable to the regulation of other emerging technologies, such as AI governance, particularly in instances where harms arise from autonomous or semi-autonomous systems. These technologies pose distinct regulatory challenges, often characterised by diffuse control structures and unclear lines of accountability. In such contexts, gatekeeper liability offers a promising framework for identifying and holding responsible those individuals or entities that design, influence, or derive benefit from the operation of these systems.

In conclusion, gatekeeper liability presents a flexible and forward-looking regulatory model that is well-suited to addressing the complexities of decentralised and technologically advanced ecosystems. By recognising the functional roles of a broad spectrum of actors and expanding the scope of accountability, this approach strengthens regulatory oversight, upholds market integrity, and enhances consumer protection across the evolving FinTech landscape.”

⁷⁷⁰ Financial Action Task Force, *Updated Guidance for a Risk-Based Approach to Virtual Assets and Virtual Asset Service Providers* (October 2021) <<https://www.fatf-gafi.org/content/dam/fatf-gafi/guidance/Updated-Guidance-VA-VASP.pdf>> accessed 10 March 2025.

7.3.3 Prudential regulation

Prudential regulation is crucial as its primary goal is to ensure the safety and soundness of financial institutions and the broader financial system, which is essential for maintaining financial stability.⁷⁷¹ Although prudential regulation and consumer protection are generally considered to operate within separate domains, the distinction between them is often nebulous in practice.⁷⁷²

Prudential regulation refers to the framework of laws, rules, and supervisory practices.⁷⁷³

Prudential regulation includes microprudential and macroprudential regulation.⁷⁷⁴

Microprudential regulation focuses on individual financial institutions, whereas macroprudential regulation addresses the stability of the overall financial system.⁷⁷⁵ Following the 2008 Financial Crisis, the application of macroprudential policy to regulate economic boom-bust cycles became a central focus of macroeconomic research.⁷⁷⁶ However, given that the primary regulatory focus for consumer protection in P2P lending is centred on the platforms, microprudential regulation should be emphasised, while macroprudential regulation also applies to P2P lending, as it forms part of the broader financial services sector.

⁷⁷¹ Franklin Allen and others, 'Enhancing Prudential Standards in Financial Regulations'(2016) 49 *Journal of Financial Services Research* 133.

⁷⁷² O. Osuji, 'Responsible Lending: Consumer Protection and Prudential Regulation Perspectives' in O'Shea P and Fairweather K (eds), *Credit, Consumers and the Law: After the Global Storm* (Taylor & Francis 2016) 62-85.

⁷⁷³ C.H.R Morris, *The Law of Financial Services Groups* (OUP 2019) 57.

⁷⁷⁴ Orkida Findiku Ilollari and Gentiana Gjino, 'Financial Crisis: Implementation of Macro- and Micro-Prudential Regulation' (2013) 5(1) *Review of Applied Socio-Economic Research* 83.

⁷⁷⁵ Liviu Serbanescu, 'Micro-prudential vs Macro-prudential Regulation' (2022) 22 *Ovidius University Annals, Economic Sciences Series* 437.

⁷⁷⁶ Chang Ma 'Financial Stability, Growth and Macroprudential Regulation' (2020) 112 *Journal of International Economics* 103259.

As shown in previous chapters, both China's and UK P2P regulations include specific microprudential rules. Both of them set licencing and minimum capital requirements for platforms. Additionally, the UK's regulation requires platforms to implement a backup plan to guarantee the ongoing management of loans in the event of a platform failure.

There are debates about the limitations of prudential regulation. For example, Carvajal *et.al.* argue that extending regulation to cover a broader range of nonbank entities and financial instruments would be too expensive and hinder innovation.⁷⁷⁷ They state that regulation should adopt a neutral and non-judgemental approach to the regulated subject. While the industry does not pose a threat to society, its direction should be determined by the industry itself.⁷⁷⁸ The assumption that financial innovation causes no harm to society relies on another assumption that the market functions effectively for all participants within the industry; however, the analysis of risks and problems in previous chapters shows that this is not the reality. Thus, prudential regulation is necessary in regulating P2P lending. It can improve confidence among both potential and existing P2P consumers by signalling the platform's financial stability and dedication to responsible practices. For example, certification or licencing acts as a safeguard, ensuring that substandard or harmful products and services are kept out of the market.

⁷⁷⁷ *Ibid.*

⁷⁷⁸ *Ibid.*

However, prudential regulation does not grant P2P consumers an enforceable legal right against the platform, which reduces the platform's level of accountability to its consumers. Therefore, while prudential regulation is an essential part of the framework for regulating P2P lending platforms, it should not be viewed as the primary strategy; it needs to complement other regulatory approaches. Importantly, adopting prudential rules for P2P lending does not mean these regulations should replicate those applied to traditional financial institutions. For example, the capital adequacy and liquidity ratios specified in Basel III standards are not practical for P2P lending platforms. However, regulators can develop suitable, feasible, and effective prudential standards specifically tailored for P2P lending.

7.3.4 Civil liability

One element of the regulatory paradigm, institutional arrangements, stems from overarching objectives and typically aligns along sectoral lines.⁷⁷⁹ For instance, P2P lending in the UK falls under the regulation of the FCA. However, beyond the oversight of specific regulators like the FCA, since P2P lending involves transactions between individuals, the activities regarding it are also governed by civil law. Therefore, the regulatory paradigm should also be concerned with how civil law collaborates with the specific regulation for P2P lending in terms of consumer protection.

Regulation operates as an *ex ante* approach, aiming to pre-emptively address potential issues and provide remedies to victims. In contrast, civil liability functions as an *ex post* approach,

⁷⁷⁹ Taylor (n 713).

addressing and resolving issues after they have occurred.⁷⁸⁰ Normally, in regulatory frameworks, the regulated party is obligated to pay a fine in the event of a violation of established regulatory standards.⁷⁸¹ These criteria are communicated in advance, and the relevant parties are expected to be informed of them. This applies even in situations where no tangible damage has resulted from breaches of these regulations. Nevertheless, a notable issue with regulation is that whether an offender is detected depends on the regulator's awareness of wrongdoing.⁷⁸² Consequently, the effectiveness of the protections offered by regulation is contingent on the vigilance and enforcement capabilities of the regulatory authorities overseeing them.⁷⁸³

Unlike regulation, civil liability is a court-driven process where the appropriate level of care is determined by the courts based on the unique facts of each case. This means that the standards may remain unclear to the parties involved until the matter is brought before the court.⁷⁸⁴ The civil liability approach offers protection through damages payment only when victims exercise their right to legal action. When used on its own, this type of protection is susceptible to the indifference of potential claimants. This is because, when the overall harm resulting from wrongdoers is substantial, the individual damages may still be insignificant.⁷⁸⁵

⁷⁸⁰ P.M. Prasad, 'The Relative Efficiency of Liability Versus Regulation in Providing Incentives to Tortfeasor' (1999) 41 *Journal of the Indian Law Institute* 405.

⁷⁸¹ *Ibid.*

⁷⁸² *Ibid.*

⁷⁸³ *Ibid.*

⁷⁸⁴ *Ibid.*

⁷⁸⁵ *Ibid.*

However, the cost of legal action is often significant. For example, the onus of proof is on claimants to determine fault and prove a causal connection between the misconduct and the damage sustained by the claimants. As a result, rational victims may be reluctant to incur the costs of pursuing court action for redress, as the expenses often outweigh the potential compensation, a phenomenon referred to as rational apathy.⁷⁸⁶

Bergh and Visscher have investigated private collective actions as a solution to address rational apathy in the context of preventing consumer law infringements. They find that while collective actions can help mitigate the issue, they may also exacerbate principal-agent problems between lawyers and clients and increase the likelihood of frivolous lawsuits.⁷⁸⁷

Collective litigation can have a positive impact on addressing rational apathy in P2P lending, particularly when users join forces to sue the platform. However, in addition to the drawbacks argued by Bergh and Visscher, further challenges arise when lenders pursue collective lawsuits against defaulting borrowers. For instance, in cases where a platform collapses and some borrowers default, collective actions are less effective at mitigating rational apathy, as individual lenders may find themselves involved in multiple lawsuits. This leads to significant litigation costs, particularly in terms of time and effort.

⁷⁸⁶ Roger van den Bergh and Louis T. Visscher, 'The Prevention Function of Collective Actions for Damages in Consumer law' (2008) 1 Erasmus Law Review 2.

⁷⁸⁷ *Ibid.*

Nevertheless, these drawbacks of civil liability in P2P lending do not inherently imply that regulation is superior to civil liability.⁷⁸⁸ Private parties are typically first to find a wrongdoer's violation of duty, making them the initial responders in such situations. Therefore, civil liability and regulation play complementary roles, though they do not fulfil identical functions. As argued by Didžiulis, private enforcement serves as an umbrella for financial regulation,⁷⁸⁹ showing the significant role of private litigation in the financial service market. The utilisation of their respective strengths and capabilities should be optimised in P2P lending regulation by integrating them for a more comprehensive and effective regulatory framework for protecting P2P consumers.

Furthermore, requiring platforms to offer a dispute resolution mechanism for users by regulation can significantly alleviate the challenges associated with pursuing legal recourse. Such mechanisms provide users with a more accessible, cost-effective, and time-efficient alternative to formal court proceedings. By resolving conflicts directly through the platform, users can avoid the complexities and high costs typically associated with litigation. Additionally, these mechanisms foster a sense of accountability within the platform itself, encouraging quicker resolutions and reducing the burden on the judicial system. Ultimately, this approach can enhance consumer trust and promote a more secure and transparent P2P lending environment.

⁷⁸⁸ Fabrizio Cafaggi, 'A Coordinated Approach to Regulation and Civil Liability in European Law: Rethinking Institutional Complementarities' (European University Institute Working Paper 3, 2005)

⁷⁸⁹ Laurynas Didžiulis, 'Private Enforcement of European Financial Markets Regulation and Lithuanian Experience' (2016) 1 *International Journal for Financial Services* 1.

7.3.5 Look-through regulation for P2P loan securitisation

As discussed in Chapter 2, the securitisation of P2P loans has increased systemic risks and introduced significant regulatory challenges. While applying gatekeeper liability could help mitigate some of these risks by enhancing the transparency and clarity of P2P loans, a more targeted regulatory approach would be more effective. Therefore, this section proposes the adoption of a look-through regulation approach to address this issue.

Look-through regulation has been adopted across various areas of law in many legislations over time. In the area of financial regulation, it refers to a regulatory method that identifies the true source of funds and their ultimate destination through financial intermediaries or financial products.⁷⁹⁰ For instance, when the US Securities and Exchange Commission (SEC) revised the Investment Advisers Act of 1940 in 1998, the term "look through" was included in the explanatory notes related to determining the number of clients served by the investment adviser.⁷⁹¹ The look-through approach is also present in the Basel standard for calculating asset securitisation risk weighting.⁷⁹² An additional example can be found in the EU Solvency Capital Requirement.⁷⁹³

⁷⁹⁰ W. Gou, '穿透式监管和资产管理'[Look-through Regulation and Asset Management]' (2017) China Finance 17.

⁷⁹¹ Investment Company Act, Section 3(c)(1).

⁷⁹² Basel Committee on Banking Supervision, 'Basel III: Finalising Post-Crisis Reforms (Basel 3.1)' (Bank for International Settlements, December 2017).

⁷⁹³ Commission Delegated Regulation (EU) 2015/35 of 10 October 2014 supplementing Directive 2009/138/EC of the European Parliament and of the Council on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II) [2015] OJ L12/1, Article 84(1).

In P2P lending, the disclosure regulations and regular reporting requirements in the UK and China already fall within the scope of look-through regulation. However, the regulation concerning P2P securitisation remains insufficient. Shifting the risks linked to the loans originated on the platform from the lenders to investors in the capital markets⁷⁹⁴ can lead to opacity, as the end investors may have limited visibility into the underlying assets and the associated risks. Implementing look-through regulation would help improve transparency at every stage of the securitisation process. By providing a clearer view of the loan originations, the flow of funds, and the true nature of the underlying assets, look-through regulation ensures that all parties involved, including investors, are better informed about the risks they are assuming. This heightened transparency not only protects investors but also contributes to the overall stability and integrity of the P2P lending ecosystem.

7.4 Conclusion

This chapter examines the classification of P2P platforms, emphasising their active role as digital lending intermediaries that are neither purely information intermediaries nor purely financial intermediaries. This recognition highlights the inadequacy of fault-based regulation alone and suggests that platforms must take greater responsibility for the activities conducted through their services. To address this, the chapter proposes gatekeeper liability as a more effective mechanism for enhancing consumer protection, striking a careful balance between fostering industry innovation and safeguarding consumer interests.

⁷⁹⁴ Vincenzo Bavoso, 'Financial Intermediation in the Age of FinTech: P2P Lending and the Reinvention of Banking' (2022) 42 *Oxford Journal of Legal Studies* 48.

The chapter also highlights the importance of prudential regulation, emphasising that the design of specific rules should align with the needs of P2P lending rather than simply replicate those of the banking industry. Moreover, the complementary relationship between civil liability and regulation is viewed as a dual approach to protecting P2P consumers. However, challenges exist for P2P consumers in pursuing legal action, including the issue of rational apathy. The chapter suggests encouraging platforms to facilitate dispute resolution between consumers by regulation, thereby strengthening consumer protection.

Furthermore, to mitigate the risks associated with P2P loan securitisation, the chapter advocates for the adoption of a look-through regulatory approach. This method would enhance transparency by allowing regulators to see through complex financial structures, ensuring that underlying risks are properly identified and managed.

Overall, this chapter presents a comprehensive framework that integrates gatekeeper liability, prudential regulation, and look-through regulation, aiming to create a more robust and effective regulatory structure for P2P lending and consumer protection. It also considers the role of civil liability in P2P lending, which works in tandem with regulatory measures.

Chapter 8 Conclusion

8.1 Summary of main findings

This thesis has examined the regulation of P2P lending from the perspective of consumer protection. P2P lending is an innovative form of FinTech that allows individuals to lend directly to one another through digital platforms. The argument put forth in this thesis underscores the distinctive tripartite relationship that exists between individuals and P2P lending platforms, framing P2P lending as a new form of intermediation that diverges from traditional concepts of financial intermediation or information intermediation. It rethinks the regulatory framework by drawing insights from the regulatory experiences of the UK and China. The main findings of this thesis, based on the four research questions, are as follows:

8.1.1 Justifications for regulating P2P lending

This thesis argues that P2P users are consumers and that the primary justification for regulating P2P lending is consumer protection. P2P users are similar to ordinary consumers who often lack specialised financial literacy in lending. While P2P borrowers face risks similar to those encountered by borrowers in personal or microfinance lending, P2P lenders are exposed to a unique set of risks. They bear excessive credit risks in two aspects: borrower defaults and platform defaults. However, these lenders must rely on the platform to make decisions and pursue loan repayments. Since platforms are not held liable for the accuracy of the information or credit ratings they provide, as long as they are not obviously at fault, there is a moral hazard where platforms might exploit the information asymmetry to the detriment of lenders and encourage expansive and risky loans. When a borrower's default occurs, the

lender(s) often depend on platforms to facilitate loan recovery, and it can be challenging for them to collect debts independently, especially when the cost of pursuing a defaulted loan exceeds the loan amount itself. P2P lenders' reliance on platforms creates an uneven playing field in P2P lending, making them the most vulnerable group in the event of any adverse developments in the industry. This vulnerability underscores the necessity of protecting P2P lenders who are the weaker party in this tripartite relationship, through regulation.

8.1.2 Critical issues in evaluating and designing a P2P lending regulatory regime

P2P lending is an evolution from micro-finance along with the development of IT. It is a type of non-bank intermediated finance rather than a form of disintermediated finance lending because it does not eliminate intermediation from its lending process; instead, it replaces the bank intermediary with a platform intermediary. The key findings regarding the design and evaluation of P2P lending regulation are as follows:

(1) Regulation needs to consider the complex tripartite relationship and the dual layers of trust inherent in P2P lending. Considering the perspective of lenders, a crucial regulatory concern revolves around ensuring their understanding of the risks and terms associated with P2P lending transactions to safeguard their diverse expectations. As the primary source of information for a lender's investment decision comes from the platform, determining the extent of the platform's responsibility becomes a pivotal issue in regulation. Similar to lenders, borrowers grapple with issues related to agency and asymmetric information. This is mainly due to the fact that they have to depend on the platforms to meet their obligations until the funds are received.

Moreover, concerns arise when evaluating the terms and commitments that borrowers owe to the platform and the lenders, including questions about the fairness of these obligations and whether they are carried out in a reasonable way.

Also, there is a legitimate concern in ensuring that the funds lent are utilised in a manner that aligns with its values and advances its interests. While the funds transacted through P2P lending platforms involve only private individuals, there exists the possibility of involvement in illicit activities such as money laundering or illicit financing.

(2) Due to the significant information asymmetry in P2P lending, along with the phenomenon of P2P lenders making irrational decisions and engaging in herding behaviour, free-market theories are inadequate for effectively governing this sector in both theoretical and practical terms. This thesis approaches P2P lending through the lens of behavioural economics to justify an interventional approach to regulation. Based on this understanding, the thesis advocates for a regulatory framework grounded in the principles of soft paternalism.

(3) As P2P lending contributes to the democratisation of finance by allowing a broader range of individuals and SMEs to access financial services, regulation should consider this social value of P2P lending. Thus, while implementing interventional measures to protect consumers, regulatory frameworks should also take into account the platforms' capability to absorb compliance costs. It is essential to strike a balance that protects consumers without stifling the development and innovation within the industry.

8.1.3 Insights from the Comparative Study

This thesis compares two distinct P2P lending markets and their respective regulations: the UK and China. The comparison is conducted in two ways: first, by reviewing each market and its regulations individually, and second, by applying a functional comparative approach to assess regulatory rules based on three key functions—transparency, clarity, and fairness—in regulating the P2P lending market. The comparative study finds that:

(1) An unregulated P2P lending market can rapidly fall into disarray, and once transparency is diminished and consumer trust is undermined, the challenges associated with implementing regulatory interventions become far greater than those involved in maintaining and promoting transparency in a stable market.

(2) As the P2P lending industry evolved, regulatory approaches in both countries became increasingly stringent and interventionist. This shift was driven by the realisation that minimal regulation or disclosure-based regulation alone was inadequate for protecting consumers. As a result, China's previously unregulated market grew progressively more controlled before its eventual end, while the UK approach has continued to move from an arm's-length approach to a consumerist narrative.

(3) Compared to China's "one-size-fits-all" regulation, the UK's responsive regulatory approach is more adaptable and better suited to the rapidly evolving P2P lending industry. The UK framework is also more detailed, particularly in terms of risk warnings, and accounts for diverse situations, especially concerning wind-down arrangements. However, China's regulations place greater emphasis on addressing conflicts of interest between the platform

and its users. In both countries, regulatory measures remain insufficient to fully protect consumers from platform misconduct, and a gap persists in resolving disputes between P2P users.

(4) P2P lending platforms do not fit neatly into the categories of either information intermediaries or financial intermediaries. This underscores the need for a unique regulatory framework, rather than limiting P2P lending to the role of an information intermediary or applying regulations designed for financial institutions.

(5) As the platform is best situated to mitigate problematic practices, imposing more liability on it for misconduct occurring within its operation can be an effective means of preventing such wrongful conduct. Importantly, this does not automatically absolve the primary wrongdoer of liability; rather it introduces a unique form of accountability that reflects the platform's role in either enabling or failing to prevent such misconduct. Thus, the core consideration in P2P lending regulation lies in determining the responsibilities that platforms should bear.

8.1.4 A new regulatory paradigm for P2P lending

This thesis found that fault-based liability, applied in both China and the UK for P2P lending platforms, is insufficient for P2P lending consumer protection and the long-term development of the industry. Fault-based liability often assumes that intermediaries are passive entities, making it appear unfair to hold them responsible for the actions of the primary actors.

However, P2P lending platforms are not passive intermediaries; they possess knowledge and control over users' behaviour.

In light of this, the thesis proposes adopting gatekeeper liability to enhance platform responsibility. This is based on the argument that P2P platforms play a dual role as gatekeepers. On one hand, they should bear responsibility for certain wrongdoings that platforms are capable of preventing or resolving. On the other hand, given the costs and the platform's limited capacity, it would be unfair to hold them accountable for all wrongdoings. To address this, the thesis introduces the concept of collaborative gatekeeper liability, which requires platforms to proactively monitor and detect signs of suspicious activity, collaborate with regulatory bodies, and report any client behaviour that may indicate potential misconduct.

As a cohesive regulatory framework for the P2P lending industry, the thesis also highlights the need for prudential regulation and civil liability to prevent harm and provide remedies to users, as well as the necessity for regulations that encourage platforms to facilitate dispute resolution between users. Additionally, the thesis discusses the value of a look-through regulatory approach for P2P loan securitisation, further underscoring the need for a comprehensive and adaptable regulatory strategy.

8.2 Limitations and further research

8.2.1 Limitations of the comparative study

In conducting a functional comparative analysis of P2P lending in the UK and China, two key limitations must be acknowledged. First, as outlined in Chapter 6, the significant differences in the outcomes of the P2P lending markets and the effectiveness of consumer protection

measures between the UK and China cannot be attributed solely to regulatory differences. Other factors, such as political influences, the development of the country's financial market, and cultural aspects related to financial behaviour, also play a role. Although these factors may not be the primary determinants of the disparities, they provide important context that may affect the effectiveness of regulatory frameworks. Therefore, the conclusions drawn from this comparative study primarily focus on highlighting the main regulatory concerns and do not fully encompass all the various factors that may complement regulation in shaping the P2P lending market and enhancing consumer protection.

Additionally, this comparative study is limited by the scope of its analysis, which is confined to the specific contexts of the UK and China. While comparing these two countries allows for the identification of universal features relevant to regulating P2P lending, as explained in Chapter 1, it is important to recognise that the findings may lack broad applicability due to significant variations in markets and legal systems across different countries. Each country's unique economic, cultural, and legal landscape means that regulatory practices effective in one jurisdiction may not necessarily be suitable or effective in another. Consequently, the conclusions drawn in this thesis should be interpreted with caution when applied to global contexts, as they may not fully account for the diverse factors that influence P2P lending regulation in other countries.

Therefore, further research that delves into the broader legal and cultural contexts, as well as those focusing on other distinctive markets and regulatory environments, could provide deeper insights and a more nuanced understanding. Such research would help uncover

complementary factors that influence the effectiveness of P2P lending regulations and contribute to a more holistic approach to consumer protection in various jurisdictions.

8.2.2 Limitation on timeliness

Another limitation of this thesis is related to its timeliness. As a part of FinTech, P2P lending is continuously evolving, with platforms updating their practices to adapt to new technology and shifting market conditions. This dynamic nature presents a challenge in maintaining the accuracy of research findings. As a result, the conclusions and insights drawn from this study are based on the current state of the P2P lending industry and may not fully account for future developments.

Consequently, continuous research is essential to stay abreast of the latest advancements and to address new challenges and opportunities that emerge in the P2P lending market. One foreseeable development in this field is the increased application of artificial intelligence (AI) in both industry practices and regulatory frameworks. The rapid evolution of AI has the potential to significantly reshape the P2P lending landscape, presenting both opportunities and challenges that require careful consideration. The growing use of AI by P2P lending platforms could greatly enhance the efficiency of loan matching and risk assessment, enabling more personalised lending for lenders and accurate financial solutions for borrowers. Also, AI algorithms have the capability to analyse vast amounts of data to identify patterns and predict borrower behaviour, potentially reducing default rates and improving overall platform performance. However, the integration of AI also introduces several challenges, particularly concerning data privacy, the potential misuse of personal data and algorithmic bias. Continued

research is necessary to navigate these complexities and to develop frameworks that harness the benefits of AI while safeguarding against its risks.

8.2.3 P2P lending in the macro-financial system

While this thesis primarily focuses on consumer protection in the context of P2P lending, it is also crucial to consider the broader implications of P2P lending on the macro-financial system. To gain a comprehensive understanding of its impact, further research is needed to explore its potential systemic effects, particularly in two key areas.

First, the development of P2P lending markets, as observed in the UK, where platforms have increasingly shifted towards facilitating secured loans, requires further attention. This shift raises a question about the role of P2P lending in contributing to macroeconomic phenomena. For example, in the case of housing price inflation, the increasing involvement of P2P platforms in the mortgage market may impact housing affordability and financial stability, potentially contributing to the formation or worsening of housing price bubbles. It is therefore necessary to investigate whether P2P lending has played a significant role in driving up property prices and to determine whether targeted regulatory intervention is needed to mitigate these effects and maintain a stable housing market.

Second, gaining a deeper understanding of the position of P2P lending within the broader financial ecosystem is essential for developing comprehensive regulatory strategies. P2P lending does not operate in isolation but interacts with traditional financial institutions and markets, potentially influencing financial stability and market dynamics. For instance, a sudden shock in the P2P lending sector could have ripple effects across the financial system,

potentially affecting credit availability and overall market confidence. Therefore, it is necessary to assess the potential systemic risks posed by P2P lending and to identify strategies for managing these risks to safeguard the integrity and sustainability of the financial system. This will likely need to be conducted primarily through empirical studies or quantitative analysis and prediction.

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