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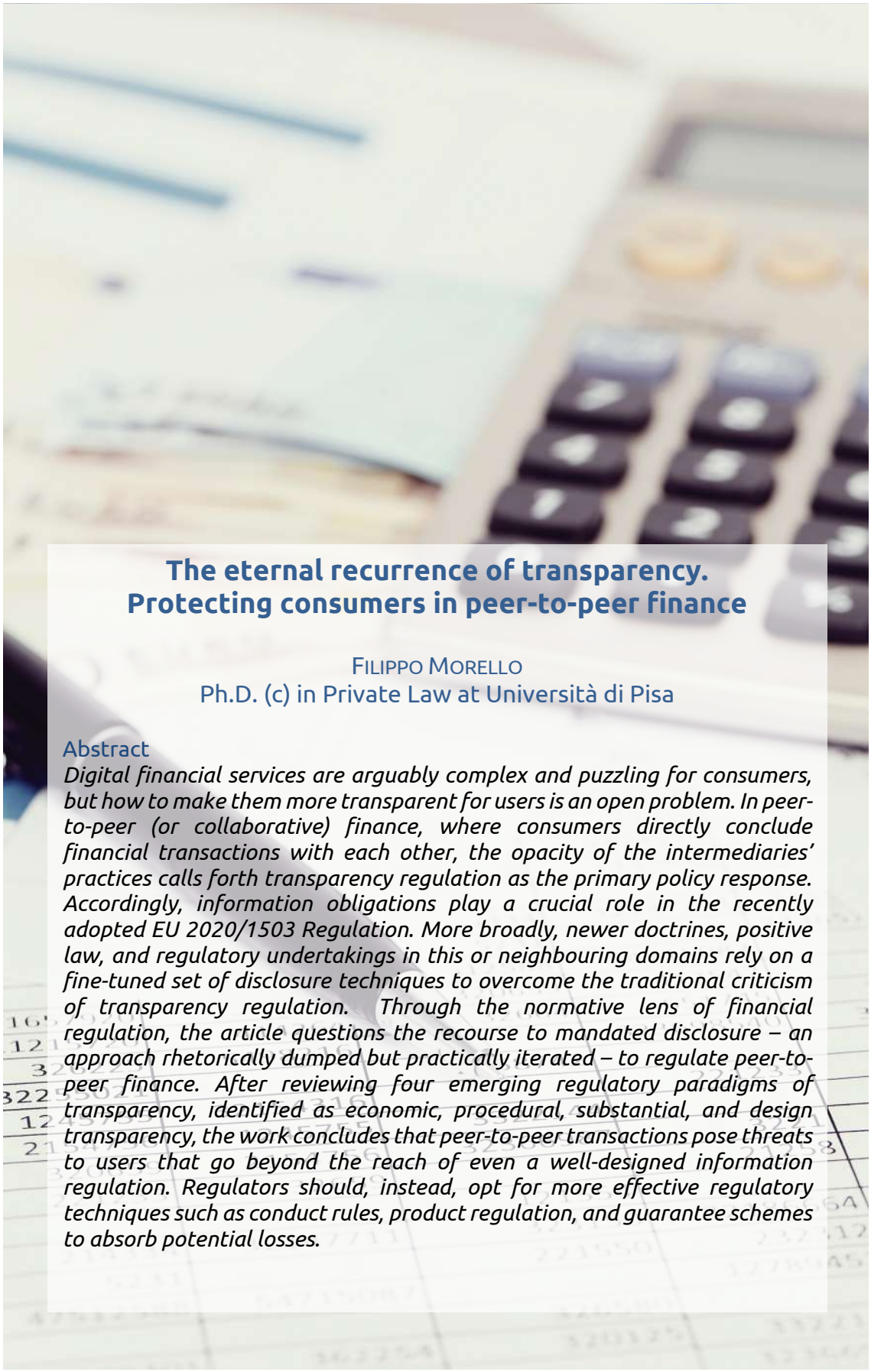

The eternal recurrence of transparency. Protecting consumers in peer-to-peer finance

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Abstract

Digital financial services are arguably complex and puzzling for consumers, but how to make them more transparent for users is an open problem. In peer-to-peer (or collaborative) finance, where consumers directly conclude financial transactions with each other, the opacity of the intermediaries' practices calls forth transparency regulation as the primary policy response. Accordingly, information obligations play a crucial role in the recently adopted EU 2020/1503 Regulation. More broadly, newer doctrines, positive law, and regulatory undertakings in this or neighbouring domains rely on a fine-tuned set of disclosure techniques to overcome the traditional criticism of transparency regulation. Through the normative lens of financial regulation, the article questions the recourse to mandated disclosure – an approach rhetorically dumped but practically iterated – to regulate peer-to-peer finance. After reviewing four emerging regulatory paradigms of transparency, identified as economic, procedural, substantial, and design transparency, the work concludes that peer-to-peer transactions pose threats to users that go beyond the reach of even a well-designed information regulation. Regulators should, instead, opt for more effective regulatory techniques such as conduct rules, product regulation, and guarantee schemes to absorb potential losses.

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Keywords: Peer-to-peer finance; consumer protection; transparency.

Summary: Introduction. – 1. Peer-to-peer consumer finance. – 1.1. Insurance. – 1.2. Investment. – 1.3. Lending. – 2. Unity in multiplicity. Risks and shortcomings. – 3. Consumers' protection through transparency? – 3.1. Procedural transparency. – 3.2. Economic transparency. – 3.3. Substantial transparency. – 3.4 The (tiny) room for legal design. – 4. Beyond the blinders of information asymmetry. – 4.1. Market failures and policy options for consumer protection. – 4.2. Market failures and policy options for regulation. – Conclusions.

Introduction.

The transparency regime laid down in European retail financial law is not the same as fifteen years ago. The orthodox information asymmetry view underpinning mandated disclosure proved questionable in theory[1] and unable to prevent the 2008-2009 financial distress propagation to consumers. However, these circumstances did not yield a radical overhaul of consumer finance regulation, in which transparency regulation still plays a big part. This can be explained, along with path-dependency, with the renewal of disclosure itself, whose rationales and techniques have significantly renovated over the recent years. The thrust towards language simplification, streamlining of the information, personalisation of disclosure, and non-written explanations are just a few instances of the old-but-new regulatory paradigm.

These adjustments come with a massive problem for scholars and regulators, i.e., whether the revived transparency logic is effectively up to date with the swirling evolution of consumer finance. The present work engages with one specific limb of this overarching question, notably the efficacy of transparency regulation in peer-to-peer financial services. The first EU regulatory initiatives in this domain glimpse the belief that disclosure is still what consumers utmost need. This is evident in the Regulation on Crowdfunding Service Providers, where information duties and warning obligations surround the financial transactions concluded by consumers. Less visibly, a similar rationale lurks, yet with important caveats, in other recent consumer law statutes and doctrines. Albeit tentative, such an approach can be pre-emptively assessed with the analytical toolkit of financial regulation, which builds on the welfare, behavioural economics findings to formulate legal and policy arguments.[2] Using this method, the present work critically reviews the quest for transparency in peer-to-peer finance and its expected output in terms of consumer protection. The analysis reaches two normative conclusions. First, the adequacy of transparency regulation needs to be questioned vis-à-vis the increasing body of legal and economic literature on the risks of peer-to-peer markets. Second, financial regulation offers a variety of complementary regulatory strategies that might effectively complement disclosure duties.

[1] O Ben-Shahar and C E Schneider, 'The Failure of Mandated Disclosure' (2011) 159 UPLR 647.
[2] J Armour, D. Awrey, P Davies, L Enriques, J Gordon, C Mayer, J Payne, *Principles of Financial Regulation* (Oxford University Press 2016).

The article is structured as follows. Section 1 introduces the collaborative finance industry in the insurance, investment, and lending markets. Section 2 draws on the financial regulation thinking to detect the main risks of peer-to-peer finance. Section 3 examines four transparency paradigms that underpin the early laws on the sector and concludes that none of these effectively reduces the risks identified in section 2. Section 4 suggests moving forward from the 'informative' paradigm in peer-to-peer markets and advances more appropriate legal and regulatory options.

1. Peer-to-peer consumer finance.

Peer-to-peer financial services offer online interfaces where users can trade financial assets among themselves. While the financial positions traded are simple ones, such as lending, insurance, and investment, the innovative trait of these services consists in the direct contractual tie between the ultimate participants. [3] Such horizontal link is merely indirect in institutional finance. For instance, despite being mutually necessary for the bank's activity, banks' depositors and borrowers are not bound to each other by a contract.[4] Similarly, it is true that in insurance, policyholders cover each other's risks. Still, as a matter of law, every policyholder has only a contract with the insurer whereby the latter takes up the former's risk. Thus, what makes the peer-to-peer economy both ubiquitous and profitable is the substitution of settled middlemen with a new kind of online broker, the digital platform, that arranges direct transactions among peers with low intermediation costs.[5]

Concerning consumer finance, peer-to-peer platforms mainly offer insurance, investment, and lending services.

1.1. Insurance.

In peer-to-peer insurance, consumers longing for protection against risk can access an online platform disclosing their insurance needs. The platform screens the applicants, groups them into clusters based on preferences and risk categories, and for each cluster collects uniform premiums in a common fund. 'Peer' users are typically clustered together so that same-risk consumers

[3] The notion of 'simple position' to refer to insurance, investment, and lending is generic. According to J Benjamin, *Financial Law* (Oxford University Press 2007) 49, simple financial positions are characterised by the fact that the credit exposure of the risk taker is not protected. In the Author's view, insurance is a simple financial position, while lending and investment are funded positions. Simple Financial Position in a different way. Risk buyer and risk seller

[4] During their ordinary business, banks take up deposits from savers and lend the money they collect to borrowers in search of capital. This function is normally associated with the transformation of maturity, credit, and liquidity. See J Armour, D. Awrey, P Davies, L Enriques, J Gordon, C Mayer, J Payne, *Principles of Financial Regulation*, 423-424.

[5] A Bertolini, F Episcopo, Cherchiu, 'Liability of Online Platforms' (European Parliament Research Service, 2021) 7. The specificity of peer-to-peer financial platforms is that they operate at the periphery of the financial system, in the markets for end-users of financial assets such as individuals and small-medium enterprises. The idea of the markets for consumers and small-medium businesses a s the periphery of the financial system is developed by K Pistor, 'Towards a Legal Theory of Finance' (European Corporate Governance Institute (ECGI) Law Working Paper No. 196/2013) 17.

mutually insure themselves (and the same holds for same-risk businesses).[6] Throughout the policy period, the platform manages the money pool and pays the policyholders out upon the occurrence of the event they are insured against.[7] As insurance companies, the intermediary weighs and segments the risk and indemnifies the insured party. Unlike proper insurers, however, peer-to-peer platforms hold the premiums separately from their balance sheets and pay policyholders without drawing their funds, so they do not run a fully-fledged insurance business and are well beyond the boundaries of insurance services as a regulated activity. The business models of peer-to-peer insurance are mainly two. In the 'broker' model, the premiums collected by the broker are half pooled in a fund managed by himself and half directed to a proper insurer. Policyholders can claim the indemnities up to a specific figure to the broker and higher amounts to the insurance.[8] In the 'self-governing' model, all premiums are pooled in a fund held by the platform and managed by stakeholders. For an indemnity to be paid, policyholders must address their claims to their fellow stakeholders, who decide on the settlement.[9]

In legal terms, not being part of the peer-to-peer agreement, platforms are often licensed as brokers instead of insurers and are subject to the organisation and conduct rules pending on brokering services providers.[10] Whether the multi-party transactions they set up fit with the notion of insurance contracts intended in national private law may vary from the different business models and domestic legislation. Due to the absence of an insurance company as the counterparty, neither the 'broker' nor the 'self-governing' arrangements can be unreservedly labelled as insurance agreements. The misalignment has profound regulatory consequences. Exemplarily enough, the Insurance Distribution Directive, which promotes fairness and transparency in the sale and promotion of insurance products, only applies to the service providers intermediating an 'insurance contract' (art. 2, 1), a notion undefined in the Directive and drawn from domestic law.[11] The multi-party transactions set up by insurance platforms are thus very prone to escape the Directive.

[6] Bargaining with a 'peer' does not imply that the parties have common features or belong to the came category (consumers, businesses). It just emphasizes that they are at the same level in disintermediated transactions. On the concept of 'peer' in the sharing economy, see M L Rego, J C Carvalho, 'Insurance in Today's Sharing Economy. New Challenges Ahead or a Return to the Origins of Insurance?', in P Marano, K. Noussia (ed.), *InsurTech. A Legal and Regulatory View* (Spinger 2020) 29.

[7] P Marano, 'Navigating InsurTech: The Digital Intermediaries of Insurance Products and Customer Protection in the EU' (2019) 26 2 MJECL 305.

[8] Institute of International Finance, 'Innovation in Insurance: How technology is changing the industry', Institute of International Finance (2016) 11.

[9] A third model, the so-called 'carrier model', is very much akin to a traditional insurance contract negotiated and concluded online. See M L Rego, J C Carvalho, 'Insurance in Today's Sharing Economy. New Challenges Ahead or a Return to the Origins of Insurance?', in P Marano, K. Noussia, *InsurTech. A Legal and Regulatory View* (Spinger 2020) 27.

[10] OECD, 'Regulatory and Supervisory Framework for Insurance Intermediation' (2020).

[11] Directive (EU) 2016/97 of the European Parliament and of the Council of 20 January 2016 on insurance distribution (recast) [2016] OJ L 26. See P Corrias, Profili Generali della Nuova Disciplina recata dalla Direttiva 2016/97 (2018) 2 RTDE 158.

1.2. Investment.

The only activity considered within 'peer-to-peer' investment in this study is crowdfunding, which enables consumers (and firms) to invest in debt, equity, or hybrid securities issued by a small or medium firm through a digital marketplace. Platform-intermediated trading, on the one hand, and peer-to-peer investment, on the other, occur in various fashions, but only crowdfunding combines both elements. For instance, online interfaces are used in stock exchanges and otc markets, where, however, the intermediaries take part in the issue, distribution, and holding of debt and equity securities and cannot be regarded as mere brokers or marketplace platforms.[12] Similarly, although transactions in crypto-assets rely heavily on platforms, participants in this market invest in a network of dispersed transactions and not directly in a 'peer' project or enterprise.[13] On a different note, the microfinance galaxy encompasses a broad array of peer-to-peer services, in which, nonetheless, the presence of an intermediating platform is not necessary.[14]

In crowdfunding, the platform serves as a marketplace for users, namely investors and businesses searching for equity, debt, or hybrid funding. Platforms do not hold securities on behalf of investors, but they work as matchmakers and manage cashflows between the parties. Small and medium businesses, screened by the platform, offer their products to a cohort of professional or individual buyers, who scroll through the financial products and make their investment decisions. Three kinds of investment crowdfunding exist.[15] The 'reward-based' model allows users to fund a firm in return for production units. Investors are both financiers and consumers of the items or services produced by the issuing firm. The 'equity-based' model consists of shares purchases whereby investors become part of the shareholding and acquire economic and non-economic rights.[16] Other intermediaries offer 'lending-based' crowdfunding options, in which investors purchase transferable debt securities and then make a margin through either the debt interests or a profitable transfer.

The legal question around crowdfunding has long been whether the traded instruments represent 'securities' within securities regulation. Crowdfunding

[12] J Armour, D. Awrey, P Davies, L Enriques, J Gordon, C Mayer, J Payne, *Principles of Financial Regulation* (Oxford University Press 2016) 181; J Benjamin, *Financial Law* (Oxford University Press 2007) 151.

[13] The specificities of the markets for cryptoassets depend both on the kind of transactions performed and on the object of the transactions, i.e. entitlements to be registered in distributed-ledgers. These features suggest that investing in cryptoassets can hardly be regarded as 'peer-to-peer' investing and thus pose it beyond the scope of the present research. However, there is significant evidence that blockchain technology can serve peer-to-peer platforms to carry out their intermediation. See L Gonzalez, 'Blockchain, Herding and Trust in Peer-to-Peer Lending' (2020) 46 MF 815; E F Greene, J M Amico and S Bala, 'Blockchain, Marketplace Lending and Crowdfunding: Emerging Issues and Opportunities in FinTech' in Iris H-Y Chiu and I G MacNeil (ed.), *Research Handbook on Shadow Banking* (Elgar Publishing 2018) 253.

[14] A Roy, 'Poverty Capital: Microfinance and the Making of Development' (Routledge, 2010).

[15] J Armour L Enriques, 'The Promise and Perils of Crowdfunding: Between Corporate Finance and Consumer Contracts' (2018) 81 MLR 1 54; E Kirby and S Worner, 'Crowdfunding: An Infant Industry Growing Fast' (2014) OICV-IOSCO, Staff Working Paper.

[16] The prominent right is, of course, the entitlement to a proportionate share of the profit. See ESMA, 'Opinion on Investment-Based Crowdfunding' (2014).

positions can indeed be intended as financial instruments.[17] Yet, the Prospectus Regulation – according to which securities must be issued at first instance upon an informative prospectus – does not apply to issues under 8 million over 12 months.[18] Notably, the recent EU Regulation 2020/1503 on crowdfunding services for business contains a comprehensive set of rules that range from the organisational and operational requirements (articles from 3 to 11) to the authorisation and supervision regimes (articles from 12 to 18).[19] Despite not being applicable to projects owned by consumers, the Regulation lays down noticeable informative safeguards for unsophisticated investors; among these, mandatory disclosure of the characteristics of the products (articles 19 and 20), an entry test and a pre-emptive simulation of the ability to bear losses (article 21), a pre-contractual reflection period (article 22), a personalised 'key investment information sheet' (article 23).

1.3. Lending.

A third and final collaborative offshoot of financial services is peer-to-peer lending. Addressed to both consumers and businesses, it is a particular form of crowdfunding where multiple investors lend money to one or more credit applicants. Peer-to-peer lending deserves a specific focus since, unlike 'lending-based' crowdfunding, it also addresses consumers on the borrowing side of the credit relationship. In peer-to-peer lending, consumers lend when searching for a diversified and profitable investment and borrow as project owners when unworthy of banking credit or in need of more flexible loans.[20] As for the functioning, peer-to-peer platforms are comparable to other crowdfunding marketplaces: they assess creditworthiness, provide prospective borrowers and lenders with information on the available offers, set up transactions following users' preferences, and oversee performance.

In terms of the legal regime, peer-to-peer consumer lending lies in regulatory limbo. The originated loans do not constitute 'credit agreements' within the Consumer Credit Directive (2008/48/EU), the consumers' counterparty not being a professional but consumers in turn.[21] Then, loan

[17] O Havrylchyk and M Verdier, 'The Financial Intermediation Role of the P2P Lending Platforms' (2018) 60 CES 115. In order to be securities, financial instruments must be offered to the public, cash-settled, and transferable; the three criteria can be detected in reward, equity, and lending crowdfunding instruments.

[18] Regulation (EU) 2017/1129 of the European Parliament and of the Council of 14 June 2017 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market and repealing Directive 2003/71/EC [2017] OJ L 168. The application of the low value exemption might change depending on whether we look at the crowdfunding instruments as component of a whole issue or if we look at each crowdfunding share as an autonomous financial product.

[19] Regulation (EU) 2020/1503 of the European Parliament and of the Council of 7 October 2020 on European crowdfunding service providers for business, amending Regulation (EU) 2017/1129 and Directive (EU) 2019/1937 [2020] OJ L 347.

[20] There is a huge question as to whether peer-to-peer lending is a substitute or a complementary of banking consumer credit. See N Branzoli and I Supino, 'FinTech Credit: A Critical Review of Empirical Research Literature' (2020) Bank of Italy Occasional Paper No. 549; H. Tang, 'Peer-to-Peer Lenders Versus Banks: Substitutes or Complements?' (2019) 32 RFS 1900; C De Roure, L Pelizzon and A V Thakor, 'P2P Lenders Versus Banks: Cream Skimming or Bottom Fishing?' (2018) SAFE Working Paper No. 206.

[21] Directive 2008/48/EC of the European Parliament and of the Council of 23 April 2008 on credit agreements for consumers [2008] OJ L 133. The literature on the uneasy application of the Directive to peer-to-peer lending is vast. See, among many, F Ferretti, 'Peer-to-Peer Lending and EU Credit Laws: A Creditworthiness Assessment, Credit-Risk Analysis or … Neither of the Two?' (2021) 22 1 GLJ 102; T

shares funded by lending investors hardly fall within the scope of securities regulation.[22] Finally, the EU Regulation on crowdfunding service providers explicitly exempts consumers projects from its scope of application (art. 1, par. 2, a). As a result, horizontal lending transactions are designed by the platforms' terms of services subscribed by users, with general consumer law provisions as the only potential counterweight. Nevertheless, consumer law is barely applicable in a digital environment where the ultimate relationships are discrete bilateral contracts between consumers.[23]

2. Unity in multiplicity. Risks and shortcomings.

Such a diverse array of financial services has significant standard features that justify a unitary analysis. Beyond the different financial positions traded, peer-to-peer transactions share an equivalent backbone. Once consumers subscribe to platforms' terms and conditions and create their accounts, they can start buying and selling behind a pseudonym and a financial rating. Once admitted, they choose or are matched with a cohort of fitting counterparts, be they co-insured parties, small businesses in need of funding, or consumers eager to lend or borrow.[24] As a result of the matching, each user has a bundle of bilateral contracts with the alleged peers. Despite not being part of these contracts, the intermediary is responsible for their accounting and settlement. Indemnities, returns on investments, and loan instalments are driven by the platform that draws on shared pools or users' funds to clear the due transactions. Behind their collaborative veil, all peer-to-peer intermediaries ultimately cut intermediation costs by outsourcing financial risk to the crowd: a wider variety of offers and decision-making power inevitably come with unprecedented burdens for consumers. Widespread regulatory inertia exacerbates the bearing of the neighbour's financial risk.[25] Afraid to stifle the benefits of an innovative business model, legislators and regulatory agencies have been reluctant to step in so far.[26]

The peer-to-peer sector has displayed several risks so far. Some of these threaten the existence or profitability of the intermediaries that sustain the market and hence consumers; they can thus be regarded as regulatory. Others pertain directly to consumer protection and are likely to cause actual harm or

Jorgensen, 'Peer to Peer Lending. A New Digital Intermediary, New Legal Challenges' (2018) 1 NJCL 232; R Lenz, 'Peer-to-Peer Lending: Opportunities and Risks' (2016) 7 EJRR 688.

[22] See nt 16.

[23] P Palka, 'Terms of Service Are Not Contracts. Beyond Contract Law in the Regulation of Online Platforms', in S Grundmann (ed), *European contract law in the digital age* (Intersentia 2018) 135.

[24] In the different market sectors considered, the matching takes different shapes. However, in insurance, investment, and lending, the ultimate matching is made by the platform relying on the preferences, the needs, and the financial situation of consumers. The degree of the platform gatekeeping power then varies sensibly according to the business model.

[25] C Busch and V Mak, 'Peer-to-Peer Lending in the European Union' (2016) 4 EuCML 181.

[26] Many commentators point out that the crowdfunding market is still in its infancy and that a constraining regulation would not be suitable for now. In line with this idea, J Armour L Enriques, 'The Promise and Perils of Crowdfunding: Between Corporate Finance and Consumer Contracts' (2018) 81 MLR 1 54; E Kirby and S Worner, 'Crowdfunding: An Infant Industry Growing Fast' (2014) OICV-IOSCO, Staff Working Paper. Beyond that, after the approval of the Regulation, one cannot ignore that the new rules have a very narrow scope and that they are overly permissive. The reasons for these criticisms are articulated throughout the article.

increase distrust in platform users. At the regulation stage, peer-to-peer financial platforms are exposed to a peculiar risk of runs from users.[27] Although platforms do not take deposits and do not hold the users' assets on their balance sheet, they are vulnerable to a run risk similar to banks'.[28] Users' assets on platforms, namely the rights to be paid upon a specific loss, a return on equity or debt investment, and the repayment of a loan, are medium- to long-term, highly illiquid positions. To rebalance the fact that these assets are, to some extent, locked-in, platforms offer a set of exit and liquidity options: secondary markets, mandatory purchase by the platforms, and rights to withdraw. The run scenario occurs when consumers, very prone to irrational and herd behaviours, resort in large numbers to such options. The likely result is, at best, a depreciation of the assets traded on the platform; at worse, the getaway of all users and the failure of the platform.[29] A second and remarkable source of risk is the dissociation between the gatekeeper and matchmaker, the platform, and the consumers that bear the financial risks in platform transactions. The fact that platforms are not directly affected by such risk makes them prone to poor performance in screening and matching. When this results in over-inclusion and poor matchmaking, the market will likely fail.[30] Third, there is a substantial risk that peer-to-peer intermediaries acquire a dominant position in the market and preserve it through non-competitive practices, such as artificially low prices and other barriers to entry.[31] Once again, practices that hinder competition may progressively lead the market to waste appeal and value. As anticipated, these concerns affect the market intermediaries in the first instance and end-users subsequently.

In the consumer protection outlook, platforms' users face severe asymmetries vis-à-vis the intermediary and the ultimate counterparties. The unbalance has its roots in the economic position of consumers, and it is exacerbated by the complexity and opacity of the marketplace.[32] The firsts dimension of asymmetry concerns the contractual relationship between each user and the platform. Users' subscription to the terms of service - the

[27] O Havrylchyk, 'Regulatory Framework for the Loan-Based Crowdfunding Platforms' (2018) OECD Economics Department Working Papers No. 1513.

[28] The classic bank run scenario occurs when a huge number of depositors withdraw cash for fear of the bank's failure, and thus lead the bank astray drying up the liquidity reserves and forcing the bank to liquidate other assets to accommodate the withdraw demand. Bank runs are self-fulfilling prophecies. See J Armour, D. Awrey, P Davies, L Enriques, J Gordon, C Mayer, J Payne, Principles of Financial Regulation (Oxford University Press 2016) 110; D W Diamond and P H Dybvig, 'Bank Runs, Deposit Insurance, and Liquidity' (1983) 91 JPE 401.

[29] The covid crisis was not gone far from triggering the presented 'run risk'. See R Jones, 'Peer-to-peer Lending: 'I'm 19,050th in the Queue to Get My Savings Back' The Guardian (17th October 2020); N Pedersen, 'The Impact of COVID-19 on Peer-to-Peer Lending' KoganPage (27th November 2020).

[30] A similar scenario in financial markets is very much correlated with the so-called 'originate-to-distribute' business model, whereby the fabrication of a financial product by an actor that is not affected by the costs and consequences of its circulation. See T Adrian and B Jones, 'Shadow Banking and Market-Based Finance' (2018) IMF No. 18/14. A typical example of such model, somehow replicated by peer-to-peer platforms, is securitisation, where lax-screening by risk-less intermediaries played a huge role in the 2007-2009 financial crisis outbreak. See B J Keys, T Mukherjee, A Seru, V Vig, 'Did Securitization Lead to Lax Screening? Evidence from Subprime Loans' (2010) 125 QJE 307.

[31] C Busch, I Graef, J Hoffman, A Gawer, 'Uncovering Blindspots in the Policy Debate on Platform Power. Final Report' (2021) European Commission, 8.

[32] For an overview on the main issues that consumers are faced with when accessing financial markets, see J Armour, D. Awrey, P Davies, L Enriques, J Gordon, C Mayer, J Payne, Principles of Financial Regulation (Oxford University Press 2016) 325.

normative source of the transactions – entitle the platform to proceed with all the steps necessary to conclude the downstream contracts. In terms of readability and accessibility, terms of services are not only long, difficult to understand as many boilerplates, but even very hard to find on digital interfaces. [33] This often results in consumers that surf the marketplace searching for attractive returns, unaware of their rights and duties under the contract. This is linked to the second asymmetry users are faced with, i.e., the understanding and selection of financial products. While platforms typically screen users when they sign up, the choice of financial products is an unsupervised operation almost entirely left to users.[34] As long as brokers do not actively distribute the financial positions, the risk that consumers enter transactions they don't need or, worse, detrimental to them is inherent to the platform business model. The misallocation of products is, thus, in all respects, a problem of poor and uninformed decision-making from market participants. Finally, there are severe concerns that consumers interested in saving money do not understand the kind of service provided by the platforms and mistake them for traditional banks. Unlike banking savings services, namely deposits, platforms offer highly illiquid products that cannot be converted into cash on demand.[35] In addition, the consumers' assets are not covered by any of the mandatory compensation schemes provided for bank deposits.[36] This means that consumers are unsecured creditors very likely to end up empty-handed if the horizontal counterparts or the platform default. So, where mistakenly convinced to deal with a perfect bank surrogate, consumers might see their liquidity and protection expectations disappointed.

3. Consumers' protection through transparency?

At first sight, at the root of consumers' vulnerability in peer-to-peer markets, there is a combination of inexperience, financial illiteracy, and insufficient knowledge of platforms' services. Traditionally, the legal response to similar shortcomings would have been transparency regulation to restore the cognitive and informative equality of the bargaining parties. Despite the severe criticism this regulatory technique has faced,[37] recent trends in consumer law

[33] D Wielsch, 'Private Law Regulation of Digital Intermediaries' (2019) ERPL 197; P Palka, 'Terms of Service Are Not Contracts. Beyond Contract Law in the Regulation of Online Platforms, in S Grundmann (ed), *European contract law in the digital age* (Intersentia 2018) 135.

[34] Platforms do an important job in evaluating and segmenting risk, that results in consumers being pooled in risk categories and having access to instruments belonging to a certain risk category. However, this activity is made spontaneously by platforms with different methods and objectives and, above all, platforms do not directly engage in the ultimate choice for one product instead of one other.

[35] Liquidity transformation, a prerogative of banking activity, is not offered by platforms, that only offer secondary markets trading to liquidate the investments. In the context of peer-to-peer lending, the first platform to initiate a secondary market where loans could be transferred was Prosper in 2009. Prosper closed the secondary market in 2016, but many others have decided to offer a similar service to their investors.

[36] Deposit compensation schemes have become a cornerstone of depositors' protection within the EU. The different national instruments have been in part harmonised through the Directive 2014/49/EU of the European Parliament and of the Council of 16 April 2014 on deposit guarantee schemes [2014] OJ L 173. See J Kerlin, *The Role of Deposit Guarantee Schemes as a Financial Safety Net in the European Union* (Palgrave Macmillan 2017).

[37] O Ben-Shahar and C E Schneider, 'The Failure of Mandated Disclosure' (2011) 159 UPLR 647.

and policy continue to pursue the clarity and comprehensibility of retail services, albeit with fine-tuned tools. These new transparency paradigms are gradually being implemented in peer-to-peer finance too.

3.1. Procedural transparency.

A promising strain of legislation entitles individuals to shed light on how their data are processed throughout commercial processes, mainly when automated decision-making occurs. Exemplarily, the GDPR provides the data subject with, among others, a right to be informed about any automated decision-making process to her account (articles 13 and 14). In these cases, the data subject can access the data (article 15), ask for human intervention (article 22), and, according to some scholars, he is entitled to receive an explanation of the nature and logic of the automated process.[38] The GDPR is not a one-off. The newly adopted EU Regulation on Crowdfunding mandates intermediaries that 'apply credit scores' or 'suggest the pricing of crowdfunding offers' to 'make available a description of the method used to calculate such credit scores or prices' (article 19, par. 6). These provisions lay the foundations of a 'procedural transparency' approach that calls forth a technological 'due process' to avoid flaws, biases, and possible discriminations in the treatment of online users.[39] In peer-to-peer relationships, the platform gathers vast amounts of consumers' data from various sources and processes them very obscurely. [40] The technological asymmetry is even more profound considering how the platform holds the consumers' assets, how users are matched with each other, and the settlement of transactions. In short, users only scratch the surface of sophisticated digital infrastructures.

Does a likewise transparency paradigm curb users' vulnerability in peer-to-peer finance? It is hardly the case. First, the procedural transparency regime lacks effectiveness. The technological and commercial engines behind platform transactions are often too complex to be explained to platform users. There is little if no chance consumers would understand where the possible flaws occurred and act accordingly. Then, not all procedural transparency provisions bestow subjects with rights to obtain a revision of automated decision-making; when this is the case, unawareness or inertia of the interested party makes

[38] In favour of a proper right to explanation in the GDPR are G Malgieri and G Comandé, 'Why a Right to Legibility of Automated Decision-Making Exists in the General Data Protection Regulation' (2017) 7 IDPL 243, as opposed to S Wachter, B Mittelstadt and L Floridi, 'Why a Right to Explanation of Automated Decision-Making Does Not Exist in the General Data Protection Regulation' (2017) 7 IDPL 76.

[39] D Keats-Citron, 'Technological Due Process' (2008) 85 6 WULR 1249.

[40] The problem of technological black boxes that process consumers' and firms' data is nowadays well known to legal scholars. See, among many, I Mendoza and L A Bygrave, 'The Right Not to Be Subject to Automated Decisions Based on Profiling', in T-E Synodinou, P Jougleux, C Markou, T Prastitou (edited), *EU Internet Law. Regulation and Enforcement* (Springer 2017) 77; B Reddix-Smalls, 'Credit Scoring and Trade Secrecy: An Algorithmic Quagmire or How the Lack of Transparency in Complex Financial Models Scuttled the Finance Market', (2011) 12 UCDBLJ 94. The difficulties to explain algorithmic decision-making derive from many factors, not least the availability of that information for the data controller (and its employees) himself. Very often, what consumers and firms can only aspire to is an intuitive reconstruction of the decision (A D Selbst, S Barocas, 'The Intuitive Appeal of Explainable Machines (2018) 87 FLR 1085) or a counterfactual hypothesis (S Wachter, B Mittelstadt and C Russell, 'Counterfactual Explanations Without Opening the Blck Box: Automated Decisions and the GDPR' (2018) 31 2 HJLT 841).

them barely viable.[41] Second, in economic terms, the resources and time invested in fostering procedural disclosure would raise the intermediation costs without any tangible offset on consumers' welfare.[42] Interestingly, the Proposal of a Regulation on Artificial Intelligence, released in April 2021 by the European Commission, somehow revisits the procedural transparency put forward by the GDPR.[43] In the Proposal, the AI systems used to evaluate credit scores or creditworthiness of natural persons – among which platform ratings certainly fall – are classified in the 'high-risk' category.[44] The relevant norms in this respect are aimed at restricting the use, implementing auditing and supervision systems, and promoting sound data governance.[45] In a nutshell, the proposal acknowledges that procedural fairness is hardly accomplished through transparency regulation.

3.2. Economic transparency.

A different model of transparency upheld in recent regulatory interventions can be regarded as 'economic' as it aims to supply to consumers all the bits of information material to value the assets they purchase. This is the case of the disclosure duties provided in the EU Crowdfunding Regulation, whereby the crowdfunding platforms are required to disclose the costs, the charges, the risks, the default rates, and, above all, all the features of the product purchased (articles 19, 20, and 23).[46] The focus on the characteristics of the traded positions recalls the 'disclosure regulation' regime that oversees securities

[41] One problem of the transparency norms in this domain is that they do not directly entitle to a revision of the decision. See L Edwards and M Veale, 'Slave to the Algorithm? Why a 'Right to Explanation' is Probably Not the Remedy You are Looking For' (2017) 16 DLTREV 18.
[42] Needless to say, producing and making information available is costly for businesses. Even more costly in terms of time and resources would be waiting for consumers to understand and exercise their rights.
[43] Proposal for a Regulation of the European Parliament and of the Council laying down harmonised rules on Artificial Intelligence (Artificial Intelligence Act) and amending certain Union legislative acts. COM/2021/206 final.
[44] Annex III also considers as 'high-risk' applications of AI in the following areas: biometric identification and categorisation of natural persons (1), management and operation of critical infrastructure (2), education and vocational training (3), employment, workers management and access to self-employment (4), law enforcement (6), migration, asylum and border control management (7), and administration of justice and democratic processes (8).
[45] Article 8 states that high-risk activities must comply with the requirements laid down in the following articles. Article 9 mandates risk management systems. Article 10 requires high-risks systems to comply with requirements of training, validation and testing datasets. Article 12 provides that high-risk AI systems must be designed so as to keep track and record of the performed tasks. Article 14 requires that the high-risk AI systems are designed and developed so that they can be effectively overseen by a natural person. More obligations for providers or high-risk systems are laid down in the following articles.
[46] Articles 19 requires crowdfunding services providers to inform customers on 'the costs, financial risks and charges related to crowdfunding services or investments, about the crowdfunding project selection criteria, and about the nature of, and risks associated with, their crowdfunding services' in a fair, clear, and not misleading manner (par. 1). They shall also inform users that crowdfunding instruments are not covered by any compensation scheme, neither for depositors nor for investors (par. 2) and that, if they are non-sophisticated investors, they have a pre-contractual reflection period granted in article 22 (par. 3). In terms of costs, article 20 provides that service providers disclose 'annually the default rates of the crowdfunding projects offered on their crowdfunding platform over at least the preceding 36 months' and publish an yearly statement with the expected default rates of all instruments' categories. Article 23 mandates providers to present to investors a Key Investment Information Sheet, containing the information on the instrument set out in Annex I and with a series of warnings on the investment risks.

markets.[47] The rationale of disclosure regulation is that the more issuers of debt or equity instruments are required to make all price-sensitive information public, the more informed traders will use that information to make securities markets liquid, efficient, and accessible for less-informed investors.[48] Within the EU legal framework, disclosure regulation is epitomised in the Prospectus Regulation, which mandates the publication of a prospectus at the issue of securities in primary markets. Besides, the MiFID II Directive embraces the same logic in regulating securities distribution in secondary markets.[49] Disclosure regulation is thus a two-step technique: disclosure duties on the issuer to make securities markets work in the first instance; mandatory information on the quality and risk of the product to be provided to ultimate investors.[50] The twofold dimension of disclosure regulation is repeated in the crowdfunding sector by requiring project proponents and products providers to disclose all the information needed to value their offers on the one hand and by reinforcing the duties of information of the platform at the time of secondary distribution on the other.

Where systematically adopted for peer-to-peer consumer finance, economic transparency would hardly foster consumer welfare. First, since many users on the supply side are consumers, a prospectus-like disclosure would be very costly and unreliable, if not unattainable at all. Disclosure regulation is built on the financial and cognitive capital of the issuing firms. Unlike consumers, firms often handle massive information on their businesses and resort to credit-rating agencies to make their funding credible. Second, increasing the informative flow among the bargaining peers is likely to create excessive divides between different classes of retail investors: the more informed ones, capable of evaluating the information, would secure the better offers, leaving the riskier ones to the less sophisticated consumers and potentially pushing them off the market. This is precisely what happened in the early years of peer-to-peer finance when platforms let users free to exchange information and arrange transactions among them. In that phase, informed investors systematically outperformed the weaker ones, almost causing the market to

[47] L Enriques and S Gilotta, 'Disclosure and Financial Market Regulation', in N Moloney, E Ferran and J Payne (ed), *The Oxford Handbook of Financial Regulation* (Oxford University Press 2015), 511.

[48] Disclosure regulation is an authentic transposition in law of the efficient market theory. With all information available, informed traders are supposed to trade on them and make a profit from a bid-ask price. See J Armour, D. Awrey, P Davies, L Enriques, J Gordon, C Mayer, J Payne, Principles of Financial Regulation (Oxford University Press 2016) 181.

[49] The described approach rests on the orthodox view whereby, if adequately informed on the quality of financial products, consumers and retail investors can properly value their assets and make efficient decisions for themselves. Despite contentious, such a view still underpins many consumer law statutes such as the Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU [2014] OJ L 173. It must be noted that, despite the MiFID II still encompasses some disclosure regulation provisions, there are significant regulatory differences from primary and secondary markets. The MiFID II approach towards retail investors in secondary markets is addressed in section 3.3., 'substantial transparency'.

[50] Some critics regard the Directives on consumer credits (the Consumer Credit and the Mortgage Credit Directive) as remnants of the neoclassical understanding of market relationships, where participants only need information to bargain effectively. See I Domurath, 'The Case for Vulnerability as the Normative Standard in European Consumer Credit and Mortgage Law – An Inquiry into the Paradigms of Consumer Law' (2013) 3 EuCML 124.

crunch.[51] Third and finally, disclosure regulation works in markets where highly informed traders – such as institutional investors – can evaluate information and embed it in product prices. This is not the case for peer-to-peer finance, where the most sophisticated traders are solid and experienced investors or small businesses.

Succinctly, economic transparency in peer-to-peer finance is in several respects a 'waste of resources'.[52]

3.3. Substantial transparency.

Recent advancements in consumer law and policy seem to treasure the scientific criticisms of the neoclassical information asymmetry paradigm.[53] Thicker duties on business and intermediaries in terms of education, advice, and gatekeeping of consumers, on the one hand, higher simplicity in the manner and language of the information, on the other, are the main instances of a new 'substantial transparency' paradigm. Consumers' comprehension is key to this logic, rather than mere information flows. The Crowdfunding Regulation is imbued with a substantial transparency approach. Article 21 mandates an 'entry knowledge test' and a 'simulation of the ability to bear losses' if the crowdfunding services are provided to 'unsophisticated investors'.[54] Intermediaries must warn consumers of the results of the assessments without any duty to prevent them from buying or investing. The duties somehow replicate the obligations envisioned in article 25 of the MiFID II Directive. When selling financial products to retail investors, investment firms offering financial advice are required to evaluate the investors' appropriateness, that is, the alignment of the product with the clients' objectives and financial situation.[55] Where the investment is not advised, firms are in charge of evaluating the suitability of clients' choices, intended as the

[51] This risk led platforms to turn into gatekeepers that rate users when they entry the market and allow all the others to bargain based on that rating. See B Vallée and Y Zeng, 'Marketplace Lending: A New Banking Paradigm?' (2019) 32 RFS 1939.

[52] J Armour L Enriques, 'The Promise and Perils of Crowdfunding: Between Corporate Finance and Consumer Contracts' (2018) 81 MLR 1 5.

[53] O Ben-Shahar and C E Schneider, 'The Failure of Mandated Disclosure' (2011) 159 UPLR 647.

[54] According to article 21, the entry knowledge test is aimed at evaluate 'whether and which crowdfunding services offered are appropriate for the prospective non-sophisticated investors' (par. 1). For the purpose of the entry test, service providers are expected to consider the 'information about the prospective non-sophisticated investor's experience, investment objectives, financial situation and basic understanding of risks involved in investing in general and in investing in the types of investments offered on the crowdfunding platform', with special reference to the investors' experience in the market for transferrable securities and to their understanding of the crowdfunding services (par. 2). The assessment, to be reviewed every two years (par. 3), shall include a simulation on the ability to bear losses calculated by the platform as the 10% of investors' net worth (par. 5). Importantly, as set out in paragraphs 4 and 6, actual and prospective non-sophisticated investors shall not be prevented from investing where the two tests show that the investment is highly risky for them.

[55] Remarkably, the UK Financial Conduct Authority has recently introduced an adapted version of the appropriateness rule for peer-to-peer loans. See Financial Conduct Authority (FCA), 'Loan-Based ('Peer-to-Peer') and Investment-Based Crowdfunding Platforms: Feedback to CP18/20 and Final Rules', Policy Statement, PS19/14, 2019. On the implementation of these rules, The Investment and Saving Alliance, 'Peer-to-peer Lending: Approach to the Implementation of the Appropriateness Test' (2019).

understanding of the financial products they are about to purchase.[56] Then, a similar paradigm of transparency is visible in the recent Proposal of the EU Commission that amends the Directive 2008/48/EC on consumer credit released in June 2021.[57] The Proposal reinforces information and explanation duties on consumer counterparts and extends the 2008/48/EC Directive norms to crowdfunding services providers. [58] Finally, a more thorough path to transparency has also emerged in unfair terms litigation. The EU Court of Justice has increasingly stressed the need for contractual clauses to be drafted plainly and clear as to their effects. In this regard, article 4, par. 2, EC Directive 93/13, laying down that core terms are exempted from the unfairness test 'in so far as these terms are in plain, intelligible language' is now intended as requiring the 'economic transparency' of the contract.[59] As a result, clauses setting out the subject matter and costs in an unclear manner can now be reviewed within the unfairness doctrine.

Whether the intelligibility of the content and effects of each contract in peer-to-peer environments improves consumers' position is at least arguable. Substantial transparency postulates that, if adequately informed, all consumers can make good decisions for themselves. Unfortunately, this is not the case. The group of people referred to as 'consumers' usually encompass a great diversity of financial literacy, trading experience and, above all, wealth conditions. Understanding the functioning and risks of financial transactions and investing accordingly is a prerogative for a minority of retail investors in traditional markets[60] and a true mirage for those in peer-to-peer markets – reportedly more vulnerable on average.[61] Then, it is hard to believe that the entry knowledge test and the simulation to bear losses without a denial to invest would effectively discourage investors from poor investing decisions. As

[56] European Securities and Markets Authority and European Banking Authority, 'Joint Guidelines on the assessment of the suitability of members of the management body and key function holders under Directive 2013/36/EU and Directive 2014/65/EU' (2017) EBA/GL/2017/12.

[57] European Commission, 'Proposal for a Directive of the European Parliament and of the Council on consumer credits', COM/2021/347 final.

[58] The rationale for including crowdlending within the scope of the Consumer Credit Directive is discussed in depth in the European Commission, 'Commission Staff Working Document – Impact assessment report accompanying the Proposal for a Directive of the European Parliament and the Council on consumer credits', COM (2021) 347 final.

[59] European Court of Justice, *Kásler e Káslerné Rábai* case (C-26/13), par. 73, 'for the purpose of complying with the requirement of transparency, to determine whether the contract sets out transparently the reason for and the particularities of the mechanism for converting the foreign currency and the relationship between that mechanism and the mechanism laid down by other terms relating to the advance of the loan, so that the consumer can foresee, on the basis of clear, intelligible criteria, the economic consequences for him which derive from it'. Such an 'economic' interpretation of the transparency requirements derives from the ECJ *RWE Vertrieb* ruling (C-180/2013, par. 49). See F Della Negra, 'Protecting Consumers Against Unfair Terms in Mortgage Contracts: Tends and Perspectives in the Recent Case Law of the CJEU' (2020) 2 EJCL 205.

[60] A. Schwartz and L Wilde, 'Intervening in Markets on the Basis of Imperfect Information: A Legal and Economic Analysis' (1979) 127 UPLR 630, suggested long ago that regulators could easily require businesses to disclose information as targeted at the more sophisticated consumers, the only sensitive ones, thus bringing more welfare for all users. The so-called 'informed minority argument' has been later rebutted, claiming that businesses are very much likely to personalise and customise practices depending on the features of each consumer. See O Bar-Gill and E Warren, 'Making Credit Safer' (2008) 157 UPLR 1, 11.

[61] C De Roure, L Pelizzon and A V Thakor, 'P2P Lenders Versus Banks: Cream Skimming or Bottom Fishing?' (2018) SAFE Working Paper No. 206.

well known, nudging vulnerable consumers might not be enough.[62] Finally, in a normative outlook, although the ECJ doctrine of 'economic transparency' is effective in bilateral banking agreements, an ex-post review of each of the granular contracts that consumers enter would be almost impossible.[63] To conclude, unquestionably, tailored information and explanations are the best that transparency can offer. But transparency is not a panacea for all kinds of market shortcomings.

3.4. The (tiny) room for legal design.

'Legal design' has also recently revived the reasoning around the transparency of consumer contracts. Conceived as a transposition of design thinking to legal subjects, legal design draws on a multidisciplinary cognitive and figurative knowledge background to make legal sources easily readable and intelligible for individuals. Legal design's evolutionary contribution consists of a call for a higher clarity of legal norms, contracts, and other legal materials. The means to this end are streamlining the legal language and turning contents into images, patterns, and simulations.[64] In the context of digital services, legal design is deemed to play a crucial role in making online environments more accessible and user-friendly. Peer-to-peer platforms already exploit the teachings of legal design. Keeping faith in the promise of cutting down intermediation times and costs, interfaces are easy to surf and directly address consumers through the different financial positions offered. Transactional environments, then, accurately filter information to ensure users only opt for the core economic terms, leaving all supplemental information behind. Users are unaware of how the performance and settlement occur as they are fully delegated to the platform.[65]

In the discrepancy between what consumers are shown and the reality of the legal relationships, peer-to-peer finance lays bare two significant flaws of legal design. First, legal design does not aim at modifying the legal characterisation or regulation of imbalanced relationships. In the context of financial platforms, the measures to foster usability and appeal of the trading interface do not affect the kind of transactions consumers enter or make them more aware.[66] On the contrary, so long as it increases consumers' trust without addressing the

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[62] O Bar-Gill and E Warren, 'Making Credit Safer' (2008) 157 UPLR 1, 11. As well-known, the idea of 'nudging' was brilliantly developed in R H Thaler and C R Sunstein, *Nudge* (Yale University Press, 2008).

[63] P Palka, 'Terms of Service Are Not Contracts. Beyond Contract Law in the Regulation of Online Platforms, in S Grundmann (ed), *European contract law in the digital age* (Intersentia 2018) 135

[64] M Hagan, 'Exploding the Fine Print: Designing Visual, Interactive, Consumer-Centric Contracts and Disclosures' in M Corrales, M Fenwick, H Haapio (ed), *Legal Tech, Smart Contracts and Blockchain* (Springer, 2019) 93.

[65] Reading the platforms' terms of services or contractual conditions, normally 20 or more pages of intricated operations, can give a sense of the dissociation between what appears to consumers and the reality of platform intermediation. See, for instance, the terms of use of the following peer-to-peer platforms: https://d34m5i9by2qell.cloudfront.net/agreements/IT/Condizioni_Generali_Di_Utilizzo.pdf (BLender); http://pub.motusquo.it/Le-Condizioni-di-Prestito-MotusQuo.pdf (MotusQuo); https://prestiamoci.it/wp-content/uploads/2021/09/02-CONTRATTO-PRESTATORE-010-2021.pdf (Prestiamoci). In any case, the relationship between the interface and the business behind (and the difference between them) is very hard to grapple in digital platforms. See A Gawer, 'Digital Platforms' Boundaries: The Interplay of Firm Scope, Platform Sides, and Digital Interfaces' (2020) LRP 102045.

[66] Many questions on the private law of platform transactions are entirely left to the unilateral decision of the platform: is there a contract? Between whom? How is it regulated?

consequences of their decision-making, legal design risks making users overconfident. It does not prevent financial losses, and it potentially multiplies them.[67] Second, even if well-conceived, design strategies are likely to be captured by financial firms in two respects: the exploitation of consumers' biases by guiding their decisions on the interface; the concealment of the effective bundle of duties and rights, which hinders the chance to sue the platform or the peers and therefore limits the access to justice.[68] To conclude, while legal design can be helpful to enhance the clarity and accountability of transactions, it fails to tackle consumers' exposure to financial risk.

4. Beyond the blinders of information asymmetry.

The focus on transparency in the emerging peer-to-peer markets regulation builds on a flawed analysis in terms of market failures. The market failures framework is a robust analytical toolbox, especially in rapidly evolving markets where regulators catch up with only preliminary evidence and raw data. However, if improperly handled, it leads policymakers astray. The recourse to procedural, economic, substantial, and design transparency rests on the mistaken assumption that information asymmetry is the primary market failure affecting peer-to-peer markets. As section 2 above extensively shows, this is not the case. The remainder of the work attempts to demonstrate that, where correctly framed within the market failure domains, the risks for consumers' protection and market regulation can be tackled with more effective legal and regulatory tools. The policy options recommended below just exemplify that a paradigm shift is possible and should not be intended as exhaustive or radically alternative to some sort of disclosure rules.

4.1. Market failures and policy options for consumer protection.

On close examination, the risks identified under the 'consumer protection' label and described as 'opacities' in section 2 can be thoroughly understood as market failures other than information asymmetry. In the light of well-known economic and behavioural findings, the problem of consumer choice vis-à-vis complex intermediaries and entangled financial products can no longer be framed as an issue of mere information. Market access is spoilt by decision-making biases inherent to consumers operating in financial markets.[69] Bound rationality is a combination of many factors: ignorance of market mechanisms and financial products;[70] reference dependence, i.e. the inertia that leads to the irrational preference for the situation one is into the detriment of any possible

[67] Overconfidence is a pernicious problem of consumers financial markets: consumers gain the confidence they usually lack and expose themselves to hazardous decisions. Overconfidence is also very likely to create herd behaviour. See C Sunstein, 'Empirically Informed Regulation' (2011) 78 UCLR 1349.
[68] P Palka, M Kuziemski, A M Nowak, A Jablonowska, H-W Micklitz, G Sartor, 'Consumer Law and Artificial Intelligence. Challenges to the EU Consumer Law and Policy Stemming from the Business' Use of Artificial Intelligence' (2018) 11 ARTSY Project final report 14.
[69] J Armour, D. Awrey, P Davies, L Enriques, J Gordon, C Mayer, J Payne, Principles of Financial Regulation (Oxford University Press 2016) 326; J Y Campbell, H E Jackson, B C Madrian and P Tufano, 'Consumer Financial Protection' (2011) 25 JEP 91.
[70] See the abundant literature cited in O Bar-Gill and E Warren, 'Making Credit Safer' (2008) 157 UPLR 1.

change;[71] instantaneous gratification, the inability to take forward-looking decisions;[72] lack of any experience given that financial products are 'credence goods'.[73] The asymmetric position in which consumers lie is thus a function of manifold and hardly eradicable factors. It is also reflected in the dependence on the intermediating platform, the poor matching with other peers, and the unawareness of the offered service – the three risks identified as market protection issues.[74] These risks are likely to result in unexpected financial losses, a decline in confidence, and an exit from the market. Luckily, financial regulation has the tools to directly tackle them and not just to warn consumers about their existence.

Different and integrated strategies can be deployed to address bound rationality in collaborative finance. First, recent financial laws increasingly resort to conduct regulation to ensure that intermediaries provide services safely. The Crowdfunding Regulation itself has various examples of conduct regulation: the rules on the provision of crowdfunding services (article 3), the duty to put in place effective and prudent management (article 4), the due diligence requirements (article 5), and the rules on the individual portfolio of loans (article 6), on complaints handling (article 7), and conflict of interests (Article 8). The Regulation also requires crowdfunding providers that carry out 'payment transactions related to transferable securities and admitted instruments for crowdfunding purposes' to keep their clients' assets in a deposit held by a bank or credit institution (article 10). The provision acknowledges the need for separating consumers' assets from the intermediary's balance sheet, thus safeguarding them from the case of the platform's default. Given the high rate of platforms default, a likewise provision should be adopted for all peer-to-peer services providers.[75] However, the Regulation is too mild for the entry rules, i.e., the business intermediary's engagement in clients' admission to the market. Instead of an entry test and a test to simulate the ability to bear losses, peer-to-peer intermediaries should be made more deeply responsible for the entry decisions. In other words, financial platforms should be obliged to deny access to unworthy consumers, thus taking responsibility for harmful inclusion. A likewise example of an effective gatekeeping duty, enforced through private law remedies, already exists in financial markets, and it is the creditworthiness assessment in the consumer credit domain.[76] Transposing it to collaborative consumer finance should be a top priority for regulators. In addition, regulators should consider two other intervention strategies besides entry requirements: product regulation and safety nets. The former consists of mandatory provisions on the financial products traded on platforms, such as limits to the indebtment or investment of a single user and caps on the interest rates and fees consumers

[71] N Wilkinson, *An Introduction to Behavioural Economics* (Palgrave Macmillan, 2008), 103.
[72] G Ainslie, 'Specious Reward: A Behavioural Theory of Impulsiveness and Impulse Control' (1975) 82 PS 463.
[73] U Dulleck and R Kerschbamer, 'On Doctors, Mechanics and Computer Specialists: The Economics of Credence Goods' (2006) 46 JEL 5.
[74] See section 2 'Unity in multiplicity. Risks and opacities in collaborative finance'.
[75] Namely, it should be extended to all forms of peer-to-peer financial service offered to consumers.
[76] See articles 8, Consumer Credit Directive and 18, Mortgage Credit Directive. The literature on this point is vast. See European Banking Authority, 'Guidelines on Credit Worthiness Assessment. Final Report' (2015).

pay.[77] A 'loan-to-income' and 'loan-to-value' ratio and the right to an early termination are instances of product regulation that the EU legislator should derive from consumer credit law. Safety nets represent compensation schemes that repay investors in the case of financial losses. Compensation schemes mandated by the legislator are usually public, as in the case of depositors and investors. However, in the peer-to-peer context, they might well be established and run by each platform and funded by both users and the intermediary.[78] They should mandatorily cover at least a share of the losses suffered by consumers.

Where adequately coordinated, the proposed measures effectively complement disclosure regulation.

4.2. Market failures and policy options for regulation.

Besides consumer protection, the primary concern of the present work, the regulatory initiative in peer-to-peer finance cannot overlook the 'market regulation' dimension. The dichotomy between consumer protection and market regulation is very often merely theoretical. There's little doubt that measures aimed at preventing harm for consumers immediately impact the market, raising intermediation costs, modifying business incentives, and, hopefully, making financial marketplaces safer. At the same time, the likelihood that markets don't work properly and even risk collapsing directly impacts consumer welfare, both in terms of present harm to current users and lack of chances for future ones. The 'run risk' identified in section two provides a clear example of how entangled the two dimensions are. Once investors exit markets in herd, all participants suffer immediate losses for the assets' depreciation and perspective losses if the market collapses. In the market failures outlook, a similar risk is an example of negative externality: individually sensible decisions are likely to result in irrational herd behaviour. Once again, the Crowdfunding Regulation provides an interesting but weak solution. Article 25 allows providers to offer 'bulletin boards' where investors can sell their loans or crowdfunding instruments to other users. The board solution is a double-edged sword. It allows investors to liquidate their assets, thus granting access to a withdrawal option. But it also paves the way for a steep depreciation and potential implosion if investors resort abruptly to the secondary market. The trade-off is clear: is it preferable to lock consumers to their illiquid investments or mandate secondary markets to the detriment of their assets' value and overall market stability? As a precautionary measure, the former seems more advisable.

Finally, the law can tackle the risk of lax screening by adjusting the remuneration mechanisms. Platforms typically charge users different fees: subscription ones when consumers sign up, periodic intermediation ones, and origination fees linked to the number of transactions set up. Origination fees are riskier as they create room for moral hazard. Moral hazard occurs when market participants act opportunistically or negligently as they do not directly

[77] O Bar-Gill and E Warren, 'Making Credit Safer' (2008) 157 UPLR 1.
[78] See n 36.

bear the consequences of their behaviour.[79] It can be dealt with by making individuals responsible for their behaviour or by changing the incentives that lead them to embrace moral hazard. In the context of platforms' remuneration, an early solution would be detaching the fees charged by the platforms from the number of transactions they generate. Banning origination fees to the benefit of subscription and intermediation ones can be an initial step to curb the moral hazard of the risk-less gatekeepers.[80] [81]

Conclusions.

Financial law is all about analysing and governing financial risk. In doing so, it adopts a decreasing scale of tolerance. It prohibits a practice when too dangerous, governs it where possible, and makes the risks visible when perfectly bearable.

In laying down the rules for collaborative finance, the justification for maintaining the risk visibility stage is feeble. Although mandated disclosure sounds very intriguing in the face of very opaque and complex transactions, the challenges of peer-to-peer markets can be better grasped away from the conceptual framework of information asymmetry. When analysing the vulnerability of consumers in-depth, one cannot go without noticing that their weakness is way more profound than a contingent imbalance in knowledge. Besides transparency regulation, consumers in horizontal finance need protective rules that pre-emptively shape service providers' conduct of business. At the same time, they need a tailored product regulation discipline and prompt and extensive compensation schemes to prevent and absorb financial harm, respectively. Further adjustments, then, should target secondary markets and remuneration schemes to ensure that they do not undermine the trust on which online marketplaces rest. The EU financial regulator should re-orient the course of its intervention along these lines as early as possible.

[79] T Baker, 'On the genealogy of moral hazard' (1992) 75 2 TLR 237.

[80] Origination fees, despite being distortive, do not impinge on the conflict-of-interest rules as set out in article 8 of the Crowdfunding Regulation. Origination fees do not fall within the scope of Article 8, par. 1 and 2, which prevent platforms from respectively having any participation in the offers and from participating in the shareholding or management of project owners. Instead, they represent a milder conflict as intended in the subsequent paragraphs of the article, whereby any concurring interest must be adequately disclosed to consumers. This would not be sufficient to prevent moral hazard.

[81] As for competition law issues, they cannot be dealt with in this work. For an overview of the main points, see F Bostoen and D Mandrescu, 'Assessing Abuse of Dominance in the Platform Economy: A Case Study of App Stores' (2020) ECJ; P Belleflamme and M Peitz, 'Managing Competition on a Two-Sided Platform' (2019) 28 JEMS 5.