Eugenia Macchiavello and Antonella Sciarrone Alibrandi

Marketplace Lending as a New Means of Raising Capital in the Internal Market: True Disintermediation or Reintermediation?

Abstract: Marketplace lending, enabled by technological innovation, represents a new opportunity for raising capital. It is regarded by the EU as having the potential to expand the financing options of SMEs and improve the integration of the Internal Capital Market. However, applying traditional legal categories and existing laws to marketplace lending and to other examples of the new "platform economy" is not simple. Member States have adopted very different regulatory responses towards marketplace lending, with negative effects on the internal market. The essence of the regulatory dilemma consists in determining whether marketplace lending represents – as it has been depicted by platforms themselves, particularly in contractual agreements through disclaimers – a true disintermediated method of raising capital, an innovative form of intermediation, or a traditional kind of intermediation disguised in new and fashionable clothing. The answer to this question has relevant consequences for the regulatory treatment of marketplace lending and it requires a uniform response in the EU, at least with respect to the largest cross-border platforms. After briefly describing marketplace lending in Europe and the various current trends in regulating it, the paper discusses the main regulatory issues from the perspective of the above-mentioned issues. It analyzes the recently adopted Regulation on European Crowdfunding Services Providers in order to verify whether the regulatory choices that it has made are effective, both for the further development of marketplace lending and for addressing the associated risks.

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1 Lending-Based Crowdfunding in the Framework of the Capital Markets Union and FinTech Action Plans: The "Platform Dilemma"

Marketplace lending (also called P2P lending or lending-based crowdfunding) consists of the provision of loans to consumers or businesses by a multitude of individuals or entities (a "crowd"), each supplying only a small portion of the amount requested, generally through an online platform. Together with equity crowdfunding, marketplace lending took root in the context of the last financial crisis and, since then, has experienced continuous growth, so that it has come to represent the largest segment of European alternative finance. In particular, the consumer-based segment comprises 41 percent of the European alternative finance market, while the business-lending segment represents 14 percent.[1]

1 Other relevant shares of the alternative market are equity-based crowdfunding at 6 percent,

In both these segments, the UK is the most significant contributor, followed by Germany, France, while the fourth biggest market is Poland, in the first segment, and the Netherlands, in the second one.[2]

Marketplace lending appears to contribute to the promotion of innovation[3] and expanding financial inclusion,[4] thanks to cost minimization[5] and the speed of the underwriting process. Business lending through crowdfunding platforms is growing rapidly: in 2018, British P2P business lending accounted for 11.59 percent of the annual estimated volume of total new loans to small and me-

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real estate crowdfunding at 8 percent, and other types of securities at 5 percent. Other minor marketplace lending segments are balance sheet lending (in which the platform provides a loan from its balance sheet) for business (3 percent) and for consumers (0.1 percent). *Tania Ziegler et al.*, 'Shifting Paradigms – The 4th European Alternative Finance Benchmarking Report', (2019), p. 31–33, <https://www.jbs.cam.ac.uk/fileadmin/user_upload/research/centres/alternative-finance/downloads/2019-04-4th-european-alternative-finance-benchmarking-industry-report-shifting-paradigms.pdf> (last access for all electronic sources if not otherwise indicated: 11 August 2020). Last update to the text and sources: 7 February 2021.

2 See *Tania Ziegler et al.*, 'The Global Alternative Finance Market Benchmarking Report' (2020), p. 81–82, <https://www.jbs.cam.ac.uk/fileadmin/user_upload/research/centres/alternative-finance/downloads/2020–04–22-ccaf-global-alternative-finance-market-benchmarking-report.pdf>.
This and the following paragraphs draw from our previous contributions: *Eugenia Macchiavello*, 'Peer-to-peer Lending and the "Democratization" of Credit Markets: Another Financial Innovation Puzzling Regulators', Columbia Journal of European Law (2015) 21(3) 521, 540–42; *Id.*, 'Financial-Return Crowdfunding and Regulatory Approaches in the Shadow Banking, Fintech and Collaborative Finance Era', European Company and Financial Law Review 14(4) (2017) 662; *Guido Ferrarini/Eugenia Macchiavello*, 'FinTech and Alternative Finance in the CMU: The Regulation of Marketplace Investing, in: Emilios Avgouleas/Danny Busch/Guido Ferrarini (eds.), Capital Markets Union in Europe, 2018, p. 208 et seqq.; *Antonella Sciarrone Alibrandi et al.*, 'Marketplace lending. Verso nuove forme di intermediazione finanziaria?', Consob Quaderno Fintech No. 5/2019, <http://www.consob.it/documents/46180/46181/FinTech_5.pdf/a92a97f0-7d0e-43de-9fcd-4acfd97199f2>; *Eugenia Macchiavello*, 'What to Expect When You Are Expecting' a European Crowdfunding Regulation: The Current "Bermuda Triangle" and Future Scenarios for Marketplace Lending and Investing in Europe' (August 20, 2019), European Banking Institute Working Paper Series – No. 55/2019, <https://ssrn.com/abstract=3493688>.

3 About the tendency of nonbank lenders to finance more innovative projects than banks for reasons related to differences in funding costs and types, see *Jason Roderick Donaldson/Giorgia Piacentino/Anjan Thakor*, 'Intermediation Variety', (June 2019) NBER Working Paper No. 25946, <https://www.nber.org/papers/w25946>.

4 For the data about the percentage of unbanked or underbanked persons in certain EU countries, see *Ziegler et al*, (fn. 2), p. 94.

5 Platform operating costs are minimized through the use of technology (e.g. automated systems) and off-balance-sheet loans, the absence of transformation and maturity risk, and by the ability to avoid banking regulations: *Carlos Serrano-Cinca/Bego Gutierrez-Nieto/Luz López-Palacios*, 'Determinants of Default in P2P Lending', PLoS One 10(10) (2015), 1, p. 3.

dium-sized enterprises (SMEs), which represented a 25% growth rate over the previous year.[6] Furthermore, P2P consumer lending platforms appear to serve areas that may be underserved by traditional banks (because these areas have fewer branches or are economically depressed) and borrowers who are generally categorized by banks as subprime but able to sustain a loan.[7] It is also an interesting investment opportunity in terms of diversification (because it is an alternative and therefore more resilient market) and because of the possibility of both financial and nonfinancial/altruistic returns, while also improving competition, diversification, and innovation in the financial markets.[8]

Just as the financial crisis of 2007–2008 led to the initial explosion in crowdfunding, the pandemic and the global economic crisis that we have just gone through may potentially offer an opportunity for the phenomenon's further development. Since crowdfunding (and marketplace lending in particular) has proven in recent years to be an important alternative form of finance for consumers, start-ups, and SMEs, it could, in the wake of the pandemic, make a significant contribution to the fight against the negative economic effects of COVID-19.[9] Dur-

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6 *Ziegler et al.* (fn. 2), p. 85.

7 *Julapa Jagtiani/Catharine Lemieux*, 'Do Fintech Lenders Penetrate Areas That Are Underserved By Traditional Banks?, Journal of Economics and Business 100 (2018) 43; *Id.*, 'Fintech Lending: Financial Inclusion, Risk Pricing, and Alternative Information', (26 December 2017), Federal Reserve of Philadelphia Working Paper No. 17/2017, available at <https://ssrn.com/abstract=3096098>; *Julapa Jagtiani/Lauren Lambie-Hanson/Timothy Lambie-Hanson*, 'Fintech Lending and Mortgage Credit Access', Federal Reserve Bank of Philadelphia Working Paper No. 19–47, (November 2019), <https://www.philadelphiafed.org/-/media/research-and-data/publications/working-papers/2019/wp19–47.pdf>; *Calebe De Roure/Loriana Pelizzon/Anjar V. Thakor*, 'P2P Lenders Versus Banks: Creak Skimming or Bottom Fishing?', SAFE Working Paper No. 206/2019, <http://hdl.handle.net/10419/203316> (as regards the German consumer credit market, P2P lenders target riskier borrowers and the risk-adjusted interest rates are lower than those offered by banks). About business lending (but more generally referring to lending platforms that are managed by Big Tech instead of crowdfunding platforms), see *Harald Hau et al.*, 'Fintech Credit, Financial Inclusion and Entrepreneurial Growth', (2018) Working Paper, abstract available at <https://editorialexpress.com/cgi-bin/conference/download.cgi?db_name=EEAESEM2018&paper_id=598>; *Harald Hau et al.*, 'How FinTech Enters China's Credit Market', (2019), AEA Papers and Proceedings, 109, 60, <https://pubs.aeaweb.org/doi/pdfplus/10.1257/pandp.20191012> (observing that FinTech credit companies provide more credit to borrowers with lower credit scores).

8 Among other sources, see *European Commission*, 'Unleashing the Potential of Crowdfunding in the European Union', (Communication), COM(2014) 172 final 2, at 5, <http://ec.europa.eu/internal_market/finances/docs/crowdfunding/140327-communication_en.pdf>.

9 *Ratna Sahay et al.*, 'The Promise of Fintech Financial Inclusion in the Post COVID-19 Era', (2020), 16 et seqq., https://www.imf.org/en/Publications/Departmental-Papers-Policy-Papers/Issues/2020/06/29/The-Promise-of-Fintech-Financial-Inclusion-in-the-Post-COVID-19-Era-48623.

ing 2020, however, the growth of marketplace lending was not as pronounced as it could have been,[10] probably in view of the fact that an adequate regulatory framework for the phenomenon had not yet been established in Europe, and, in the absence of an effective EU regime, governments did not offered targeted support to the activities of the platforms.

Yet, already in the earliest stages of the Capital Markets Union[11] and FinTech Action Plans,[12] the European Commission included crowdfunding service providers in the scope of action. More specifically, the Commission advanced in March 2018 a Proposal[13] for a Regulation on European Crowdfunding Service Providers for Business (hereinafter ECSP Regulation), in consideration of its potential for expanding SME financing options and for improving the integration of the Internal Capital Market. After a lengthy legislative process, during which the original

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See also *European Commission*, 'Consultation on a New Digital Finance Strategy for Europe/FinTech Action Plan', (3 April 2020), <https://ec.europa.eu/info/sites/info/files/business_economy_euro/banking_and_finance/documents/2020-digital-finance-strategy-consultation-document_en.pdf>.

10 Preliminary data (April 2020) show a significant negative impact of the pandemic on marketplace lending, both as respects capital inflow (new investments) from investors and deal flow (the number of new projects registered on platforms) – in both cases, representing more than a 50 percent decline. There has only been a small impact thus far (in terms of payment delays and cash flow problems) on existing projects. The survey also reports on a lack of support for platforms from governments and certain measures taken by platforms to help crowd-borrowers (waiver of late repayment fees, delayed capital repayment on loans, operational support in the preparation of contingency plans, and provision of information on government subsidies): *European Crowdfunding Network* (*ECN*), 'Early Impact of CoVid19 on the European Crowdfunding Sector' (April 2020), <https://eurocrowd.org/wp-content/blogs.dir/sites/85/2020/04/ECN_CoVid19_Survey_20200414.pdf>. A recent study (January 2021) shows improvements in the European mechanisms for raising capital (e. g., equity-based crowdfunding, including donation-based crowdfunding, which reported exceptional growth during the pandemic aimed at supporting hospitals, etc.), while a decrease in overall marketplace lending in terms of volume (-3 percent) and the number of transactions (-2 percent), despite an increase in the number of borrowers (which has grown by 8 percent), in particular new ones (+28 percent): Tania Ziegler et al., 'The Global Covid-19 FinTech. Market Rapid Assessment Study', (December 2020), 87–88, <https://www.jbs.cam.ac.uk/wp-content/uploads/2020/12/2020-ccaf-global-covid-fintech-market-rapid-assessment-study.pdf>.

11 *European Commission*, 'Action Plan on Building a Capital Markets Union' (Communication) COM/2015/0468 final (30 September 2015); *Id.*, 'Mid-Term Review of the Capital Markets Union Action Plan', COM(2017) 292 final (8 June 2017).

12 *European Commission*, 'FinTech Action Plan: For a More Competitive and Innovative European Financial Sector', (Communication) COM/2018/0109 final (8 March 2020).

13 *European Commission*, 'Proposal for a Regulation of the European Parliament and of the Council on European Crowdfunding Service Providers (ECSP) for Business', (8 March 2018) COM(2018)113.

proposal was subject to several modifications, the final text[14] was adopted by the Council only on 20 July 2020 and by the European Parliament on 7 October 2020; it was published in the Official Journal on 20 October 2020.[15] Significantly, this is the first regulation adopted in the FinTech sector at the EU level and, with regard to the basic choices contained therein, it therefore constitutes an important point of reference for further regulations that will be issued in the coming months.

The need for a European regulation focused on crowdfunding service providers can also be explained by the fact that this type of marketplace, although part of the more general phenomenon called the "platform economy",[16] often associated with the "sharing economy," but more recently re-defined as "crowd-based capitalism" because of its profit-driven character and concentrated power,[17] responds to financial needs and therefore poses particular issues. An online platform is generally identified as 'a digital service that facilitates interactions between two or more distinct but interdependent sets of users (whether firms or individuals) who interact through the service via the Internet ("multi-sided platforms").'[18] They tend to be characterized by a fragmentation of the traditional value chain and the provision of services by other users (not by the platform) who might simultaneously be both consumers and producers ("prosumers").

14 *Council of the European Union*, 'Position of the Council at first reading with a view to the adoption of a Regulation […] on European crowdfunding service providers for business, and amending Regulation (EU) 2017/1129 and Directive (EU) 2019/1937', <https://data.consilium.europa.eu/doc/document/ST-6800-2020-INIT/en/pdf>.

15 Regulation (EU) 2020/1503 […] of 7 October 2020 on European Crowdfunding Service Providers for Business. The Regulation will then enter into force the 20th day after the publication but will be applied from 10 November 2021, saved for differentiated dates of application for certain rules/cases. For a detailed analysis of the ECSP Regulation, please see: *Eugenia Macchiavello*, 'The European Crowdfunding Service Providers Regulation and the Future of Marketplace Lending and Investing in Europe: The 'Crowdfunding Nature' Dilemma', European Business Law Review 2021, 32(3) 557; *Id.*, 'Marketplace Lending and Investing in Europe and the EC Proposal for a Regulation on European Crowdfunding Service Providers for Businesses', in Elisabetta Bani/Edyta Rutkowska-Tomaszewska/Beata Pachuca-Smulska (eds.), Public Law and the Challenges of New Technologies and Digital Markets, Volume II, 2020, p. 119; see also *Id.*, 'Disintermediation in Fund-raising: Marketplace Investing Platforms and EU Financial Regulation', in Iris H. Chiu/Gudula Deipenbrock (eds.), Routledge Handbook on FinTech and Law, 2021, p. 291 et seqq.

16 *Orly Lobel*, 'The Law of the Platform', Minnesota Law Review 2016, 101(1), 87; *FSB*, 'Decentralised Financial Technologies. Report on Financial Stability, Regulatory and Governance Implications', (6 June 2019), <https://www.fsb.org/wp-content/uploads/P060619.pdf>.

17 See *Arun Sundararajan*, The Sharing Economy: The End of Employment and the Rise of Crowd-Based Capitalism, 2016.

18 *OECD*, An Introduction to Online Platforms and Their Role in the Digital Transformation, 2019, <https://www.oecd.org/innovation/an-introduction-to-online-platforms-and-their-role-in-the-digital-transformation-53e5f593-en.htm>.

This results in a complex nexus of multiple contracts governing the relationships among the users and between the platform and the users, and in the creation of peer-to-peer (P2P) marketplaces, in which platforms connect parties (often through algorithms) and provide standard contracts and rating systems to cope with the absence of a trusted party, with all participants benefiting from global network effects and broad accessibility.[19] As interpreted in light of the traditional systems of raising capital, this entails the replacement of traditional financial intermediaries, including underwriters, analysts, distributors, etc., with "P2P-marketplaces" (in both the primary and secondary markets).

In light of such a platform-based structure, it is not easy to apply traditional legal categories (such as those relating to financial instruments, markets, issuers, underwriters, etc.) to marketplace lending or to subject it to existing laws in various sectors (banking law, investment and markets regulation, AML/CT law, business law, consumer protection, etc.). This difficulty is enhanced by the variety of business models used in marketplace lending. None of the very different sets of rules adopted by several Member States to deal with the phenomenon have resulted in an effective regulatory response from an internal market point of view. Different levels of investor protection among countries and distorted competition are in fact detrimental to the goal of a high level of harmonization in financial regulation and to the postcrisis trend towards greater integration.

It is therefore to be welcomed that European authorities have chosen to issue a regulation aimed at clarifying, specifically with respect to ECSPs, the basic "platform dilemma". The crucial question relates, in fact, to whether marketplace lending represents – as originally described by actors in the sector, especially in contractual agreements by means of disclaimers – a true disintermediated method of raising capital, a mere informational and technical service,[20] an innovative form of financial intermediation, or a traditional type of financial intermediation disguised in new and fashionable clothing.

The answer to this question has relevant consequences for regulatory treatment of marketplace lending as well as its resulting market structure, and, at the same time, must be uniform in the EU, at least as regards the biggest and cross-border platforms.[21] The European Court of Justice (ECJ) has so far responded to

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19 *OECD* (fn. 18), p. 11 et seqq.; *Linar Einav/Chiara Farronato/Jonathan Levin*, 'Peer-to-peer markets', NBER Working Paper No. 21496/2015, <http://www.nber.org/papers/w21496>.

20 Exempted under Art. 2(a) e-commerce Directive (No. 2000/31 [2000]); Art. 2(2)(d) Services in the Internal Market Directive (2006/123/CE), Art. 56 TFEU.

21 With respect to online platforms, see also Regulation (EU) 2019/1150 on promoting fairness and transparency for business users of online intermediation services and the proposals present-

such issues in the context of other economic sectors on a case-by-case (and "service-by-service") basis. For instance, in the transportation field, the ECJ has viewed Uber as a direct provider of transportation services (requiring a national license), under the theory that it created a new market ("non-professional transportation") and that its services (in principle, information society services) are an integral part of the new transportation market it has created, and the Uber exercises a decisive influence over the conditions under which drivers operate (e. g., the organization of the labour force, price-setting, control over quality, liability for damages, etc.).[22] On the other hand, in the accommodations sector, the ECJ has seen Airbnb as constituting a mere service of the information society and therefore exempted "sellers" from the need to procure national licenses as real estate agents because of the presence of a pre-existing market (for short-term accommodations, although only offered by professionals) and the lack of their decisive influence on the product (the platform does not set the rental price nor select the hosts or accommodations).[23] The Court has also been asked whether a P2P lending platform can be considered a "creditor" under Article 3(b) of the Consumer Credit Directive (2008/48/EC) where it has only facilitated P2P loans, but it did not issue a preliminary ruling due to the sudden default of the concerned platform.[24]

In the following sections, after describing the main business models of marketplace lending in Europe and each model's related risks, as well as various trends in the regulation of these models at the national level, we will analyze the recent ECSP Regulation to evaluate the choices made in the regulation with respect to the highlighted risks and, more generally, with respect to the platform dilemma, taking into account the possible effect of this regulatory approach on the market structure of European marketplace lending.

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ed by the Commission in December 2020 (while this contribution was already under review) concerning a Single Market For Digital Services (COM(2020) 825 final) and concerning Digital Markets (COM(2020) 842 final).

22 Case C-434/15 *Asociación Profesional Élite Taxi v Uber Systems Spain SL* [2018] OJ C-72/2; case C-320/16 *Uber France Sas* (GC, 10 April 2018).

23 Case C-390/18 *Airbnb Ireland* (GC, 19 December 2019). See *Liesbet Van Acker*, *C-390/18 – The CJEU Finally Clears the Air(bnb) Regarding Information Society Services*, EuCML 2 (2020) 77.

24 Case C-311/15 *TrustBuddy AB v Lauri Pihlajaniemi* [2016] OJ C-38/46 and [2015] OJ C-294/38.

2 Marketplace Lending in Europe: Main Business Models and Related Risks

One of the main drivers adding complexity to the platform dilemma is the wide variety of business models that exist in the market today and that are available to both borrowers and lenders. Under the basic and (so far) most widespread model of marketplace lending (called a "client-segregated account"),[25] loans are disbursed by crowd-lenders (each providing small sums) at their own risk through contracts with crowd-borrowers, with the platform only facilitating transactions through the provision of various services, for which the platform is remunerated on a fee basis. For instance, the platform generally performs the pre-screening of applicants (e. g., based on credit scores and/or algorithms) and publishes the details of the project on its website, thereby putting crowd-borrowers and crowd-lenders in contact. Platforms also tend to set up communication and feedback systems,[26] provide boilerplate contracts, handle the contractual relationships that are formed (including credit collection) and, when a separate payment service provider is not used, money transfers. However, significant variations in the models exist and some solutions are aimed at reducing the typical information asymmetry in credit markets and at and aligning the interests of the platforms and the investors but at the same time the same enhance the role of the platforms. For instance, some platforms let crowd-lenders decide which loans to finance based on the objective characteristics of the loan (maturity, interest rate, risk category, collateral, size, reimbursement options, etc.) used as search filters and based on the available information (also 'soft' information, pitches, backers' support, etc.) about the crowd-borrower (e. g. sex, age, job, residence, purpose of the financing, etc.) but often suggest or impose a certain level of diversification on the crowd-investors. Some platforms feature lending groups that have a leader who co-invests and conducts due diligence in order to reduce information

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25 *Committee on the Global Financial System (CGFS)/Financial Stability Board (FSB),* 'FinTech Credit. Market Structure, Business Models and Financial Stability Implications', 2017, p. 11 et seqq.; *Tania Ziegler/Rotem Shneor,* 'Lending Crowdfunding: Principles and Market Development', in: Roten Shneor/Liang Zhao/Bjørn-Tore Flåten (eds) Advances in Crowdfunding, 2020, 63, p. 68 – 70.

26 About reputational mechanisms in online credit markets that are useful for reducing information asymmetry and moral hazard by improving credit risk analysis and creating incentives not to default (so as to avoid social stigma), see *Xin, Yi*, 'Asymmetric Information, Reputation, and Welfare in Online Credit Markets' (August 1, 2020), <https://ssrn.com/abstract=3580468>; *Ruyi Ge et al.*, 'Predicting and Deterring Default with Social Media Information in Peer-to-Peer Lending', Journal of Management Information Systems 34(2) (2017) 401.

asymmetries. Some set up guarantee funds to cover crowd-borrower defaults but the characteristics of the same might differ significantly in terms of conditions to receive the compensation (e.g. based on the discretion of the platforms or, instead, on objective and predetermined criteria), order of satisfaction, amount of reimbursement (partial, total, which percentage of the capital invested).[27] The price of loans might depend on competitive bids or, more frequently, on the platform's rating of the crowd-borrowers.[28] Creditworthiness assessments are often based on innovative and technology-led systems that take into account not only traditional "hard" financial information (e.g., financial statements and credit scores) but also "soft" financial (e.g., payment history, including utility bills, and buying habits) and nonfinancial (e.g. social media likes or followers) information.[29] The platforms are remunerated in the form of fees, which are generally dependent on the volume of loans disbursed and/or the performance of the loans.[30]

Some platforms, following an increasingly popular business model, have set up algorithmic or "auto-bid" systems that automatically assign crowd-lenders' funds to crowd-borrowers based on their risk profiles and characteristics (expect-

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27 *CGFS-FSB* (fn. 25) p. 8, 12–13; *Financial Conduct Authority (FCA),* '*FCA*, 'Loan-based ('peer-to-peer') and Investment-Based Crowdfunding Platforms: Feedback on Our Post-Implementation Review and Proposed Changes to the Regulatory Framework', (July 2018), CP 18/20, p. 18, 20, 30–31, <https://www.fca.org.uk/publication/consultation/cp18-20.pdf>.

28 For evidence of a better credit allocation when prices are set by platforms instead of an auction mechanism, see *Talal Rahimy*, 'Can Online Platforms Improve Resource Allocation by Controlling Prices?', (May 2020), <https://www.researchgate.net/publication/342200397_Can_Online_Platforms_Improve_Resource_Allocation_by_Controlling_Prices>.

29 On the ability of such systems to predict creditworthiness better than traditional credit scores, see *Julapa Jagtiani/Catharine Lemieux,* 'The Roles of Alternative Data and Machine Learning in Fintech Lending: Evidence from the LendingClub consumer platform', Financial Management 48 (2019) 1009; *Nikita Aggarwal,* 'Machine Learning, Big Data and the Regulation of Consumer Credit Markets: The Case of Algorithmic Credit Scoring' in: Nikita Aggarwal et al (eds) Autonomous Systems and the Law, 2019; *J. Yan/W. Yu/J. L. Zhao*, 'How Signaling and Search Costs Affect Information Asymmetry in P2P Lending: The Economics of Big Data', Financial Innovation 1(1) (2015) 19. See also *Cummins et al.* (fn. 30), p. 20 et seqq.; *Tobias Berg et al.*, 'On the Rise of FinTechs – Credit Scoring Using Digital Footprints', (July 15, 2019), Michael J. Brennan Irish Finance Working Paper Series Research Paper No. 18–12, <https://ssrn.com/abstract=3163781>.

30 These fees include origination fees (from the borrower), repayment fees (from the lender), late payment fees, trading fees, servicing fees, and others. See *Stijn Claessens et al.*, 'Fintech Credit Markets Around the World: Size, Drivers and Policy Issues', BIS Quarterly Review (23 September 2018), 29, p. 32, <https://www.bis.org/publ/qtrpdf/r_qt1809e.pdf>; *Mark Cummins et al.*, 'Addressing Information Asymmetries in Online Peer-to-Peer Lending', in: Theo Lynn et al. (eds), Disrupting Finance. FinTech and Strategy in the 21st Century, 2019, 15, p. 18.

ed return, interest rate, maturity, etc.),[31] also with an eye toward ensuring investment diversification. Some other platforms engage in co-lending; that is, the platform participates in each loan on the platform together with the crowd-lenders in a (generally) limited percentage of the total loan amount.

In another model, called the "notary" business model, which is common in Germany and the US, the platform prescreens borrowers, publishes the projects online, and collects the funds, but a bank originates the loans and immediately resells them to a Special Purpose Vehicles (SPV) created by the platform, which subsequently issues notes to crowd-lenders representing their portion of the credit and remains the only counterparty of the crowd-lenders. A variation of this model entails securitization of loans, which are disbursed by a bank, assigned to the SPV and then repackaged, with the SPV's notes sold to the crowd.

Another model (the "balance sheet" model), which is common in Australia, Canada, and the US, involves the platform collecting the funds from the crowd through bonds or equity and providing the loans on its account or buying the loans provided in the first place by a bank. Like the notary model, crowd-lenders have recourse only against the platform, but under the balance sheet model the platform assumes the risk of borrower defaults.

Finally, under the "guaranteed return" model, a variation of the balance sheet model, the platform ensures a certain return to crowd-lenders investing in loan portfolios having a composition that is decided by the platform. This

31 In 2017, a large number of European platforms offered auto-bid or auto-selection functions for P2P consumer lending (82 percent) and P2P property lending (67 percent), while the percentage was lower for P2P business lending (25 percent). See Ziegler et al., 'Shifting', (fn. 1), p. 40 – 41. Recent studies seem to evidence a better performance of algorithms in predicting defaults in China – which favours the use of auto-bid mechanisms – but also shows that the algorithms contain gender and race-based biases: *Runshan Fu/Yan Huang/Param Vir Singh,* 'Crowds, Lending, Machine, and Bias', June 24, 2020, <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3206027>. Better results in terms of welfare for lenders, borrowers, and platforms (Pareto efficiency) seem to be associated with passive models (in which platforms perform the information research) or bank-like models (in which platforms bear liquidity risks: e. g., the Bandora "Go and Grow" product). See *Fabio Braggion et al.*, 'The Value of "New" and "Old" Intermediation in Online Debt Crowdfunding', CEPR Discussion Paper No. 14740/2020, <https://cepr.org/active/publications/discussion_papers/dp.php?dpno=14740#>. Partially *contra* to these conclusions and challenging the ability of the automatic systems used by some British platforms to reach information efficiency, see *Julian R. Franks/Nicolas Andre Benigno Serrano-Velarde/Oren Sussman*, 'Marketplace Lending, Information Aggregation, and Liquidity' (March 16, 2020), European Corporate Governance Institute–Finance Working Paper No. 678/2020, Review of Financial Studies (Forthcoming), p. 3, <https://ssrn.com/abstract=2869945>.

model is widespread in China and growing also in the US and UK.[32] Compared with the auto-bid system, the platform management component of this model is more evident and a certain return is promised, but the difference can be nuanced by different levels of investor power, automation, and guaranteed returns.

The sector is constantly developing, with the regular appearance of new and interesting subsegments like invoice trading.[33] Invoice trading consists of a platform's facilitation of the sale of an enterprise's business receivables at a discount to investors so that the enterprise can gain liquidity, but this phenomenon will not be analysed here, as it deserves a separate discussion.

From a regulatory point of view, it is important to identify the risks inherent in marketplace lending and for regulators to be aware that each business model entails its own risks.[34] The most important of these risks pertain to crowd-lender/

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32 About the different models, see *Eleanor Kirby/Shane Worner*, 'Crowdfunding: An Infant Industry Growing Fast', OICV-IOSCO Staff Working Paper 3/2014, <http://www.iosco.org/research/pdf/swp/Crowd-funding-An-Infant-Industry-Growing-Fast.pdf>; *CGFS/FSB* (fn. 25); *Claessens et al.* (fn. 30), p. 30 et seqq.

33 In 2017, invoice trading represented, at a volume of € 535.84 million, 15.9 percent of the European alternative finance market. It was the second-biggest subsector of this market after P2P consumer lending. See *Ziegler et al.*, 'Shifting' (fn. 1) p. 31. In 2018, it was the fourth-biggest, at a volume of €803 million. *Ziegler*, 'Global' (fn. 2) 78 – 79. Concerning the challenges in regulating invoice trading in Italy, *see Eugenia Macchiavello*, 'La Regolazione del FinTech tra Innovazione, Esigenze di Tutela e Level-Playing Field: L'inesplorato Caso dell'Invoice Trading', Banca, impresa e società 3 (2019) 497 (in Italian only, with English abstract). Art. 45(2)(d) of the ECSP Regulation considers extending its scope to this segment of the alternative finance market.

34 More extensively about the characteristics, business models, benefits, and risks of Financial Return Crowdfunding (FRC) and for references, see *Eugenia Macchiavello*, 'Peer-to-peer Lending' (fn. 2) p. 540 – 42; *Id.*, 'Financial-Return Crowdfunding' (fn. 2); *Guido Ferrarini/Eugenia Macchiavello*, 'Investment-based Crowdfunding: Is MiFID II Enough?', in: Danny Busch/Guido Ferrarini (eds.), Regulation of EU Financial Markets: MiFID II, 2017, p. 668 et seqq.; *Id.*, 'FinTech and Alternative Finance' (fn. 2); *John Armour/Luca Enriques*, 'The Promise and Perils of Crowdfunding: Between Corporate Finance and Consumer Contracts', The Modern Law Review 81(1) (2018) 51; *Antonella Sciarrone Alibrandi et al.* (fn. 2); *Mark Fenwick/Joseph A. McCahery/Erik P.M. Vermeulen*, 'Fintech and the Financing of Entrepreneurs: From Crowdfunding to Marketplace Lending' In: Douglas Cumming/Lars Hornuf (eds), The Economics of Crowdfunding, 2018; *FCA*, 'The FCA's Regulatory Approach to Crowdfunding and Similar Activities', (2013) CP13/13; *European Commission Financial Services User Group*, 'Crowdfunding from an Investor Perspective, (EU 2015), 25; *Mark Carney*, 'The Promise of FinTech – Something New Under the Sun?', speech at Deutsche Bundesbank G20 conference 'Digitalising Finance, Financial Inclusion and Financial Literacy', (Wiesbaden, 25 January 2017), <www.bankofengland.co.uk/-/media/boe/files/speech/2017/the-promise-of-fintech-something-new-under-the-sun.pdf?la=en&hash=0C2E1BBF1AA5-CE510BD5DF40EB5D1711E4DC560F>; *FSB*, 'Financial Stability Implications from FinTech. Super-

investor protection, and there are some variations in this risk depending on the business model under discussion.

Under the basic model, crowd-lenders face the risk of losing the capital invested, both because of the possibility of borrower default or, in the absence of an effective contingent plan and new servicing, the platform's default. They might also be harmed by misleading or insufficient information, herding,[35] lax pre-screening or other agency problems, and conflicts of interest with the platform; for example, with respect to the latter, where remuneration schemes are based on the volume and number of loans intermediated and only crowd-lenders bear the credit risk. Considering that investors contribute only a limited sum to each loan, a collective action problem is also present unless the platform assumes the role of the lenders'/investors' agent and has not itself defaulted.

When algorithms or even portfolio management systems are deployed, risk management, liability, and the parties against whom legal recourse is available become central issues.[36] Notary models entail the usual issues of "originate-to-distribute" models (in terms of incentives and legal recourse available only against the SPV) and (systemic) risks related to the closer interconnection with the banking sector. Balance sheet models are less innovative and therefore raise fewer foundational issues; they are closer to the structure of investment banks and investment funds.

Illiquidity represents an additional relevant risk on the investor side. To improve liquidity, some platforms offer crowd-lenders the opportunity to resell

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visory and Regulatory Issues that Merit Authorities' Attention', (27 June 2017), <www.fsb.org/wp-content/uploads/R270617.pdf>; *CGFS/FSB* (fn. 25); *EBA*, 'Opinion on Lending-based Crowdfunding', EBA/Op/2015/03'; *ESMA*, 'Opinion on Investment-based Crowdfunding', ESMA/2014/1378; *Claessens et al* (fn. 30).

35 Studies attest to the fact that crowd-lenders seem subject to herding, but based on rational factors ("rational herding"), relying, correctly, on soft information and signals from more informed investors. See *Rajkamal Iyer et al.*, 'Screening Peers Softly: Inferring the Quality of Small Borrowers', Management Science 62(6) (2016) 1554*; A. Mohammadi/K. Shafi,* 'How Wise Are Crowd? A Comparative Study of Crowd and Institutions', (2019) Paper presented at DRUID19 Conference, Frederiksberg, Denmark, <https://conference.druid.dk/acc_papers/0j8pnrgwc9fqajb5ylj6ew9fuoh3ul.pdf> (most successful borrowers have a good online reputation and track record). Nonetheless, on the risk of investor biases and mispricing, see *Laura Gonzalez/Yuliya Komarova Loureiro*, 'When Can a Photo Increase Credit? The Impact of Lender and Borrower Profiles on Online Peer-to-Peer Loans, Journal of Behavioral and Experimental Finance 2 (2014) 44; *Saman Adhami/Gianfranco Gianfrate/Sofia A. Johan,* 'Risks and Returns in Crowdlending', March 3, 2019, <https://ssrn.com/abstract=3345874>; for a review of the relevant literature, see *Cummins et al.* (fn. 30), 20 et seqq.; *Alexander Bachmann et al.*, 'Online Peer-to-Peer Lending – A Literature Review', Journal of Internet Banking and Commerce 16(2) (2011) 1.

36 About marketplace lending and AI, see also the paper by Reiner in this Special Issue.

their rights on the platform (e. g., early reimbursement) or on P2P marketplaces ("bulletin boards").[37]

Recently, the sector has been characterized by a growing number of institutional and professional investors participating in the marketplace as lenders.[38] This raises issues about how to take advantage of institutional investors' ability to reduce information asymmetry (through, for example, the use of proprietary algorithms) while limiting the risk of cherry picking by these investors at the expense of retail investors.[39] It should be kept in mind that it has been in reaction to such "institutionalization" (as well as to liquidity problems) that many platforms in the US, China, and UK have recently moved away from the original "direct" and auction-based models to automatic investment and portfolio management models (while at the same reducing the information available on the platform); this has been done in order to decrease the resource disparity between retail and sophisticated investors.[40]

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37 In 2014, 29 percent of lending-based platforms featured some form of secondary market for their products (versus only 9.5 percent of European equity-based platforms). See *Giuliana Borello et al.*, 'The Funding Gap and The Role of Financial Return Crowdfunding: Some Evidence From European Platforms', JIBC 20(1) (2015) 1, p. 13, 16.

38 Fifty-five percent of P2P business lending platforms and 38 percent of P2P property lending platforms have disclosed that in 2018 more than one-third of their volumes (versus only 10 percent of P2P consumer lending platforms) were funded by institutional investors. The level of "institutionalization" is different across countries, with high percentages in Benelux, Italy, and Germany (respectively, 90 percent, 88 percent, and 64 percent, but irrespective of the business model, and therefore including invoice trading, which is characterized by the dominance of institutional investors) and low percentages in the Commonwealth of Independent States, Eastern Europe, Central Europe, and the Baltics (respectively, 2 percent, 4 percent, 5 percent, and 5 percent). See *Ziegler et al.* (fn. 2), p. 86 – 88.

39 There is evidence that sophisticated investors – including retail investors using robo-advisors – outperform unsophisticated investors; for this reason, some platforms have decided to intensify prescreening while reducing information available to investors in order to level the playing field. See *Boris Vallée/Yao Zeng*, 'Marketplace Lending: A New Banking Paradigm?', The Review of Financial Studies 32(5) (2019) 1939; *Mohammadi/Shafi* (fn. 35) (institutional investors outperform retail investors in predicting borrower default, especially in the cases of riskier and smaller loans).

40 *Tetyana Balyuk/Sergei A. Davydenko*, 'Reintermediation in FinTech: Evidence from Online Lending', (August 8, 2019), Michael J. Brennan Irish Finance Working Paper Series Research Paper No. 18 – 17, 31st Australasian Finance and Banking Conference 2018, <https://ssrn.com/abstract=3189236> (theorizing a shift towards reintermediation in P2P lending markets because of improved screening by platforms, done in order to attract unsophisticated investors with their more passive attitude of reliance on the platform's efforts; however, the sample – and prediction – is limited to the US market, with some reference to the UK market); *Vallée/Zeng* (fn. 39),

Crowd-borrowers, on the other hand, might face collective action issues in debt restructuring, discrimination in selection,[41] abusive contractual terms, and negative consequences from the publication of unprotected corporate information.

Finally, the financial system might have to deal with the consequences of the inadequate management of platforms' operational risk with respect to fraud, cybersecurity, money laundering, and the financing of terrorism. Systemic risk remains low at present, but this may change in light of the sector's growth rate and increased interconnections with the mainstream financing sector. Some of these risks have begun to materialize with the first platform defaults in Europe, which have increased regulators' attention and concerns.[42]

3 Regulatory Trends and Main Policy Issues in Various European Countries

Member States' regulatory responses to marketplace lending, as mentioned above, have been extremely varied.[43] Marketplace lending platforms, for in-

p. 1946. With respect to the UK P2P market and the move towards auto-bid and institutional investments as a response to liquidity shocks, see *Franks et al.* (fn. 31).

41 About the risk of discrimination against certain minorities when using algorithms in credit markets, see *Andreas Fuster et al.*, 'Predictably Unequal? The Effects of Machine Learning on Credit Markets' (March 11, 2020), <https://ssrn.com/abstract=3072038>.

42 The Swedish platform TrustBuddy went into administration in October 2015 and has been investigated for "serious misconduct" by its management, while the British platform Lendy entered into administration in May 2019: <http://www.p2pfinancenews.co.uk/2019/05/29/p2p-administrations-a-timeline/>. See also fn. 24.

43 For a comparative analysis of the main European systems and related discussion, please refer to the contributions indicated in footnote 2 and to: *European Commission*, 'Crowdfunding in the EU Capital Markets Union', Commission Staff Working Document, SWD(2016) 154 final, <https://ec.europa.eu/info/system/files/crowdfunding-report-03052016_en.pdf>; *Matthias Klaes et al.*, 'Identifying Market and Regulatory Obstacles to Crossborder Development of Crowdfunding in the EU', (2017), <https://ec.europa.eu/info/sites/info/files/171216-crowdfunding-report_en.pdf>; *CrowdfundingHub*, 'Crowdfunding Crossing Borders', (2016), <https://drive.google.com/file/d/0B7uykMX1rDrWU3BRZTBMNzFwLVE/view>; *Olena Havrylchyk*, 'Regulatory Framework for the Loan-Based Crowdfunding Platforms', OECD Economics Department Working Papers No. 1513/2018, <https://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=ECO/WKP(2018)61&docLanguage=En>; *Dirk A. Zetzsche/Christina Preiner*, 'Cross-Border Crowdfunding – Towards a Single Crowdfunding Market for Europe', European Business Organization Law Review 19 (2018) 217; *Deirdre Ahern*, 'Regulatory Arbitrage in a FinTech World: Devising an Optimal EU Regulatory Response to Crowdlending', (March 1, 2018), European Banking Institute Working

stance, have received varied legal classifications and consequent regulatory treatments, depending on the country:

a) as payment service providers (PSPs) or even as payment agents of EU PSPs when directly handling client money; nonetheless, platforms perform much more complex services than PSPs such as project owner selection, matching, pricing, information channelling, which better characterize crowdfunding activities and are not covered by rules governing PSPs; therefore, such relevant services remain unregulated (in e. g., Italy, Poland, the Czech Republic, Denmark, Sweden);

b) as intermediaries conducting a form of banking activity without the required authorization: in some countries, lending was formerly reserved to banks and therefore platforms could be considered as facilitators of an illegal activity performed by private lenders (Germany and France before the reform); other countries have regarded the platforms' activity as the collection of repayable funds from the public or simply as the facilitation of such collection. This characterization depends on the particular borders of the banking monopoly and the transposition of the Capital Requirement Directive/Regulation in each country (in, e. g., Italy and Belgium, where there is a prohibition on the collection of repayable funds from the public even if by non-professionals). However, this perspective appears to misread the reality of marketplace lending: in fact, platforms do not perform the typical economic functions of banks (maturity/liquidity transformation and money creation through the activity of receiving repayable deposits in order to provide loans), offer more limited kinds of services, and – at least under models other than the balance sheet model – do not lend at their own risk.[44] More complex business models deploying auto-bid systems or even individual portfolio management and guaranteed returns models, the use of contingent funds and investment advice, with crowd-lenders bearing credit and liquidity risks, indeed raise important regulatory issues but only from an in-

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Paper Series 2018 No. 24, <https://ssrn.com/abstract=3163728>; *Sebastiaan N. Hooghiemstra/Karl de Buysere*, 'The Perfect Regulation of Crowdfunding: What Should the European Regulator Do?', in: Oliver Gajda/Dennis Brüntje (eds.), Crowdfunding in Europe – State of the Art in Theory and Practice, 2015; *Elif Härkönen*, 'Regulating Equity Crowdfunding Service Providers – An Innovation-Oriented Approach to Alternative Financing', NJCL 1 (2018), 201; *T. Jørgensen*, 'Peer-to-Peer Lending – A New Digital Intermediary, New Legal Challenges', NJCL 1 (2018) 231 (concerning the Nordic and Eastern European countries).

44 See *Claessens et al.* (fn. 30), p. 32; *Balyuk/Davidenko* (fn. 40), 38; *CGFS/FSB* (fn. 25), 31; *Olena Havrylchyk/Marianne Verdier*, 'The Financial Intermediation Role of the P2P Lending Platforms', Comparative Economic Studies 60 (2018) 115; *Boris Vallée/Yao Zeng* (fn. 39) (marketplace lending is characterized by joint information production by both platforms and investors); *Anjan V. Thakor*, 'Fintech and Banking: What Do We Know?', Journal of Financial Intermediation 41 (2020), 1.

vestment (not banking) law perspective (see below). Banking law issues can only arise in case of of lenders' instant redemption rights, absence of asset separation, or the absence of any decisional power over the destination of the funds to crowd-borrowers,;[45]

c) as credit brokers who professionally connect lenders and borrowers to allow the same to conclude loan contracts (e.g., Estonia and Finland for consumer loans, and Norway for all loans). Credit brokers are generally subject to light national regimes which are focused on borrower (not investor) protection. At the EU level, the discipline of credit intermediaries has only been partially harmonized by the Mortgage Credit Directive (2014/17/EU); furthermore, such EU law tends to apply only in the case of professional lenders (while crowd-lenders are considered nonprofessional; see Art. 1(1)b-c Consumer credit directive – CCD – No. 2008/48/CE and below);

d) as investment firms that perform, depending on the business model, reception and transmission of orders, placing without firm commitment, investment advice, individual portfolio management, or as managers of investment funds. The fact that they offer investment opportunities and channel relevant investment information makes the activity of platforms something closer to investment services than banking activity; nonetheless, MiFID II applies only in the case of investment services pertaining to financial instruments. However, not only does the identification of all of the typical features of such investment services depend on national interpretations that are not straightforward (see below) but, preliminarily, the legal characterization of loans as financial instruments is debated. In fact, while crowd-loans might recall debt securities (bonds) in terms of the obligation to repay capital and interest, they might not implicate the same standardization (in particular with respect to their size and applicable interest rate, which are sometimes set within a range based on an auction or matching, or even, in the case of auto-bid/portfolio management, on the composition of a personalized portfolio) or transferability rules. In particular, "financial instruments" are not defined except by example in MiFID II, and Member States traditionally employ different interpretations and criteria. Nonetheless, the Commission has identified their 'negotiability in the capital market' as their fundamental

45 Certain authors (*Havrylchyk/Verdier*, fn. 44; *Braggion et al.*, fn. 31, 2) recognize some similarities between marketplace lending and banking activity, specifically in the use of auto-investment mechanisms (portfolios of short-term loan liabilities invested in long-term loan liabilities) and credit scoring – because of the reliance on platforms' due diligence – and in the creation of liquidity for secondary markets. Nonetheless, they also recognize that significant differences remain, including the fact that investors bear the risks and also potentially provide instructions/orders.

feature, and described this as transferability in all contexts in which buyers and sellers of securities meet, clarifying that these 'contexts' might not correspond to regulated trading venues but instead refer to the absence of significant obstacles to transferability (e.g., with respect to contractual terms, legal restrictions, etc.).[46] Therefore, the transferability of crowd-loans on the same platform (through bulletin boards or kinds of secondary markets, especially when multilateral matching systems allow the conclusion of a contract) raises the issue of whether they can be characterized as transferable securities (as recognized in the Netherlands) and whether borrowers can be characterized as issuers (even when they are consumers);[47]

e) as alternative investment funds – when crowdfunding operations entail the use of a collective investment scheme, collecting funds from the public (e.g. in the form of shares and investing in companies' debt instruments), or acquiring loans or even directly providing the same, the Alternative Investment Fund Managers Directive (AIFMD) No. 2011/61/EU (and the related Regulations EuVECA No. 345/2013, EuSEF No. 346/2013 and ELTIF No. 2015/760, with specific reference to loan origination) should apply. This Directive subjects fund managers to general conduct and organizational requirements in addition to specific disclosures, but the rules about loan origination, leverage limits, retail investors' access, and marketing (at the product level) are not harmonized among Member States;[48]

f) finally, as a (generally) new financial intermediary subject to special regulation (e.g., in France, UK, and the Netherlands; applying the same regime to both marketplace investing and marketplace lending, Portugal, Spain, Belgium, Finland, and Lithuania). The regimes cover both consumer and business loans (UK and Spain; in France, only business and educational loans) or only business loans (Portugal, Netherlands, Lithuania, and Finland).

These regulations related to crowdfunding have in common the creation of a new kind of financial intermediary, authorized by the national or European fi-

46 *European Commission*, 'Questions and Answers on the MiFID Directive 2004/39/EC', p. 1, 22, <https://ec.europa.eu/info/sites/info/files/business_economy_euro/banking_and_finance/documents/mifid-2004-0039-commission-questions-answers_en_0.pdf>.

47 See in more detail *Eugenia Macchiavello,* 'Financial-return' (fn. 2), 689; *Id.*, 'FinTech Regulation from a Cross-sectoral Perspective, in Veerle Colaert/Danny Busch/Thomas Incalza (eds.), European Financial Regulation: Levelling the Cross-Sectoral Playing Field, 2019, p. 63, p. 69; *Id.*, 'European Crowdfunding Service Providers' (fn. 15)'; *Id.*, 'What to Expect' (fn. 2); *Id.*, 'Disintermediation' (fn. 15).

48 See *ESMA*, 'Key Principles for a European Framework on Loan Origination by Funds – Opinion', (11 April 2016), ESMA/2016/596.

nancial authority after verification of the "fit and proper" qualifications of the managers and directors, an adequate business plan, business continuity arrangements, professional insurance (in some places, such as in Spain, Portugal, and Finland, as an alternative to a certain amount of minimum capital) and, in some countries, proper corporate organization (Spain and Portugal). These actors are subject to a lighter and more flexible regulatory regime than banks or investment firms focused primarily on informational requirements, but in general the borrower remains the only party responsible for information about the project and the borrower him or herself.[49] Crowdfunding providers are also subject to other general conduct rules, such as requirements to act honestly, fairly, and professionally towards clients (both crowd-lender and crowd-borrowers), with policies in place to avoid and manage conflicts of interest, In some countries, crowd-borrowers are considered at least in part to have the same status as consumers under consumer credit legislation (UK, Netherlands, Finland, Lithuania). A general duty to avoid money laundering tends also to be recognized.[50]

Organizational requirements, when imposed (e. g., Spain and Portugal), are not detailed, relying and rely on the discretion of platforms over their business organization. The UK has, however, recently introduced more demanding requirements in terms of risk management with respect to more complex models such as loan pricing services and portfolio management that promise a certain level of return; even simple models must meet a minimum level of internal governance (e. g., an independent risk management function, an independent internal audit function, and a compliance function) on a proportionality principle basis, mirroring the requirements placed on dealers and investment managers.[51]

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49 Relevant information, especially about the lender, the proposed investments and their risks and costs, and past performance, with warnings about the absence of traditional safeguards, must be presented on the website and in a document that takes the place of a prospectus (under an exemption from prospectus requirements, where applicable to investment products other than transferable securities) that is not approved by the relevant authority. In certain countries, the law or the authority mandates the use of a standard document (France and Portugal) but the document is required everywhere to be concise and easy to understand.

50 While Austria, Germany, and France have extended AML/CT rules to platforms, the regimes in the UK, Spain, and Portugal only require that platforms have an AML/CT policy.

51 Platforms that price loans are required to gather sufficient information about the borrower, to categorize borrowers according to their credit risk in a systematic and structured way (taking into account the probability of default and the loss in the event of default), and set a fair and appropriate price reflecting the risk profile of the borrower. Platforms that also offer portfolio management with a guaranteed return must have a risk management framework ensuring that they can achieve the stated target rate of return with a reasonable degree of confidence; they must be able to evaluate loans, at least when originated, in the event of default, and when the platform is facilitating an investor's exit. When advertising a certain return, platforms

Prudential requirements are generally absent, save in the UK, Lithuania and – when loans intermediated exceed €2 million – Spain, the last of which also mandates certain own funds requirements.

On the other hand, crowdfunding providers everywhere face significant limitations on their permissible activities; for example, activities reserved to other intermediaries, in particular investment services or payment services, are prohibited except when specifically authorized. In addition, save in the UK and the Netherlands, the size of loan requests from the same borrower in 12 months is generally limited to somewhere between €1 million and 5 million,[52] and there are limitations on the maximum investable amount contributed by each retail crowd-lender per project and per year.[53]

The majority of jurisdictions do not require platforms to assess the appropriateness of an investment for the crowd-lender, but there are exceptions such as in the Netherlands (for investments above €500), Belgium, Lithuania, and, starting in 2019, the UK. Platforms are generally only required to disclose the criteria deployed in pre-screening applicants, but in Spain and the Netherlands there is an explicit duty of due diligence in selecting crowd-borrowers. Only a few jurisdictions recognize a right of withdrawal for crowd-lenders (the UK and the Netherlands).

Most regimes also allow traditional financial institutions to conduct crowdfunding operations (except in Spain), without the limitations and constraints of crowdfunding platforms in terms of services and offer/investible amounts, but generally subject them, in addition to the regulations specific to their regime, to requirements specifically applicable to crowdfunding (e.g. disclosure duties and other investor protection measures).[54]

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should be able to demonstrate the use of appropriate data and a robust modelling capability, and disclose actual historical returns against target rates: *FCA* (fn. 27); *Id*, 'Loan-based ('peer-to-peer') and Investment-based Crowdfunding Platforms: Feedback to CP18/20 and Final Rules', (June 2019), PS19/14, 10 – 13, <https://www.fca.org.uk/publication/policy/ps19-14.pdf>.

52 The maximum threshold is €1 million in France and Portugal, €2 million in Spain, and €5 million in Lithuania and Finland. In the Netherlands, the reference is the general exemption from the prospectus obligation for maximum consideration, which corresponds to € 2.5 million.

53 In France, the maximum size of the investment for retail investors is €2,000 per project and per issuer on a given platform; in Spain and Portugal, it is €3,000 per issuer and €10,000 per year in total on all platforms (these limits do not apply to institutional investors or to legal persons or individuals with an income above certain levels); and €80,000 in the Netherlands.

54 In Lithuania, regulated firms must respect the higher prudential requirements and the stricter "fit and proper" requirements between the ones set in the crowdfunding regulations and those applicable to their own regimes (Art. 7(6) and 8(7) Crowdfunding Law). In Portugal, Article

All of these differences in regulations applicable to marketplace lending trace back, on the one hand, to the above-mentioned variety of business models and, on the other, to the persistent differences in legal traditions and implementation of EU Directives, and to the presence of a number of unharmonized areas (e. g. company law and lending activity) despite recent efforts to create Capital Markets and Banking Unions. For instance, Member States offer different definitions or identification criteria applicable to certain investment services, financial instruments, and transferable securities; EU financial law (e. g. MiFID, the Prospectus Regulation, MAR, etc.) must be implemented in the face of these differences[55] and in the face of varied thresholds and coverages (e. g., transferable securities versus investment products) applicable to the prospectus exemption.[56]

Thus, marketplace lending platforms interested in offering cross-border crowdfunding services face significant regulatory obstacles because their activity is potentially subject to oversight by different authorities and to additional national rules. This situation applies even when certain portions of a platform's activity are covered by a European passport; for instance, in case of a crowdfunding platform authorized as a payment service provider services offered by the same other than payment services, such as credit scoring, debt collection, etc., might fall outside the scope of the passport. Furthermore, the diversity in the regimes applied to marketplace platforms in the territory of the EU clashes with the current objective of creating a real single market (in terms of regulatory arbitrage, European freedoms, equal investor protection, etc.). In light of these problems, it is no surprise that the level of cross-border activity in Europe, although increasing, remains limited.[57]

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15 of *Regulamento* 1/2016 requires banks to comply with their own rules when offering crowdfunding.

55 For instance, in Poland, Italy, Denmark, and Sweden, the shares of private limited liability companies are not considered transferable securities, while this is not the case in Hungary. See *Macchiavello*, 'Financial-return' (fn. 2) 698. See, more recently, concerning the characterization of crypto-assets in various Member States and different interpretations of the concept of financial instrument/transferable security, *ESMA*, 'Initial Coin Offerings and Crypto-Assets. Advice', (9 January 2019), ESMA50 – 157 – 1391.

56 Ranging, under the previous EU Prospectus Directive No. 2003/71/CE, from €100,000 (for a mandatory exemption) to €5 million (for an optional exemption) in total consideration per offer in 12 months and, under the recent EU Regulation No. 2017/1129/EU, from €1 million to €8 million in 12 months.

57 For recent data about investments and requests for funds across European borders, which have been increasing in recent years, see *Klaes et al.* (fn. 43); *Ziegler et al.*, 'Shifting' (fn. 1), p. 48 – 51; *Karsten Wenzlaff et al.*, 'Crowdfunding in Europe: Between Fragmentation and Harmonization', in: Roten Shneor/Liang Zhao/Bjørn-Tore Flåten (eds) Advances in Crowdfunding, 2020, 373, p. 376 – 78.

4 The European Crowdfunding Service Provider Regulation in Light of Marketplace Lending Challenges: How Effective Is It?

4.1 An Analysis of the ECSP Regulation: The Most Controversial Issues

The ECSP Regulation, which is aimed at creating a single crowdfunding market while protecting investors, represents a great advancement for the crowdfunding sector.

As mentioned above (§1), since the Commission's Proposal for a Regulation on European Crowdfunding Service Providers for Business of March 2018, the legislative process has progressed slowly, in part because of differing views about financial-return crowdfunding intermediation emerged during trilateral negotiations (see in particular the European Parliament's resolution of 27 March 2019[58] and the very different Council suggestions of 24 June 2019[59]).[60] The text adopted in October 2020, therefore, contains several fundamental revisions from the original proposal.[61]

In the following paragraphs, we will analyse the ECSP Regulation through the lenses of the main legal and policy issues presented above. In particular, we will assess whether, first, the ECSP Regulation is able to provide solutions for the entire single market and second, whether the regime is designed to respond to the main risks presented by crowdfunding. Furthermore, we will evaluate, in light of the regulatory choices made in the adopted Regulation (also as compared to the original proposal) and the overall design of the regime, which

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58 *European Parliament*, 'Legislative Resolution of 27 March 2019 on the Proposal for a Regulation of the European Parliament and of the Council on European Crowdfunding Service Providers (ECSP) for Business (COM(2018)0113 – C8 – 0103/2018 – 2018/0048(COD)), <http://www.europarl.europa.eu/RegData/seance_pleniere/textes_adoptes/provisoire/2019/03-27/0301/P8_TA-PROV(2019)0301_EN.pdf>.

59 *Council of the European Union*, 'Proposal for a Regulation of the European Parliament and of the Council on European Crowdfunding Service Providers (ECSP) for Business and amending Regulation (EU) No 2017/1129 – Mandate for negotiations with the European Parliament – Compromise proposal', (24 June 2019), <https://data.consilium.europa.eu/doc/document/ST-10557-2019-INIT/en/pdf>.

60 In this respect, see *Macchiavello*, 'What to Expect' (fn. 2).

61 Again, for a detailed analysis of the ECSP Regulation, please see *Macchiavello*, 'The European Crowdfunding Service Providers Regulation' (fn. 15); *Id.*, 'Marketplace Lending' (fn. 15); *Id.*, 'Disintermediation in Fund-raising' (fn. 15).

function of marketplace lending platforms has been recognized and how the ECSP Regulation has addressed the platform dilemma. Finally, we will attempt to forecast the future impact of the ECSP Regulation on the European crowdfunding market.

4.2 Is the ECSP Regulation Creating the Conditions for a Single Crowdfunding Market?

4.2.1 Authorization Process and Supervisory Authority Powers

The Regulation introduces a mandatory European regime for crowdfunding platforms, requiring any legal person willing to offer crowdfunding services covered by such Regulation to apply for a new authorization (Artt. 3(1); 12), and benefiting, once authorized, from a specific European passport modelled after that of MiFID II. No exemption is envisaged for platforms operating only nationally or with low volumes, which, after a transitional period (ending 10 November 2022), which can be extended by the Commission by an additional 12 months: Art. 48(3)), will be required to comply with the ECSP regime. Already-regulated entities (banks, investment firms, e-money providers, etc.) that are interested in offering crowdfunding services need also to apply for ECSP authorization, but can take advantage of simplifications (in terms of procedure and documentation) and exemptions (e. g., to capital requirements for operational risk when already complying with their own capital requirement) in order to avoid duplication (recital 35, Artt. 12(14)-(15) and 11(3)).

The licensing and supervising authority is the national competent authority (NCA) of the Member State where the applicant is established (instead of the ESMA, as originally proposed), which will request that ESMA enter the authorized ECSP into a public register that it will set up and maintain.[62]

The requirements to obtain the authorization are harmonized and consist not only of certain ordinary requirements (minimum capital, insurance policy coverage, a programme of operations, proper internal organization, “fit and proper” managers) and plans for business continuity, but also of a description and evidence of compliance with certain prudential safeguards and a number

62 The ESMA registry will also indicate which crowdfunding services the authorized ECSP can offer, additional activities it can carry out, the Member States in which it can operate, the supervisory authority, and penalties that may be imposed (Art. 14).

of other conduct and organizational requirements[63] (see below §§4.3.1 ss.). Since the ECSP Regulation is a maximum harmonization instrument, Member States cannot impose stricter or additional requirements and, in particular, according to Art. 1(3), cannot impose on platforms the same requirements of banks or require crowd-borrowers/crowd-lenders to obtain a banking license or an express dispensation or exemption.

The powers of the NCA are harmonized in an extremely detailed way (Art. 30 ff)[64] and the ESMA's RTSs will further harmonize standard forms, templates, and procedures related to the authorization application, requirements, and reporting, taking into account the nature, scale, and complexity of the services offered (Artt. 12(16); 16(3)). The NCA will, however, determine the frequency and depth of the compliance assessment, which will take place in part via on-site inspections, again 'having regard to the nature, scale and complexity of the activities' of the ECSP.

Therefore, as regards the authorization process and supervision, the ECSP regime seems designed to adequately ensure harmonization, not only with respect to the authorization requirements but also with respect to supervisory practices, while ensuring that NCAs will be entrusted with a supervisory role.

4.2.2 Scope and Limitations with Respect to Activities and Products

It is possible that the goal of creating a single internal market in the crowdfunding sector may be frustrated by the limited scope of the ECSP Regulation. The Regulation, in fact, applies only to identified crowdfunding services. Crowdfunding services are defined as 'the matching of business funding interests of investors and project owners through the use of a crowdfunding platform' but identified, as regards marketplace lending, in the 'facilitation of granting of loans' (Art. 2(2)), with exclusive reference to business loans.

Consumer loans are expressly excluded under the justification that consumer loans are already covered by the CCD and also in line with the Capital Markets

63 E. g., in terms of systems and procedures for risk management; data processing; complaint handling; verification of the completeness, correctness, and clarity of the information provided; and investment limits.

64 NCAs will receive annual confidential reports from ECSPs about the projects funded, specifying for each project the project owner and the amount raised, the instrument issued, and aggregated information about the investors and invested amount (by fiscal residency and type of investor). This report will be transmitted to the ESMA in an anonymized form to facilitate the publication of aggregated statistics about the EU crowdfunding market (Art. 16).

Union's focus on business financing. Nonetheless, as anticipated (§3), the CCD only applies to loans provided to consumers by a professional lender and therefore tend not to apply to P2P loans where the lender is also a consumer,[65] despite the platforms' professional role in the lending process, including the provision of contractual documentation. However, certain countries have adopted a broader interpretation in their national consumer credit laws or have specifically extended the CCD to P2P platforms.[66] The Commission is considering revising the CCD in order to extend its coverage to P2P loans,[67] but it is unlikely that a comprehensive regime (e.g. including an authorization) for crowdfunding platforms can be accommodated under the CCD. The consumer lending segment represents the most relevant (and delicate, concerning a 'contractually weak' party) part of marketplace lending in Europe (see §1) and seems to be used by entrepreneurs even for their business activities.[68]

Furthermore, the definition of "loan" as 'an unconditional obligation to repay [the capital] with the accrued interest' might exclude from the Regulation's scope not only interest-free loans but also subordinated loans (conditioned on previous satisfaction by another creditor) and loans for which the lender's remuneration is conditioned on the investee's profits, that is, profit-participation loans (which are closer to equity investments).

The platform's "facilitation" activity mentioned above, as explained in recital 11, might, under the basic model, simply entail presentation of projects on the website and matching of the interests of crowd-lenders and crowd-borrowers. However, the recently adopted version has also allowed the activities of more complex models, subject to additional requirements, activities like scoring and pricing of investments and loans and the individual portfolio management of

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65 E.g., in Belgium, Italy, and Poland.

66 Respectively, Denmark, Finland, Estonia; and the UK, the Netherlands, Finland, and Lithuania.

67 *European Commission*, 'Staff Working Document – Impact Assessment – Legislative Proposal for an EU Framework on Crowd and Peer To Peer Finance', (30 October 2017), 32–33, <https://ec.europa.eu/info/law/better-regulation/initiatives/ares-2017-5288649_en>; *Id.*, 'Evaluation of the Consumer Credit Directive (Directive 2008/48/EC). Summary Report – Public Consultation', (May 2019), 6, <https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/1844-Evaluation-of-the-Consumer-Credit-Directive/public-consultation>; *Id.*, 'Consumer Financial Services Action Plan: Better Products, More Choice', (Communication) COM(2017) 139 final (23 March 2017), 8; *Id.*, 'Consumer Credit Agreements–Review of EU Rules. Inception Impact Assessment', (23 June 2020), p. 1, <https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12465-Consumer-credit-agreements-review-of-EU-rules>.

68 *Ziegler/Shneor* (fn. 25) 76 report that a large number of business crowd-borrowers are actually using consumer crowd-loans to support their business activities.

loans, as suggested by the European Parliament and reflecting recent market developments (see above §2). The latter consists of the 'allocation by the crowdfunding service provider of a pre-determined amount of funds of an investor, which is an original lender, to one or multiple crowdfunding projects on its crowdfunding platform in accordance with an individual mandate given by the investor on a discretionary investor-by-investor basis' (new Art. 2(1)c). The Regulation defines portfolio management as the use of 'automated processes whereby funds are automatically allocated by the crowdfunding service provider to crowdfunding projects in accordance with, as under the non-automatic portfolio management, parameters and risk indicators predetermined by the investor (such as interest rate, maturity, risk category, target return), so called auto-investing' (recital 20).[69] The use of filtering systems that display results based on criteria relating to purely objective product features (e. g., economic sector, interest rate, type of instrument) is expressly permitted and is not considered portfolio management as long as investors 'review and expressly take an investment decision in relation to each individual crowdfunding offer'; these filtering systems are not classified either as "investment advice" – a service explicitly excluded and subject to MIFID II – where the presentation is neutral, without a recommendation being formulated.

The Regulation also covers marketplace investing when it corresponds to a MiFID II placement without a firm commitment, in conjunction with reception and transmission of orders pertaining to transferable securities and – the new category of "admitted instruments", identified with the shares of limited liability companies that are not considered financial instruments under national law but are freely transferable. Therefore, debt instruments not considered to be transferable securities under national law seem to remain outside the ECSP regime. In any case, platforms must inquire about and comply with national rules and procedures pertaining to the transfer of such products (recital 14).

Various additional services and business models must find a governing legal framework outside the ECSP Regulation. For instance, because ECSPs cannot financially participate in projects (see below § 4.3.5), models providing that the platform will co-lend with the crowd-lenders (even when this is intended to align the interests of the platform and the investors) fall outside the Regulation and remain subject to national law (or EU law or a mix of the two; e. g., directly lent investment funds managed by AIFMs); they are therefore potentially excluded from any passport (in situations where the interpretation that such models are

69 In line with ESMA's position on automation in investment services. See *ESMA*, 'Guidelines on Certain Aspects of the MiFID II Suitability Requirements – Final Report', (28 May 2018).

not permitted at all does not prevail). Platforms willing to offer crowdfunding services equivalent to individual investment portfolio management, collective investment schemes, OTF/MTF, etc., should obtain the corresponding authorization which can coexist with the ECSP one: see § 4.2.1). In particular, investment funds directly providing loans (credit funds) shall obtain from the NCA an authorization as an AIFM and comply with national rules, since many relevant aspects of doing so, especially in terms of retail distribution and additional requirements for direct lending, have not yet been harmonized at the EU level, although this is currently under discussion.[70]

Additional ancillary services provided by ECSPs under national law (Art. 1(2)(b)) are also excluded from the ECSP framework.

Summing up, the ECSP Regulation seems not to cover a relevant part (at least in some geographic areas) of the market (e. g., subordinated and profit-participating loans) or certain business models (e. g. collective investment schemes, investment advice), potentially creating regulatory arbitrage and reducing market integration. Furthermore, it also leaves unregulated the market for consumer loans, the most delicate (for borrower protection concerns) and largest part of the market in terms of volumes and market size.

Maximum Offer Threshold and Space Left to National Regimes: To be covered by the ECSP Regulation, any offer from the same project owner (taking into account not only crowdfunding offers but also other offers exempted under the Prospectus Regulation) should not exceed €5 million in total consideration within 12 months. Member States that have set lower thresholds in the Prospectus Regulation framework will be able to maintain them with respect to crowdfunding only for a period of 24 months after entry into force (Artt. 1(2) and 49). Thus, harmonization in this regard will be reached, but only after a transitional period.

Furthermore, whether it is possible to regulate under national law the services and offers not covered by the ECSP Regulation is not clear nor, consequently, is it clear whether national crowdfunding regimes can still exist under certain conditions. Anyway, because the Regulation is a maximum harmonization instrument and because of its above-described scope, it should be inferred that national crowdfunding regimes, if still allowed, can only cover crowdfunding models outside the ECSP Regulation's perimeter; for instance, crowdfunding services characterized as investment advice (probably not, instead, as reception and transmission of orders only) and exempted from MiFID II through its Art. 3(1)

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70 *European Commission*, 'Assessing the Application and the Scope of Directive 2011/61/EU [...] on Alternative Investment Fund Managers', (10 June 2020), SWD(2020) 110 final, p. 29; *Id.*, 'A Digital Finance Strategy for the EU', (Communication) COM(2020) 591 final, p. 7.

(see in France) and the facilitation of consumer loans (where not already covered by the new CCD). In such cases, offers might even pertain to transferable securities (even loans, if qualified as such) equal to or below the national prospectus exemption (which can be above €5 million and up to €8 million), and offers of admitted instruments well above €5 million. Instead, Member States seem to have lost the power to regulate business models characterized as placement without guarantee and/or as reception and transmission of orders, even as respects offers of transferable securities between €5 million and the maximum threshold under national prospectus laws or offers of admitted instruments, as well as the facilitation of business loans above €5 million (but a specification and clarification would appear appropriate). It is unclear, however, whether it is possible to set up and differently regulate hybrid business models entailing co-lending by the platforms. As a result, room for regulatory competition and obstacles to the formation of a true single market might still exist.

Finally, certain relevant aspects of the regulatory scheme, some of which are discussed below, are left to Member States, such as the transferability rules of admitted instruments, marketing rules, and the regime for civil liability arising from information provided. Member States' discretions, options or variations are allowed in certain areas, such as the language and *ex ante* notification of the main informational document (§4.3.2).

4.3 Does the ECSP Regulation Address All of the Relevant Crowdfunding Risks?

4.3.1 Overview

The ECSP regime mimics the MiFID regime in simplified form, and has the aim of balancing innovation and SMEs' access to finance with investor protection. The regime is in principle the same for marketplace lending and investing but special rules and additional requirements apply in the case of particular business models seen as more complex (and generally associated with marketplace lending). The required disclosures differ depending on the type of crowdfunding and product.

In any case, the approved version, following in part the Council's suggestions and the 2019 revisions to the lending-based crowdfunding regime in the UK,[71] but going beyond the usual rules of national crowdfunding regimes, has

71 See above footnote 51 and accompanying text.

significantly expanded the duties of ECSPs, not only in terms of conduct rules but also in terms of organizational, risk management, and prudential requirements, especially for certain marketplace lending models. However, proportionality considerations and ESMA/EBA RTSs will play an important role in the application and implementation of rules.

4.3.2 Risk of Fraud, Misleading Information, and Investor Protection: Conduct and Disclosure Duties

The main risks, as evidenced above (§2), relate to investor protection. The adopted version of the Regulation has correctly decided to reserve certain protective measures for non-sophisticated investors in order to limit the platforms' requirements of sophisticated ones (see below).

ECSPs are subject to the general conduct rule to act honestly, fairly, and professionally in accordance with the best interests of their clients (Art. 3(2)). From this general duty, it might be possible to infer a duty to select projects with some diligence (see recital 18), therefore reducing any information asymmetry which might benefit crowd-investors. The adopted version has also introduced an explicit duty that ECSPs undertake a minimum level of due diligence in respect of project owners (crowd-borrowers), but only with respect to a history of criminal behaviour (for infringements of laws relating to commercial activity, insolvency, financial services, AML/CT, fraud, and professional obligations) and their establishment in noncooperative jurisdictions (with respect to AML/CT) (Art. 5).

The Regulation contains numerous disclosure obligations: ECSPs are required to make available to clients and potential clients, before they enter into the contract and also at the marketing stage, in a non-discriminatory manner, fair, clear, and not misleading information about fundamental aspects of the business under consideration such as information about themselves, the costs of the services, the financial and other risks, charges related to crowdfunding services and investments, and project selection criteria. The adopted version also requires additional information about the lack of a deposit guarantee and securities compensation coverage, the four-day reflection period for non-sophisticated investors (see below)[72] and, when the platform performs a credit scoring

72 The ECSP must inform the investor immediately before his/her expression of interest or order of the existence of the reflection period and its duration, and the modalities available to revoke his/her order or expression of interest; immediately after receipt of the offer to invest or of the

or pricing, the calculation method used and whether or not it uses audited financial statements; the method used must also comply with ESMA's RTS concerning the format and elements to be included (Art. 19).

Moreover, the adopted version has dedicated an entire article to requiring ECSPs, only when engaging in marketplace lending, to disclose annually and in a prominent part of their website, the default rates of the crowdfunding projects offered over at least the last 36 months and publish an outcome statement at the end of each financial year detailing: a) the expected and actual default rate of all loans by risk category; b) a summary of the assumptions used to determine the expected default rates; and c) in the case of portfolio management of loans where a target rate has been indicated, the actual return achieved (Art. 20). Specifications about the methodology for calculating such default rates will be provided by ESMA, in close cooperation with the EBA, through draft RTSs.

With reference to individual offers, ECSPs must provide clients with a Key Investor Information Sheet (KIIS) based on the KID-PRIIPs model;[73] the information in the KIIS must be prepared by the project owner and be fair, clear, and not misleading (Art. 23(7)).

Besides containing certain information specified in the annex pertaining to the project owner and its project (including activities and products offered, a hyperlink to financial statements when available, and key financial figures/ratios), the crowdfunding process (e.g., the minimum target and deadline for reaching it), the main risks and costs, and redress procedures, the KIIS must contain a number of warnings distinguishing crowdfunding from traditional loan activities, such as the lack of supervisor control and approval, guarantee schemes, or an appropriateness test. It shall also underline particular risks (e.g., illiquidity), as well as the opportunity to not invest more than 10 percent of the client's net worth (NW). The additional information required depends on the type of product: in the case of loans, the KIIS must contain information also about the nature, duration, and terms of the loan; interest rates or other compensation; risk mitigation measures; the repayment schedule; any defaults on credit agreements by the project owner within the past five years; and the servicing of the loan. Additional technical aspects regarding the requirements and content of the model for the KIIS, the types of main risks that are associated with crowd-

expression of interest (or, in the case of portfolio management of loans, receipt of the mandate), the ECSP must inform the investor that the reflection period has begun (Art. 22(8)).

73 See Regulation (EU) No 1286/2014 of the European Parliament and of the Council of 26 November 2014 on key information documents for packaged retail and insurance-based investment products (PRIIPs) (OJ L 352, 9.12.2014, p. 1. The authorities are considering substituting the KID for the KIIS when ECSP and PRIIPS Regulations both apply (Art. 23(15)).

funding offers, the use of certain financial ratios, and the commissions, fees, and transaction costs will be provided by ESMA through draft RTSs (Art. 23(16)).

To increase investor protection, the adopted version has favoured the KIIS language rules, which are similar to but less onerous than those of the prospectus summary,[74] instead of the base prospectus language proposed by the Commission, which allowed, as a general rule, the use of a language accepted in international finance (Art. 23(2)-(3)).[75] However, Art. 23(5) requires NCAs to inform ESMA about the KIIS languages that they accept, which creates the opportunity for regulatory competition and further harmonization in the longer term. NCAs can now require the seven-day ex ante notification (not the approval) of the KIIS (Art. 24(14)). In any case, marketing rules remain national, with ESMA publishing the relevant ones on its website to assist the platforms (Artt. 27–28).

The KIIS is prepared by the project owner (except in the case of portfolio management of loans). The original proposal required ECSPs to verify only the completeness and clarity of the KIIS and request that the project owner correct it when they identified an omission, mistake, or inaccuracy. However, the approved version also refers to the ECSP's duty to verify the 'correctness' of the same (Art. 23(11)): this expression seems to refer to the requirement of non-misleading and fair language or at least to the absence of evident mistakes in filling out the form (in terms of a correspondence between the type of information and the box filled out). However, the Regulation should be clearer about the extent of ECSPs' duties in this respect so that they can avoid liability for the lack of truthfulness of any information provided by the project owner. Otherwise, this would transform platforms into gatekeepers with a role not only comparable to but even more onerous than is assumed by lead underwriters.

Liability rules have not been harmonized, and therefore, the solutions and practical effects of platforms' co-responsibility might diverge nationally. As under the PR, Member States are required to ensure an adequate national liability regime for misleading or inaccurate information and omissions of key infor-

74 Therefore, the KIIS must be written in one of the official languages of the NCA's Member State or in a language accepted by such NCA and translated into the official or accepted language of each country in which the crowdfunding offering is made available. The investor can always request a translation and, in case the ECSP does not comply, should be advised not to invest. The effects of such choices will be evaluated by the Commission in its report due 36 months after the Regulation's entry into force, followed, if necessary, by a revision proposal (Art. 45(2)l).

75 The final version has surprisingly maintained the investor's right to require a translation into his/her language, and, should the ECSP refuse, a prohibition on the ECSPs sale of the product to that investor. This made more sense in the context of the Commission's proposal (Art. 23(13)).

mation from the KIIS, at least with respect to the project owner and its related entities. The KIIS must also disclose the names of the people responsible for the information (Art. 23(9)-(10)).

Furthermore, special conduct rules have been introduced in the cases of individual portfolio management of loans and the provision of scoring/pricing services. ECSPs offering portfolio management must disclose to investors the relevant decision-making process, take all necessary steps to pursue the client's best interest, and respect at least two parameters of preference chosen by investors.[76] Furthermore, specific additional disclosure duties apply (Artt. 3(4)-(5); 6(1)-(2); 12); in particular, the ECSPs must provide investors with a description of the systems and procedures deployed to conduct a credit risk assessment (Art. 6(2); see also below § 4.5), and, on a continuous basis or upon request, information about the composition of the portfolio.[77] For each loan, key information such as interest rate, maturity date, risk category, payment schedule, and risk mitigation measures shall be provided. Moreover, information must be provided about defaults within the past five years by any project owner, any fee in respect of the loan, and, if the ECSP has carried out a valuation of a loan, certain information about the most recent one valued (Art. 6(4)).[78] Special information requirements apply when the ECSP has set up and operates a contingent fund, including a description and explanation of the contingent fund's functioning[79] and a warning about the risk of not obtaining a payout and about ECSP's discretion with respect to such payout and its amount. These ECSPs must also disclose on a quarterly basis the performance of the fund, in particular information about the size of the contingency fund as compared to the total amounts outstanding on loans and the ratio between the payout made to the total amounts outstanding on loans (Art. 6(6)). Further specifications about the information to be disclosed and its format will be provided through RTSs drafted by the EBA in cooperation with ESMA (Art. 6(7))

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76 These parameters are 1) the minimum and maximum interest rate payable; 2) the minimum and maximum maturity date; 3) the range and distribution of risk categories; and 4) if an annual target rate of return on an investment is offered, the likelihood that the selected loans will enable the investor to achieve that rate with reasonable certainty.

77 Including its weighted average annual interest rate and loan distribution according to risk category (in percentages and absolute terms).

78 E.g., the valuation date, why it performed the valuation, and a fair description of the likely actual return, taking into account fees and default rates.

79 E.g., about the source of the money paid into the fund, how the fund is governed, to whom the money belongs, the considerations taken into account and the process followed when making a discretionary decision concerning whether or how to pay out from the fund and how the money paid into the fund will be treated in the event of insolvency (Art. 6(5)).

Finally, ECSPs offering portfolio management of loans (instead of project owners as with other services) have a responsibility to prepare, update, and correct the KIIS and to ensure that no information has been omitted or is materially misleading or inaccurate (Art. 24). The content of the KIIS reflects the type of service and replicates in part the information mentioned above: in addition to information about the ECSP and the people responsible for it, it must contain information about the prospective composition of the portfolio (see above concerning client parameters), the key elements of the internal methodology for credit risk assessment and risk categories, procedures and criteria for the selection of projects, characteristics of applicable guarantees, servicing of the loan, risk diversification strategies, and fees to be paid by the project owner or the investor (Art. 24; annex I, parts H-I).

ECSPs offering only scoring/pricing systems must publish the policies and procedures used for the credit risk assessment performed (see below §4.5) and its calculation method (Art. 4(4); 19(6)).

As anticipated, certain special protections are reserved to 'non-sophisticated' investors. This is a new category not contained in MiFID II and applies to investors not falling within the categories of professional investors or sophisticated investors (a new category as well). In particular, sophisticated investors are identified as investors who would otherwise fall into the retail investor category but request to be treated as sophisticated and who declare that they are aware of the relative consequences and present evidence of significant NW or investment experience.[80] The aim is to protect only the most fragile investors while lowering compliance costs for investors able to understand the risks and therefore not deserving of certain protective measures.

The first measure reserved to non-sophisticated investors is the "entry-knowledge test", according to which ECSPs, before investors can access the offers, must perform, every two years, a test aimed at verifying whether and

80 As specified in annex II, this applies to 1) legal entities meeting one of the following conditions: *a)* at least €100,000 in own funds; *b)* a turnover of at least €2 million; and *c)* a balance sheet of at least €1 million; 2) natural persons meeting at least two of the following conditions: *a)* personal gross income of at least €60,000 or a financial instrument portfolio (including cash deposits and financial assets) exceeding €100,000; *b)* professional experience in the financial sector in a position requiring knowledge of the transactions or services envisaged or an executive position in the legal entities listed under 1) for at least 12 months; *c)* operations on the capital markets of significant size at an average frequency of 10 per quarter over the previous four quarters. Providers must take reasonable steps to ensure that investors requesting to be categorized as sophisticated and warned about the consequences effectively qualify as such, but the providers can approve the request unless it has reasonable doubt that the information provided is correct.

which crowdfunding services are appropriate for non-sophisticated investors, considering their past investments in transferable securities, admitted instruments, and loans, and their understanding of risks and professional experience with crowdfunding. In case of a negative test result (because of an investor's insufficient knowledge, skills, or experience), the ECSP can proceed with the order only after issuing a risk warning and receiving the investor's acknowledgement (Art. 21(1)-(4)). This test is similar to an appropriateness test but is less product-specific and performed at an earlier stage.[81]

Second, ECSPs must require non-sophisticated investors, before accessing the offers and every year, to undertake a loss simulation test in order to verify their ability to bear losses, calculated as 10 percent of their NW, based on certain information.[82] Again, irrespective of the results, investors can invest after simply acknowledging the risks (Art. 21(5)-(6)). ESMA will draft an RTS about the required information and how to carry out both tests.

ECSPs must issue a warning and receive the explicit consent of the investor and evidence of his/her understanding of the investments and risks (this can consist of a positive result on the entry-knowledge test) in case of investments above €1,000 or 5 percent of the non-sophisticated investor's NW (Art. 21(7)). Finally, non-sophisticated investors have the right to a four-day reflection period, during which and before its expiration they are entitled to withdraw their investment at no cost and without providing a reason.

Thus, the ECSP Regulation has assigned a large role to disclosure and other conduct duties but with significant differences based on business model and type of investor. Investor tests seem correctly simplified. Some doubts remain about the possibility of keeping the KIIS short and effective despite the volume of information required, as well as about the ability of the KIIS to serve as an adequate informational document for both professional/sophisticated and non-sophisticated investors. Furthermore, the standardization of KIIS and its assimilation to a more traditional informational document might reduce the innovative and alternative character of crowdfunding (not taking into account nonfinancial aspects and motives as well as non-traditional types of information,

81 The approved Regulation now requires ECSPs to collect information also about clients' investment objectives and the financial situation (as under a suitability test and as suggested by the Parliament), although the evaluation pertains to the investor's knowledge, skills, and experience.

82 Regular income and total income and whether earned on a permanent or temporary basis; assets, including financial investments and cash deposits, but excluding personal and investment property and pension funds; and financial commitments.

signalling, etc.) and the positive 'rational herding' effect,[83] although the KIIS can in principle include additional information.

4.3.3 Client Money

We have analysed above the measures used to protect clients from financial loss by means of the diligent selection of projects and information disclosure, among other things, but a few aspects of this concern should be further underlined.

ECSPs are not allowed, per se, to hold client money or other assets. Nonetheless, they can provide payment services and take custody of financial instruments after they obtain relevant authorizations and comply with the specific regime (Art. 12(13)). In this case, client assets are protected under the usual financial regulation framework.

As mentioned above (§4.3.2), ECSPs must warn their clients that the money invested or lent and the instruments subscribed to through the platform are not covered by deposit protection or investor compensation schemes. Should ECSPs establish a contingent fund (apparently, only when providing portfolio management of loans), they assume additional organizational and disclosure duties (§§4.3.2 and 4.3.5).

The choice to rely on existing authorizations for holding client money appears rational, although the presence of admitted instruments (which are not financial instruments) and loans might have required some adaptations.

4.3.4 Investor Liquidity Risk

As anticipated, one of the downsides of crowdfunding investments, is the limited liquidity of loans (which generally cannot be transferred without following certain procedures, such as a notary act and/or formal notification to the borrower of the transfer, following an agreement between the original and the new creditor) or stakes in private limited companies. As mentioned, LBC platforms in particular have created forms of exchange between users to increase liquidity.

Under the ECSP Regulation, platforms can set up systems allowing clients to advertise their buying/selling interests pertaining to products previously subscribed to through the platform ('bulletin boards', Art. 25). Nonetheless, these cannot present the characteristics of a trading venue, i. e., bringing together buying

83 See above fn. 35.

and selling interests in a way that results in a multilateral contract. Therefore, users must negotiate and finalize the agreement outside the platform; it is uncertain whether the platform can even provide standard contracts. Moreover, ECSPs must specify that these systems are not regulated trading venues, that any exchanges take place under the exclusive responsibility of investors, and, where there is a suggested reference price, that it is not binding. The ECSP must also substantiate the suggested reference price.

The intention seems to be not only to require an authorization as the operator of a trading venue in case platforms want to set up a multilateral exchange for transferable securities, but also to prohibit multilateral exchanges in loans (unless permitted under national law and limited to the national territory) in order to limit regulatory arbitrage and ensure a level playing field with regulated intermediaries, as well as to limit the platform's role as an intermediary. Of course, this might reduce the effectiveness of bulletin boards and consequently the liquidity of the market.

In the adopted version, ECSPs must require prospective sellers to make the KIIS available and must ensure that non-sophisticated prospective buyers receive the required information and the risk warning. Moreover, in the case of loans, ECSPs must provide buyers with updated information about the default rates of the loans offered on such bulletin boards (Art. 25(3)c): this improves investor protection and the efficiency of such bulletin boards as exchanges but also assigns a greater gatekeeper role to marketplace lending platforms.

4.3.5 Market Integrity, Efficiency, and Stability: Organizational and Prudential Requirements

ECSPs must also establish adequate measures to ensure effective and prudent management, including the segregation of duties, provisions for business continuity, and conflicts of interest prevention and management (similar to provisions in MiFID II: Art. 8(3)-(5)); management of the operational risk that results from outsourcing; and the proper handling of complaints (complying with certain of the requirements set forth in Art. 7).

Special organizational requirements apply, once again, depending on the specific business model. Only in the case of marketplace lending (even under the basic models) does the adopted version require 'appropriate systems and controls to assess the risks related to the loans intermediated on the crowdfunding platform' (Art. 4(2), first period).

When platforms offer portfolio management of loans, they need to have in place robust internal processes and methodologies for risk management and fi-

nancial modelling (Art. 4(2), second period) and to ensure compliance, using appropriate data, with the requirements set forth in Art. 6(1)-(2) concerning respect for the parameters chosen by investors (see above §4.4). They also need to assess the credit risk of individual crowdfunding projects selected for an investor's portfolio and of the portfolio itself, as well as the project owners' prospects of meeting their obligations. When offering and operating contingent funds, ECSPs must adopt policies, procedures, and organizational arrangements to be specified in an RTS drafted by the EBA in cooperation with ESMA (Art. 6(7)).

When providing scoring/pricing services (but, it seems, according to the wording, only in respect of loans or possibly debt securities), ECSPs must establish, implement, and maintain clear and effective policies and procedures to enable them to carry out a reasonable assessment of the credit risk of offers and project owners, an assessment that must be based on adequate information,[84] price fairness, and an adequate risk management framework; the ECSPs must keep a record of the evidence of compliance with these criteria. With particular reference to loans, ECSPs must conduct a valuation of each of them at least: a) at the time of origination; b) when the project owner is unlikely to fulfil its obligations to repay the loan in full and the ECSP does not enforce any relevant security interest or take steps with analogous effect; c) after a default; and d) when the ECSP is facilitating a lender's exit before the maturity date (Art. 4(4)). The information and factors that ECSPs are required to consider in such an assessment to ensure price fairness, as well as the related minimum governance and organizational requirements, will be further specified by the EBA in close cooperation with ESMA (Art. 19(7)).

In this respect, the regime appears quite rigid, especially as regards marketplace lending and scoring (see §§4.4, 4.5), and might consequently limit innovation when market-based or more generalized AI solutions (such as certification of the algorithm used, together with disclosure, forums/feedback, borrowers' rights to object, etc.) might have assisted such innovation.

Finally, the adopted version has also embraced the Council's suggestion to introduce prudential safeguards for operational risk (Art. 11), which represents the main business risk for marketplace lending platforms. These can consist of CET1 requirements as an alternative to or in combination with professional insurance equal to the higher of €25,000 and one-quarter of the overhead in the pre-

84 Including information about audited accounts where available, information of which the ECSP is aware, information obtained from the project owner, and other information needed to perform a reasonable credit risk assessment.

vious year.[85] Such funds are intended to cover, as revealed by the requirements set for the insurance policy, the risks created by misleading information (possibly only when directly provided by the ECSP: see §4.3.2); a breach of legal and regulatory obligations; a breach of a duty of skill and care towards clients; lacking or defective procedures to prevent conflicts of interest; losses from business disruption, system failures, or process management; and gross negligence in pricing (Art. 11(7)), among other things.

The introduction of prudential requirements for all ECSPs reflects the recent reform of prudential requirements for investment firms (in the IFD/IFR package), which has eliminated the original art. 4(1)2 CRR II exemption from capital requirements for investment firms offering the services of reception/transmission of orders or offering investment advice without holding client money (art. 62(3) b IFR) and introduced a prudential requirement for operational risk even for Class 3 firms (that conduct more broker-like activity). The same reform has reduced or eliminated the differentiation in capital requirements (both initial capital and Basel capital adequacy) based on the type of investment service offered to focus more on effective risks, and even revised the definition of credit institutions. The new Art. 4(1)1 CRR II (as revised by Art. 62(3) IFR), in fact, now assigns relevance to identifying banks not only according to their activities and associated functions but also based on the systemic relevance of certain investment activities.[86] In any case, we should take into account, in this regard,

85 This requirement recalls the capital requirements of Class 3 firms under the Investment Firms Regulation (IFR 2019/2033) and Directive (IFD 2019/2034) but is potentially lower since the IFD/IFR requirement depends on the minimum capital requirement of the particular service provided; the lowest of these is €75,000.

86 This new article provides that 'credit institution' means an undertaking the business of which consists of any of the following: (a) to take deposits or other repayable funds from the public and to grant credits for its own account; (b) to carry out any of the activities referred to in points (3) and (6) of Section A of Annex I to Directive 2014/65/EU of the European Parliament and of the Council, where one of the following applies, but the undertaking is not a commodity and emission allowance dealer, a collective investment undertaking or an insurance undertaking: (i) the total value of the consolidated assets of the undertaking is equal to or exceeds EUR 30 billion; (ii) the total value of the assets of the undertaking is less than EUR 30 billion, and the undertaking is part of a group in which the total value of the consolidated assets of all undertakings in that group that individually have total assets of less than EUR 30 billion and that carry out any of the activities referred to in points (3) and (6) of Section A of Annex I to Directive 2014/65/EU is equal to or exceeds EUR 30 billion; or (iii) the total value of the assets of the undertaking is less than EUR 30 billion, and the undertaking is part of a group in which the total value of the consolidated assets of all undertakings in the group that carry out any of the activities referred to in points (3) and (6) of Section A of Annex I to Directive 2014/65/EU is equal to or exceeds EUR 30 billion, where the consolidating supervisor, in consultation with the super-

that platforms do not operate in the traditional financial sector and that they must issue warnings to make investors aware of the lack of traditional safeguards. The rationale for preserving trust and stability through strict regulation – which applies to banks and investment firms – is here instead weak.[87]

Furthermore, the ECSP Regulation fails to explicitly address cyber-security risks, even though these comprise a relevant part of crowdfunding operational risk (and of FinTech in general). However, the Digital Operational Resilience Act (DORA) Proposal,[88] which was recently presented within the Digital Finance Package,[89] should be applicable also to ECSPs, filling the gap.

Finally, the Regulation does not directly impose duties on ECSPs under the V AML/CT Directive, although the possibility of extending these duties to ECSPs will be evaluated by the Commission in its review (Art. 45(2)p). Checks that take place pursuant to this Directive are in fact to be performed by the payment services provider involved, i.e., the ECSP itself under a separate authorization, or a partner holding a payment service provider authorization. This choice links AML checks with the holding and transferring of money, but ECSPs might be in the best position to perform them, irrespective of the fact that they also offer payment services.

4.3.6 Agency Costs and Conflicts of Interest

Agency costs, as has been mentioned, represent a typical risk in crowdfunding since the financial risk rests with investors but at least the initial selection of borrowers is performed by platforms. Agency costs are particularly high when the platform's fees are linked to the volume of the loans intermediated or equivalent figures, which creates negative incentives for platforms. As has been mentioned, certain platforms, in order to assure investors about the diligent selection of loans, co-lend with the investors.

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visory college, so decides in order to address potential risks of circumvention and potential risks for the financial stability of the Union".

87 Actually, the ECSP Regulation, which allows banks and investment firms to hold at the same time their specific authorization and a ECSP one, might have the effect of rising systemic risk through increased interconnections and potential investor confusion.

88 *European Commission*, 'Proposal for a Regulation [...] on Digital Operational Resilience for the Financial Sector [...]', COM/2020/595 final. The regime would apply to all firms across the financial sector and aims at ensuring their ability to withstand all types of ICT-related disruptions and threats. Furthermore, it also provides a design for an oversight framework for ICT service providers deemed critical to the financial sector (e.g., cloud computing).

89 *European Commission*, 'A Digital Finance Strategy' (fn. 70), p. 10, 17.

The above-described general duties of conduct should contribute to reducing agency risk and, in the case of pricing/credit scoring, the ECSP Regulation provides very detailed rules in terms of disclosure and the organization and functioning of such pricing/scoring systems. Under the ECSP Regulation, platforms cannot have any financial participation in offers, not even when it would be aimed at aligning the interests of platforms and clients (as proposed by the Parliament). However, models in which platforms would partially invest in the intermediated loans under certain conditions (such as when it would help align the interests of platforms and investors) should not have been banned per se since they might create virtuous incentives that require only some additional rules related to credit risk management.

Furthermore, the Regulation remains silent about platform fees and related perverse incentives. The general requirement that there be effective conflicts of interest policies and procedures (with rules echoing the general rules of MiFID II) might mitigate risks related to these fees but, given the particularity of the risk to the crowdfunding model, explicit and tailored solutions would have been preferable; for instance, creating incentives for the platforms to charge fees based on loan performance.

Also with respect to conflicts of interest, the ECSP Regulation prohibits platform managers, employees, or controlling shareholders from acting as project owners. These persons can, however, operate on the platform as investors, conditioned on disclosure on the website and equal terms (Art. 8).

Finally, as we have seen, co-lending with institutional investors can contribute to reduce information asymmetries when transparency and equal terms are guaranteed but might otherwise lead to a cherry-picking phenomenon at the expense of retail investors. The ECSP regulation does not address this issue. Instead, platforms should be required to allow non-sophisticated investors to invest along with professional investors (e. g., after paying an additional fee) but also to disclose the details and terms of the investments made by professional investors.

4.4 A Special Focus: Loans versus Investments and Borrower Protection

The general design of the Regulation is to partially assimilate the loan regime and the investment regime, since they both share similar functions and characteristics in a digital context and the aim is to improve investor protection and trust. However, it is worth highlighting that the marketplace lending regime appears somehow stricter and more rigid than the regime for marketplace inves-

ting. As an example, even under the basic model, the ECSP Regulation requires appropriate systems and controls to assess the risks related to loan products only; in addition, the loan regime imposes additional disclosure requirements (disclosure of the default rate and outcome statement; disclosure regime in case of bulletin boards involving loans).

Moreover, in the case of pricing services, detailed rules are set only for the creditworthiness assessment, not for the pricing of investments or at least equity instruments. This is the case despite the fact that marketplace lending is, in principle, less risky than similar forms of credit intermediation that are generally subject, in the traditional sector, to simplified requirements (e. g., for credit brokers, manufacturers of PRIIPs, and AIFMs).[90]

As regards portfolio management of loans, the regime is strict not only compared to the recent British regime which likely inspired it,[91] but also compared to the corresponding traditional investment models, such as investment portfolio management (except for, e. g., product governance requirements)[92] or the management of alternative investment funds. For instance, the requirements as respects the procedures for pricing and portfolio management appear more detailed and prescriptive than those for investment portfolio management (set forth in MiFID II and Art. 47 et seqq. Commission delegated Regulation No. 2017/565 concerning disclosure, reporting to clients, and asset valuation) or alternative collective investment schemes (Art. 15 and 19 AIFMD, detailing general obligations related to due diligence in the selection and identification of investments and the management and monitoring of risks, and the Commission Delegated Regulation No. 231/2013). Even banks, which are not comparable to platforms in terms of the variety of services they offer, their structures for bearing risk, their deposit-taking and the related costs of capital, induced trust, and their systemic relevance (see above §2), have been left quite free to evaluate the creditworthiness of borrowers (within the parameters set by Basel/CRDV-CRR,

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90 See in more detail, e. g., *Macchiavello* 'Financial-return' (fn. 2) 674.

91 The ECSP regime appears stricter and less flexible in certain respects as compared to the British regime, both in general (additional organizational requirements are imposed in the UK only in the case of guaranteed returns, not for every form of portfolio management) and in terms of credit-risk assessment (which in the UK is required only when the platform prices loans, not when it just intermediates them), outcome statements (required by the FCA only when pricing services are offered), factors to be included in the credit-risk assessment (the ECSP Regulation requires the use of audited financial statements), and different levels of credit-risk analysis (e. g.. at the project, project owner, and portfolio levels).

92 Art. 45(2)f requires the Commission to assess whether the requirements for portfolio management of loans remain 'appropriate to pursue the objectives of this Regulation, in the light of MiFID II investment portfolio management.

unless offering residential consumer loans), since, because they bear the risk of borrower defaults, they should have sufficient incentives to adequately perform this activity. Nonetheless, the financial crisis and the recent surge in nonperforming loans (NPLs) have created the conditions for the adoption of the EBA's guidelines on loan origination and monitoring[93] (based on a 'comply and explain approach'); this was after the European Central Bank Guidelines for Fintech Banks had imposed specific requirements for creditworthiness assessment performed by technology-based banks.[94] Consequently, banks will be required (for new loans, starting June 2021) to comply with a new set of detailed internal governance requirements (best practices) for the granting and monitoring of credit, loan origination procedures for each type of borrower, pricing, collateral valuation, and the proper framework for monitoring.

The services that entail a creditworthiness assessment are indeed of fundamental importance for investors' decisions, opaque[95] and a source of potential agency problems/conflict of interest (since the crowd-lender bears the credit risk of the loans and the platforms are at least partially remunerated based on loan volume),[96] while being so far unregulated. Nonetheless, instead of relying more on disclosure of the methods and the general adequacy of structures and procedures, the ECSPR regime has very detailed rules about platform organization and the factors that platforms must take into account in the credit assessment, without considering the need to preserve innovation in the sector[97] and the possibility that they could rely, at least partially, on reputational capital (many

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93 *EBA*, 'Guidelines on loan origination and monitoring – Final Report', (20 May 2020), <https://eba.europa.eu/sites/default/documents/files/document_library/Publications/Guidelines/2020/Guidelines%20on%20loan%20origination%20and%20monitoring/884283/EBA%20GL%202020%2006%20Final%20Report%20on%20GL%20on%20loan%20origination%20and%20monitoring.pdf>.

94 *European Central Bank*, 'Guide to Assessments of Fintech Credit Institution Licence Applications', (March 2018), <https://www.bankingsupervision.europa.eu/ecb/pub/pdf/ssm.201803_guide_assessment_fintech_credit_inst_licensing.en.pdf?1c99fa2126f6ef80eb61a276bab94379>.

95 These innovative creditworthiness assessment methods, DON especially when proprietary, are not clearly disclosed by platforms: *CGFS-FSB* (fn. 25) 11–12: *Ziegler/Shneor* (fn. 25) 77–79.

96 See *Paolo Giudici/Branca Hadji Misheva*, 'P2p Lending Scoring Models: Do They Predict Default?', J. Digit. Bank. 2018, 2, 353; *Paolo Giudici/Branca Hadji-Misheva/Alessandro Spelta*, 'Network Based Scoring Models to Improve Credit Risk Management in Peer to Peer Lending Platforms', Front. Artif. Intell. 2019.

97 See, for instance, a study attesting to the fact that a lender selecting loans by applying a profit scoring system using multivariate regression outperforms the results obtained by using a traditional credit scoring system. See *Carlos Serrano-Cinca/Bego Gutiérrez-Nieto*, 'The Use of Profit Scoring as an Alternative to Credit Scoring Systems in Peer-to-peer (p2p) Lending', Decis. Support Syst. 2016, 89, 113.

crowd-lenders are returning investors[98]) and the incentives that would result from performance-based fees.

The assimilation of the loans and securities regimes has also had the effect of moving the protection of borrowers to the background. Borrowers benefit from the general conduct and disclosure duties of ECSPs (§4.3.2), including these duties as they apply to the selection process. Organizational rules set forth for scoring systems and portfolio management are aimed at ensuring fairness in the evaluation of borrowers (§4.3.5). However, as the recent Regulation on online intermediation services (No. 2019/1150, not even mentioned in the ECSP Regulation) has underlined, attention should also be paid to platforms' business counterparties, who are in a weaker contractual position. Therefore, in the case of SMEs, protections consisting of express warnings (e. g., about the consequences of default, the information provided in the KIIS, and specific risks), a right to dispute certain scoring results or criteria, and a right of withdrawal, should be introduced or made more explicit.

4.5 Addressing the Core Question: How Does the ECSP Regulation Deal with the Platform Dilemma? Effects on Market Structure

The approved version has filled in some relevant gaps in the original proposal and seems to respond to the most important risks of marketplace lending platforms, although it contains certain limitations.

As regards its approach to the platform dilemma, the ECSP Regulation correctly and clearly differentiates marketplace lending from banking. Nonetheless, the numerous revisions in the text of the Regulation made during negotiations also reflect a change in attitude toward the regulation of crowdfunding, moving from flexible, agile, and optional to detailed, rigid, mandatory, and stricter. The

98 The research of *Balyuk /Davydenko* (fn. 40) seems to evidence market discipline among platforms, which appear to have a tendency to improve screening in response to investor threats of withdrawal. Nonetheless, Thakor and Merton provide evidence that banks (and other deposit-taking institutions) have stronger reputational incentives than P2P lenders because of the presence of deposits and the trust these create; however, they also underline that reputation (e. g. avoiding a default crisis) is important for nonbank lenders since they would not be able to recover from an erosion of trust. This means that fee-based incentives are fundamental: *Richard T. Thakor/Robert C. Merton*, 'Trust in Lending', NBER Working Paper No. 24778/2018, https://www.nber.org/papers/w24778 (version updated September 2019 available at <https://www.researchgate.net/publication/326473894_Trust_in_Lending>); *Thakor* (fn. 44), p. 6.

original ECSP proposal attempted to characterize marketplace lending/investing platforms as "neutral" intermediaries (reflecting many national crowdfunding laws) and to balance, on the one hand, a light regime with relevant limitations on maximum offering size and permissible products/activities, with, on the other hand, investor protection and containing project owner costs, using new, technologically based, and simplified measures (e.g., the entry-knowledge test and loss simulation) and synthetic and comprehensible information. The approved version, even though it fills in some relevant gaps, seems to share the same vision only partially and aims instead at "re-intermediating" marketplace lending/investing. In fact, it has significantly increased the number and detail of requirements that ECSPs are subject to. They will also be subject to numerous future EBA/ESMA rules that will be issued in light of the nature, scale, and complexity of crowdfunding services.[99] The approach appears particularly rigid in the case of loans, an area that is not yet harmonized and, in many countries, is less regulated than banks or investment firms. The aim seems to consist of amending the duties and roles of crowdfunding providers so that it is closer to those of traditional investment firms (e.g., in terms of conduct and organizational requirements, liability, and language rules governing prospectuses); the final Regulation looks at ECSPs as gatekeepers, not just managers of marketplaces. Such further assimilation to the role of traditional investment firms, although aimed at reducing regulatory arbitrage and ensuring a level playing field in the sector, does not properly take into account that MiFID firms are able to offer a varied set of services across borders with fewer restrictions, while relying on government support with respect to, for instance, investor compensation, access to credit bureaus, and state assistance and facilitation during COVID-19, etc.[100] Unfortunately, this results in an undervaluing of the alternative (i.e., not involving investor trust and the consequent implications for stability) character of marketplace lending, as well as its need to offer innovative solutions and operate under flexible rules.

99 E.g., rules that will address pricing/scoring criteria and factors; default rate calculations and disclosures; portfolio management clients' standards and contingent funds; and governance and procedures for risk management and complaint handling.

100 See <https://www.crowdfundinsider.com/2020/03/159570-what-crowdfunding-platforms-do-in-times-of-covid19-and-why-governments-should-use-crowdfunding-to-battle-the-economic-impact-of-socialdistancing/>; *Ziegler* et al. (fn. 10) 88–89. The SEC has temporarily eased crowdfunding regulation requirements for SMEs, which has expedited the offering process: <https://www.sec.gov/rules/interim/2020/33-10781.pdf>; <https://www.orrick.com/en/Insights/2020/05/SEC-Provides-Temporary-Relief-from-Certain-Regulation-Crowdfunding-Requirements-in-COVID-19-Response>.

The exact borders of the gatekeeper role of platforms remains uncertain in light of the many possible issues that this may implicate, including the extent of the diligent selection of projects, platforms' duties to check the correctness of KIISs, platforms' civil liability, and their role in bulletin boards. These have not been clearly defined and have largely been left to national and market responses.

Finally, as has already been underlined, a portion of the adopted rules for marketplace lending has been drawn from the UK framework. In the UK, the market is particularly mature, receives government support (e.g., referrals under the 2015 Small Business, Enterprise and Employment Act), and most platforms have moved to more complex models closer to traditional intermediaries'. ECSPR rules also apply to local-only platforms with low volumes unless the reference to the proportionality principle is to be interpreted broadly, even to the point of creating a tension with ECSP rules. Therefore, the ECSP Regulation seems to anticipate the market's evolution and might appear less appropriate for some less-developed and more "alternative" markets, for which a regime relying more on initial local exemptions, reputational capital, general risk management requirements, market-based mechanisms, and certification mechanisms (e.g. concerning the adequacy of the algorithms used) would have worked better (§§4.3.5, 4.3.6; 4.4).

Furthermore, the subtle line between the use of filtering systems under the basic model and the model of automatic portfolio management – a difference that entails relevant consequences in terms of the applicable rules since portfolio management is subject to a stricter regime – might affect ECSPs' choice of business model and therefore market development.

All this, together with the exclusion of certain business models from its scope of application, suggests that the ECSP Regulation might be able to significantly affect market structures, making platforms' choices about business models more dependent on the relative regulatory regime than on true business/market choices, an effect that might not be desirable in a sector that is, in many countries, so immature and innovation-dependent.

5 Conclusions

Marketplace lending is an innovative and puzzling kind of intermediation. According to the Court of Justice's decisions in *Uber* and *Airbnb* (§1), its services can be regarded as services for the information society offered through a pre-existing market (lending), but its decisive influence over the underlying lending services, at least under the most widespread models, is undeniable: platforms

select borrowers, provide contractual documentation, and often set prices (at least within a range). Anyway, in a financial sector context, we cannot disregard the existence of several reserved activities at both the European and national level and the corresponding principles and regulatory objectives.

Under this perspective, marketplace lending is clearly distinguishable from banking (strong intermediation) because of the absence of maturity/liquidity transformation and money creation; it is even different from lending (under the basic model, in which the platform does not engage in co-lending) since the funds are made available and put at risk by crowd-lenders only. Platforms connect lenders with borrowers as credit brokers, but the area is not completely harmonized and, with respect to consumer credit, the relevant EU law (e. g., CCD) tends not to apply and, in any case, would not respond to the complex set of risks and issues raised, including those related to investor protection and the platforms' organizational requirements.

The services offered by platforms (e. g., information channelling and screening and sometimes creditworthiness assessments and matching) are of fundamental relevance for crowd-lenders, potentially affecting their investment decisions.[101] The investment aspect of the platforms is clearly evident, with their role most resembling that of investment firms (weak intermediation), but involving the creation of a new asset class. Their services are, depending on the particular business model, similar to –(and mixing some characteristics of) brokerage, markets, portfolio management, and placing but pertain to financial products (loans) instead of financial instruments, unless the free transferability of loans though bulletin boards and an innovative and harmonized interpretation of the financial instrument concept are able to change this perspective. Furthermore, the platforms seem to complement financing by incumbents, serving otherwise underserved clients with lower loan amounts, instead of competing with them,[102] ensuring a faster process and therefore limiting the need for a perfectly

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101 See *Douglas J. Cumming/Lars Hornuf*, 'Marketplace lending for SMEs', CESifo Working Paper 8100/2020, <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3541448> (investors decide whether to participate based mostly on a platform's ratings, disregarding other – financial – indicators, such as income, assets, liabilities, etc.). See also *Serrano-Cinca et al.* (fn. 5) (recognizing as relevant to investor decisions and predictions about the likelihood of default other factors, such as the purpose of the loan and the borrower's annual income, current housing situation, credit history, and indebtedness).

102 See the references and relevant text in footnote 7 of *Giorgio Barba Navaretti et al.*, 'Fintech and Banking. Friends or Foes?' (January 10, 2018), <https://ssrn.com/abstract=3099337>. However, see also *Havrylchyk/Verdier* (fn. 44) (FinTech substitutes for banks in areas hardest hit by the crisis); *Huan Tang*, 'Peer-to-Peer Lenders Versus Banks: Substitutes or Complements?', The Review of Financial Studies 32(5) (2019) 1900 (as regards the US's unsecured consumer credit mar-

level regulatory playing field. The role played by the platforms is also extremely relevant from the borrower's side, since the opportunity to even receive a loan, its economic conditions, and the post-contractual management of the parties' rights and obligations strongly depend on the tasks undertaken by the platforms.

Consequently, platforms appear to satisfy traditional financial needs but, thanks to technology (i. e., platforms and data analytics), through new business models, creating a new asset class, and a new subsector (P2P lending), which is less systemically important than traditional intermediaries'. However, this subsector is characterized by the need to balance investor protection with access to finance, borrower protection, innovation, and competition goals. All of this bolsters arguments in favor of special regulations for marketplace lending. We therefore welcome the EU's choice to introduce a special EU-wide framework for financial-return crowdfunding, which certainly takes a step forward with respect to the platform dilemma, but is subject to some criticisms as set forth in our analysis.[103]

First of all, the idea of creating a single market for crowdfunding, while adequately pursued in terms of maximum harmonization in the authorization process and supervisory practices, is undermined by the limited scope of the ECSP Regulation; in fact, it applies only to certain services and products instead of covering the entire crowdfunding universe (e. g., it excludes consumer crowdloans, certain conditional loans, and some business models such as credit funds), potentially creating regulatory arbitrage and an unlevel playing field. Still uncertain is the interplay of the ECSP Regulation with national crowdfunding regimes and other EU frameworks; in addition, certain relevant aspects of crowdfunding remain unharmonized (platforms' civil liability, marketing rules, etc.) (§4.2).

With respect to the overall regime, we support the choice to design the legal framework for both marketplace lending and investing following the traditional regulatory model for investment services, with simplifications justified by the different types of markets, assets, and activities, and by their beneficial effects and alternative characters. The regime is grounded on the proportionality principle and contains differences applicable to activities that involve different levels of complexity and risk. The ECSP Regulation also correctly focuses on disclosure (with warnings about the alternative character of each sector) and conduct rules. The adopted version seems to provide an extremely detailed and strict

ket, FinTech lenders seem to substitute for banks, serving riskier borrowers when a crisis hits the banking sector, but also to complement banks by providing smaller loans).

103 See also *Macchiavello*, 'European Crowdfunding' (fn. 15); *Id.*, 'What to Expect' (fn. 2).

framework from an organizational point of view, especially for marketplace lending platforms (although much will depend on the future ESMA/EBA RTSs and the application of the proportionality principle), with limited space given to innovative solutions and technology (e. g. RegTech solutions) (§§4.1 ss).

Looking at the specific choices made by the Regulation, it correctly addresses certain peculiar risks of crowdfunding intermediation. Investor protection has been increased in the adopted version, balanced with considerations of the needs of ECSPs and correctly focusing on unsophisticated investors. Disclosure duties are especially detailed and strict and envisage the provision of information about selection mechanisms, scoring, and past and actual performance – important and previously overlooked aspects of marketplace lending – but the KIIS as designed might not be effective in conveying the right information to all types of investors (§4.3.2). Client assets are protected under the general financial regulation framework (§4.3.3). Nonetheless, the strict approach towards the function of bulletin boards aimed at defending the monopoly of trading venues might result in a failure to adequately address investors' liquidity risk, despite some efforts in this regard, especially with respect to loans (§4.3.4).

Organizational and prudential requirements reflect a recent turn towards more attention being given to operational risk and the systemic relevance of non-bank intermediaries. Nonetheless, such requirements would appear to be rigid and particularly burdensome for certain marketplace lending business models in a way that does not seem to take into account the need for innovative and flexible models and the "alternative" character of the sector (§4.3.5). Conflicts of interest rules are also rigid and appear not to fit with the chosen "reintermediation" approach. For instance, more flexible rules prohibiting platforms' remuneration based exclusively on the volume of loans intermediated and instead incentivizing methods partially based on loan performance could have been considered. Furthermore, rules should have limited the risk that professional investors would appropriate to themselves the benefits of investments meant for non-sophisticated investors and taken advantage of co-investing for its related reductions in information asymmetries (§4.3.6).

Finally, adopting an investment perspective on crowd-loans should not cause us forget about the need to also introduce protective measures for crowd-borrowers, even when they are entrepreneurs, in line with the recent online intermediation Directive.

In conclusion, the approved version has distanced itself from the original Commission view of ECSPs as neutral intermediaries, "re-intermediating" through marketplace lending/investing. However, the exact borders of such intermediation, and consequently, the approved version's response to the platform dilemma, appear blurred. In fact, the adopted version has significantly increased

the detailed requirements placed on ECSPs, with the aim of changing the duties and roles of crowdfunding providers to be closer to those of traditional investment firms (e. g., in terms of conduct and organizational requirements, liability, and language rules about prospectuses), viewing them as important gatekeepers. This change seems to only partially take into account that MiFID firms traditionally perform a more systemically relevant role (which affects investor trust in official financial markets), are able to offer a varied set of services across borders, and rely on government support. In fact, the ECSP Regulation appears uncertain about the platforms' role as gatekeeper, swinging from one extreme to the other (see above about bulletin boards). Furthermore, certain aspects of the Regulation (the exact limits of the KIIS correctness check, civil liability rules, the need to diligently select borrowers, etc.) will significantly affect the resulting design of the intermediating role of platforms, but appear to be left to national solutions, which implies a fragmented approach.

In any case, the regime appears unbalanced in its favouring of marketplace investing over marketplace lending in a way that is not consistent with the existing general financial law framework. It seems to anticipate market evolution (already realized in the US and the UK) and might appear inappropriate for less-developed crowdfunding markets. This, coupled with the exclusion of certain business models and services, seems to suggest a potentially important (and undesirable) impact of the ECSP Regulation on existing market structures. Platform choices about the business model to use might not follow the existing market and client needs or features but only the relevant legal framework (§§4.2, 4.4 and 4.5).