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Regulating Online Peer-to-Peer Lending in the Aftermath of Dodd–Frank: In Search of an Evolving Regulatory Regime for an Evolving Industry

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Regulating Online Peer-to-Peer Lending in the Aftermath of Dodd–Frank: In Search of an Evolving Regulatory Regime for an Evolving Industry

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Abstract

The 2010 Dodd–Frank Wall Street Reform and Consumer Protection Act called for a government study of the regulatory options for on-line Peer-to-Peer lending. On-line P2P sites, most notably for-profit sites Prosper.com and LendingClub.com, offer individual “investors” the chance to lend funds to individual “borrowers.” The sites promise lower interest rates for borrowers and high rates of return for investors. In addition to the media attention such sites have generated, they also raise significant regulatory concerns on both the state and federal level. The Government Accountability Office report produced in response to the Dodd–Frank Act failed to make a strong recommendation between two primary regulatory options—a multi-faceted regulatory approach in which different federal and state agencies would exercise authority over different aspects of on-line P2P lending, or a single-regulator approach, in which a single agency (most likely the new Consumer Financial Protection Bureau) would

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be given total regulatory control over on-line P2P lending. After discussing the origins of on-line P2P lending, its particular risks, and its place in the broader context of non-commercial lending, this paper argues in favor of a multi-agency regulatory approach for on-line P2P that mirrors the approach used to regulate traditional lending.

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I. Introduction

Like Congress's prior attempt to legislate a post-bubble repair and prevention strategy for the American economy, the Sarbanes–Oxley Act of 2002 (Sarbanes–Oxley),¹ the Dodd–Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd–Frank)² has received a somewhat chilly response from legal academics.³ As was the case with Sarbanes–Oxley,⁴ however, even amid all of the proposals included for the sake of “doing something” rather than for strong policy justifications, a few nuggets of genuine value can be found. One of those, in the case of Dodd–Frank, is the opening effort to address the regulatory gap surrounding online peer-to-peer (P2P) lending. Congress directed the Comptroller General of the United States and the Government Accountability Office (GAO) to report on the ideal regulatory structure for this emerging and rapidly evolving segment of the fringe lending industry.⁵ The

1. Sarbanes–Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (2002) (codified as amended in scattered sections of 11, 15, 18, 28, and 29 U.S.C.). Roberta Romano lambasted Sarbanes–Oxley in a now famous article. See Roberta Romano, *The Sarbanes–Oxley Act and the Making of Quack Corporate Governance*, 114 YALE L.J. 1521, 1523 (2005) (arguing that the policies included in Sarbanes–Oxley “may be . . . characterized as recycled ideas advocated for quite some time by corporate governance entrepreneurs”).

2. Dodd–Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010) (codified in scattered sections of 2, 5, 7, 11, 12, 15, 18, 20, 22, 26, 28, 31, 42, and 44 U.S.C.).

3. Stephen Bainbridge recently released a paper titled in homage to Romano's Sarbanes–Oxley critique. See Stephen M. Bainbridge, *Dodd–Frank: Quack Corporate Governance Round II*, 95 MINN. L. REV. 1779 (2011). One of this Article's authors recently described Dodd–Frank as “at best an incomplete vision for increasing consumer protection and heightening corporate responsibility.” Eric C. Chaffee, *The Dodd–Frank Wall Street Reform and Consumer Protection Act: A Failed Vision for Increasing Consumer Protection and Heightening Corporate Responsibility in International Financial Transactions*, 60 AM. U. L. REV. 1431, 1431 (2011). This Article's other author refers to Dodd–Frank as a “missed opportunity” in a forthcoming paper. Geoffrey Christopher Rapp, *Mutiny by the Bounties: Will Dodd–Frank's New Whistleblower Law Reform Wall Street?*, BYU L. REV. (forthcoming 2012).

4. See Geoffrey Christopher Rapp, *Beyond Protection: Invigorating Incentives for Sarbanes–Oxley Corporate and Securities Fraud Whistleblowers*, 87 B.U. L. REV. 91, 92 (2007) (calling Sarbanes–Oxley whistleblower protection provisions “a step in the right direction”).

5. Dodd–Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 989F, 124 Stat. 1376, 1947–48 (2010) (requiring that the Comptroller General of the United States and the United States Government

GAO Report, which contains a variety of new information and insights, was issued on July 7, 2011.⁶

Online P2P lending is a booming industry⁷ that has caused tremendous regulatory confusion, yet it has received scant attention in legal scholarship. Previous work in the area among legal scholars has primarily addressed the role of P2P lending in microfinance for international development.⁸ Little work has

Accountability Office conduct a study to “determine the optimal Federal regulatory structure” for person-to-person lending).

6. U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-11-613, PERSON-TO-PERSON LENDING: NEW REGULATORY CHALLENGES COULD EMERGE AS THE INDUSTRY GROWS (2011) [hereinafter GAO REPORT], available at <http://www.gao.gov/new.items/d11613.pdf>.

7. Sheryl Jean, *Also on the Loan Menu*, DALLAS MORNING NEWS, Feb. 14, 2010, at D01 (noting that one leading site, LendingClub.com, saw an increase in loan volume from \$16 million in 2008 to \$59 million in 2009).

8. See generally Kevin E. Davis & Anna Gelpern, *Peer-to-Peer Financing for Development: Regulating the Intermediaries*, 42 N.Y.U. J. INT'L L. & POL. 1209 (2010); Raj M. Desai & Homi Kharas, *Democratizing Foreign Aid: Online Philanthropy and International Development Assistance*, 42 NYU J. INT'L L. & POL. 1111 (2010); Molly Buetz Land, *Networked Activism*, 22 HARV. HUMAN RTS. J. 205, 219–20 (2009) (discussing the peer-to-peer microlending organization Kiva); Sarah B. Lawsky, *Money for Nothing: Charitable Deductions for Microfinance Lenders*, 61 SMU L. REV. 1525 (2008) (arguing that taxpayers should be permitted to take a charitable deduction for foregone interest on interest-free loans through tax-exempt organizations like Kiva). In addition to the legal scholarship on the microfinance and international aspects of online P2P lending, an emerging body of work in behavioral economics examines for-profit online P2P sites like those that are the focus of this paper. See Natialiya Barasinska & Dorothea Schafer, *Does Gender Affect Funding Success at the Peer-to-Peer Credit Markets? Evidence from the Largest German Lending Platform 1*, (DIW Berlin, Discussion Paper No. 1094, 2010), <http://ssrn.com/abstract=1738837> (last visited Apr. 8, 2012) (finding no gender discrimination in German online P2P lending, contrary to results for US sites) (on file with the Washington and Lee Law Review); Seth Berger & Fabian Gleisner, *Emergence of Financial Intermediaries in Electronic Markets: The Case of Online P2P Lending*, 2 BUR – BUSINESS RESEARCH 39 (2009), <http://www.business-research.org/2009/1/finance/1940/berger-gleisner-emergence.pdf> (examining role of groups and paid intermediaries on Prosper.com); Jefferson Duarte et al., *Trust and Credit 4–5* (June 2, 2010) (unpublished paper presented at the American Finance Association's 2010 Atlanta Meeting), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1343275 (last visited Apr. 8, 2012) (finding that borrowers viewed as untrustworthy are less likely to receive loans on Prosper.com) (on file with the Washington and Lee Law Review); Craig R. Everett, *Group Membership, Relational Banking and Loan Default Risk: the Case of Online Social Lending 26* (Mar. 15, 2010) (unpublished manuscript), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1114428 (last visited Apr. 8, 2012) (finding that membership in a social lending group reduces risk of default

addressed the proper scope of regulation for domestic for-profit online P2P lending, other than a forthcoming piece arguing that online P2P should be completely exempt from securities regulation⁹—a position we challenge in this Article.

Like many GAO studies, the online P2P Report is written at a broad level and avoids specific recommendations.¹⁰ Still, it may

on Prosper.com) (on file with the Washington and Lee Law Review); Seth Freedman & Ginger Zhe Jin, *Do Social Networks Solve Information Problems for Peer-to-Peer Lending? Evidence from Prosper.com* (Networks, Elec. Commerce, and Telecomm. Inst., Working Paper No. 08-43, 2008), available at <http://ssrn.com/abstract=1304138> (last visited Apr. 8, 2012) (identifying information gaps in original Prosper.com lending model) (on file with the Washington and Lee Law Review); Michal Herzenstein et al., *Strategic Herding Behavior in Peer-to-Peer Lending* (Apr. 27, 2010) <http://ssrn.com/abstract=1596899> (last visited Apr. 8, 2012) (finding that lenders on Prosper engage in strategic herding behavior) (on file with the Washington and Lee Law Review); Michal Herzenstein et al., *Tell Me a Good Story and I May Lend You My Money: The Role of Narratives in Peer-to-Peer Lending Decisions* (May 13, 2010) (unpublished paper), <http://ssrn.com/abstract=1840668> (last visited Apr. 8, 2012) (on file with the Washington and Lee Law Review); Mingfeng Lin et al., *Judging Borrowers by the Company They Keep: Friendship Networks and Information Asymmetry in Online Peer-to-Peer Lending* 29 (July 1, 2011) (unpublished paper presented at the Western Finance Association's 2009 Annual Meeting), <http://ssrn.com/abstract=1355679> (last visited Apr. 8, 2012) (finding that the number of online friendships is a signal of credit quality for borrowers on Prosper.com) (on file with the Washington and Lee Law Review); Devin G. Pope & Justin R. Sydnor, *What's in a Picture? Evidence of Discrimination from Prosper.com*, 46 J. HUM. RESOURCES 53, 53 (2011) (finding racial disparities in Prosper.com lending when site formerly used pictures for borrower profiles). While such work explores a number of interesting questions and is potentially of great value in crafting narrow regulations relating to P2P lending, it sheds relatively little light on the threshold regulatory questions addressed in this paper, such as whether securities regulation should apply to P2P lending. Moreover, most of this work was based on earlier versions of the for-profit site Prosper.com, which has since substantially changed its business model.

9. See Andrew Verstein, *The Misregulation of Person-to-Person Lending*, 45 U.C. DAVIS L. REV. (forthcoming 2012) (manuscript at 26), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1823763 (last visited Apr. 8, 2012) (“While it is plausible that P2P notes were either ‘investment contracts’ or ‘notes’ for the purposes of the Securities Acts, there is also a strong case that they are neither.”).

10. See, e.g., Jeffery M. Johnson & Carl Jensen, *The Financing of Terrorism*, 2010 J. INST. JUST. INT’L STUD. 103, 109 (noting that the GAO REPORT on terrorism provides an overview but lacks discussion of specifics); Timothy Inklebarger, *DOL Calls GAO Target Date Fund Recommendations Vague*, PENSIONS & INVESTMENTS (Mar. 7, 2011), <http://www.pionline.com/article/20110307/PRINTSUB/303079977> (last visited Apr. 8, 2012) (on file with the

spur some legislative action toward clarifying the regulation of P2P sites. The Report outlines two possible regulatory schemes: the continued regulation of the investors in P2P sites by securities regulators, with regulation of borrowers the responsibility of various financial services agencies; or unified regulation under a single agency, such as the new Consumer Financial Protection Bureau (CFPB).¹¹ The Report does not provide a recommendation as between these two options, leaving the future of P2P lending regulation uncertain. This Article aims to fill the current regulatory gap and provide a recommended roadmap, as well as context, for online P2P lending.

Online P2P sites have faced tough scrutiny at the hands of American securities regulators, both on the state¹² and federal levels.¹³ Applications by leading platforms to operate in particular states have been rejected, and the SEC, for a time, prohibited leading sites from soliciting new lenders.¹⁴ Much of the regulatory uncertainty surrounding how these sites should be classified stems from what might be described as a “square peg, round hole” problem. Existing structures for securities regulation have simply not envisioned an investment opportunity in which the party seeking financing provides little or no disclosure to potential sources of capital. Moreover, in a sense, online P2P represents the perfect securities regulation exam hypothetical, incorporating thorny and long-puzzling issues such as the definition of a security, the concept of material review used by some state regulators, and the meaning of such key identities as issuers, exchanges, and the like.

Washington and Lee Law Review).

11. GAO REPORT, *supra* note 6, at 42.

12. Brent Hunsberger, *Peer-to-Peer Lending: Know the Risks*, OREGONIAN (Oct. 4, 2009), http://blog.oregonlive.com/finance/2009/10/peer-to-peer_lending_know_the.html (last visited Apr. 8, 2012) (on file with the Washington and Lee Law Review). For example, LendingClub has no authorization to sell securities in Oregon, among several other states. *Id.* Prosper was licensed in Oregon but fined \$15,000 “for selling unregistered securities and not properly disclosing their risks.” *Id.*

13. Farhad Manjoo, *On this Site, a Stranger Will Spot You Some Cash*, WASH. POST, Apr. 24, 2011, at G04 (stating that Prosper.com was shut down for nine months after the SEC found it had offered unregistered securities).

14. *Id.*

This Article recommends neither the “hands-off” approach to regulating online P2P sites that would flow from the assertion that they do not sell securities nor prohibition of online P2P lending. Instead, it argues that online P2P sites should be regulated not by a single administrative agency but in the same manner as traditional banking entities. Multiple regulators should oversee online P2P sites, depending on the particular aspect of online P2P that falls within an agencies’ regulatory authority. While this approach may not leave P2P sites free to evolve in an unfettered hyper-Darwinian fashion, it offers the best chance to protect both lenders and borrowers from the risks arising as lending goes digital.

The remainder of this Article is structured as follows: Part II offers an overview of online P2P lending, discussing the structure and business model of various sites, the historical and contemporary context for P2P lending, the importance of P2P lending’s recent emergence, and the risks these sites pose to users. Part III analyzes the current regulatory regime for P2P lending, which is governed on the borrower side by banking law and on the lender side by federal and state securities law. Part IV discusses the struggle to create a coherent regulatory regime for P2P lending, including a study of such lending and various regulatory options mandated by Dodd–Frank. Finally, Part V recommends that an organic approach be taken to regulate online P2P lending in which multiple regulators have oversight and use their individual expertise from regulating traditional lending to create and adapt regulation to the evolving world of online P2P lending.

II. An Overview of Online Peer-to-Peer Lending

A. The Basics of Online Peer-to-Peer Lending

In its most general form, online P2P lending can be defined as any transaction arranged using the Internet in which one or more individuals lend money to one or more other individuals. “Traditional” lending, by contrast, involves an institutional lender such as a commercial bank, credit union, and the like, lending money to an individual. The cornerstone of P2P lending is that

individuals, rather than institutions, stand on *both* sides of the transaction.

Pure online P2P lending could be structured without a formal intermediary, with only the communications pipelines of the World Wide Web facilitating the transaction. For instance, a person could, legalities aside, post an advertisement on Craigslist (Craigslist.com) seeking a loan for a particular purpose and offering a certain interest rate.¹⁵ Or a Facebook (Facebook.com) user could send messages to distant “friends” offering to lend them money for a specified rate of return.

Of course, while such P2P lending could arise, assuming a hospitable regulatory environment, the transaction costs associated with it would be relatively high. The level of fraud and outright criminality on Craigslist and other “open” web platforms is incredibly high,¹⁶ making it nearly impossible to find legitimate lending and borrowing partners without extensive additional investigation of potential counterparts. The Facebook alternative would be limited in that if one can only reach active participants in one’s own networks, one has fewer potential partners to reach (even if a person has more “friends” than a typical law professor).

To capture profits associated with reducing such transaction costs, online P2P lending sites have emerged. The essential selling point advanced by P2P sites is the notion that by eliminating the “middle man”—the commercial bank in a traditional loan—investors can earn higher returns and borrowers can obtain financing at lower rates.¹⁷ Such sites have been around since 2005 in Europe, where the U.K.’s Zopa was an early leader.¹⁸ The most

15. In fact, some would-be borrowers have attempted to do just that. One posting in the financial services section of the Washington, D.C. Craigslist sought a “\$75,000 loan” to start a new owner-operated trucking company. *Loan Needed/Great Collateral (Westminster)*, CRAIGSLIST (Dec. 31, 2011, 9:42 AM EST), <http://www.webcitation.org/64QPrGAyR> (last visited Apr. 8, 2012) (on file with the Washington and Lee Law Review).

16. See Aleksandra Todorova, *A Craigslist Scam You Might Fall For*, SMARTMONEY (Aug. 10, 2005), <http://www.smartmoney.com/spend/family-money/a-craigslist-scam-you-might-fall-for/> (last visited Apr. 8, 2012) (noting that Craigslist receives 200 scam complaints per month) (on file with the Washington and Lee Law Review). While this number is small compared to the overall level of traffic on the site, according to its founder “the bad guys are persistent.” *Id.*

17. Verstein, *supra* note 9, at 11.

18. G. Jeffrey MacDonald, *Web Sparks Person-to-Person Lending Around*

well-known U.S. versions of such sites are Prosper Marketplace (Prosper.com) and LendingClub (www.lendingclub.com), which represent the “heartland of P2P.”¹⁹

Prosper and LendingClub are the two most prominent online P2P sites in the United States, and both now use a similar business model.²⁰ Prospective borrowers register with the platform and complete a loan application.²¹ Investors then review loan requests and determine which to fund.²² Investors do not make loans directly to borrowers.²³ Once an investor chooses to fund a loan, a separate bank issues the loan to the borrower and then sells the loan to the P2P platform.²⁴ The platform then issues a separate note to the investor with a return on the investment contingent upon the borrower repaying the original loan.²⁵ Thus, the investor has made an investment in a note, not an actual loan, and hopes that the borrower will repay so that the note will be paid by the platform.

LendingClub charges a fee for its services, and retrading of notes prior to maturity is permitted via a web-based platform created by a separate broker–dealer firm.²⁶ The interest rate for a loan is set by the site according to its analysis of the borrower’s credit history, income, debt, and other factors.²⁷ All borrowers must meet certain minimum credit criteria.²⁸ Interest rates vary between 7% and 21%, and borrowers may request up to \$25,000.²⁹

Prosper.com utilizes a similar model. Originally, the site used an online auction to “find investors willing to make loans to

the World, CHRISTIAN SCI. MONITOR, Dec. 24, 2007, at 13.

19. Verstein, *supra* note 9, at 6.

20. *Id.*

21. HOWARD M. FRIEDMAN, SECURITIES REGULATION IN CYBERSPACE § 5.03A (3d ed. 2010 supp.).

22. *Id.*

23. *Id.*

24. *Id.*

25. *Id.*

26. *Id.*

27. Pamela Yip, *Person-to-Person Lending Is Networking Its Way Up*, DALLAS MORNING NEWS, Dec. 10, 2007, at 1D.

28. See Jean, *supra* note 7, at D1 (noting that LendingClub requires borrowers to have a FICO score of at least 660).

29. *Id.*

particular borrowers.”³⁰ The lowest bidders (that is to say, those investors willing to extend credit at the lowest interest rates) would “win” the auction, and funds from those bidders would be pooled to extend loans.³¹ However, the site modified its approach in 2010, removing from lenders the ability to determine interest rates; instead, the site sets an interest rate based on its own analysis of the applicant’s financial history.³² Prosper raised its minimum FICO score for borrowers from 520 to 640 in an effort to stem defaults.³³

A far more limited alternative is offered by a closed-end mutual fund, National Retail Fund, operated by Perpetuity, Inc.³⁴ Under this approach, investors diversify across consumer notes via purchase of mutual fund stakes.³⁵ The consumer notes are based on loans made by the fund itself; investors can browse profiles of individual borrowers to see “why they are borrowing funds and how they are doing.”³⁶ The browsing of profiles is meant to make the site seem “hip” and connected to social networking, though the Fund in fact represents a far more traditional investment medium.

A variety of other P2P lending sites also exist or have existed. Between 2001 and May 2011, at least fourteen companies have offered online P2P platforms in the United States.³⁷ These sites have used a variety of models of P2P lending, including one that created direct links between individual borrowers and individual lenders without the use of a bank in the process.³⁸ The alternative sites have been geared toward a variety of different segments of the lending market, such as small businesses, students, or those seeking loans to purchase a home.³⁹ To date, none have received the attention that has been paid, both from a business and a regulatory sense, to the market leaders, Prosper and LendingClub.

30. FRIEDMAN, *supra* note 21, § 5.03A.

31. *Id.*

32. Manjoo, *supra* note 13, at G04.

33. Hunsberger, *supra* note 12.

34. *Id.*

35. *Id.*

36. *Id.*

37. GAO REPORT, *supra* note 6, at 17 n.39.

38. *Id.* at 17.

39. *Id.*

On Prosper and LendingClub, typical borrowers are “seeking fairly small, unsecured loans for consumer purposes—such as consolidating debts, paying for home repairs, or financing personal, household, or family purchases.”⁴⁰ Reviewing the borrowers on LendingClub, for instance, one of the authors found that the overwhelming share of the applicants sought debt consolidation loans.⁴¹ However, there were a few miscellaneous loan requests—a person with a credit score between 714 and 749 sought a \$6,000 five-year loan to purchase a Honda VTX 1800 Motorcycle, and a person with a 679–713 credit score sought \$4,000 for an “engagement loan” to cover wedding expenses.⁴²

B. Historical and Contemporary Context for Peer-to-Peer Lending

P2P lending is nothing new; indeed, non-institutional lending has long been a part of economic activity around the world. What is new about the sites discussed in this Article is their online dimension. Situating P2P lending within the broader context of noncommercial lending helps reveal both some of the reasons it is attractive to borrowers (and lenders), as well as some of the special risks that emerge due to the online nature of the new platforms.

Commercial credit’s cost for borrowers is not simply the expense associated with the bank as “middle man.” Nontraditional lending is attractive for some borrowers, even if expensive, for at least two reasons. The first is its convenience. Take payday lenders, discussed elsewhere in this symposium issue,⁴³ for

40. *Id.* at 10.

41. LendingClub Screen Shot (on file with the Washington and Lee Law Review).

42. *Id.* Both loans had been close to fully funded (89% and 85% respectively).

43. See Paige Marta Skiba, *Regulation of Payday Loans Misguided?*, 69 WASH. & LEE L. REV. 1023 (2012); Christopher L. Peterson, “Warning: Predatory Lender”—A Proposal for Candid Predatory Small Loan Ordinances, 69 WASH. & LEE L. REV. 893 (2012); William M. Webster, IV, *Payday Loan Prohibitions: Protecting Financially Challenged Consumers or Pushing Them Over the Edge?*, 69 WASH. & LEE L. REV. 1051 (2012); Richard Hynes, *Payday Lending, Bankruptcy, and Insolvency*, 69 WASH. & LEE L. REV. 607 (2012); Creola Johnson, *Congress Protected the Troops: Can the New CFPB Protect Civilians from Payday Lending?*, 69 WASH. & LEE L. REV. 649 (2012); Nathalie Martin & Joshua Schwartz, *The Alliance Between Payday Lenders and Tribes: Are Both*

instance. Though they charge seemingly excessive interest rates, payday lenders offer convenience when compared to other short-term loan options.⁴⁴ Surveys of payday loan customers reveal that the main value they assign to such options is convenience, with locations near home or work.⁴⁵ In addition, commercial lending can subject potential borrowers to what might be referred to as moral interrogation. Walking into a bank, individuals with low incomes or credit defects may feel they are likely to be judged. By comparison, nontraditional lending can be less embarrassing⁴⁶ and may even offer anonymity.⁴⁷

Person-to-person lending has long been part of the fringe economy. One need only think of borrowing from loan sharks or lending gas money to one's college roommate to realize how common person-to-person lending actually is. Most people, if not all, have resorted to some form of person-to-person lending in their lives.

With that said, P2P lending takes a remarkable variety of forms, including some that are quite formalized. An examination of three of these forms demonstrates just how varied person-to-person lending can be. The first is the "rotating credit association," "RCA," or "ROSCA." The RCA is the "basis for the peer lending methodology."⁴⁸ The Chinese hui, Japanese ko or tanomoshi, Korean kye, Mexican tanda, and Nigerian esusu are all forms of this kind of lending.⁴⁹ In Cantonese-speaking China, they have been around for perhaps 1,800 years,⁵⁰ and in this country, they

Tribal Sovereignty and Consumer Protection at Risk?, 69 WASH. & LEE L. REV. 751 (2012).

44. See Nathalie Martin, *1000% Interest—Good While Supplies Last: A Study of Payday Loan Practices and Solutions*, 52 ARIZ. L. REV. 563, 596 (2010).

45. *Id.*

46. *Id.*

47. Christopher L. Peterson, *Removing the Target: Protecting Military Service Members and Veterans from Financial Predators*, HUM. RIGHTS, Spring 2008, at 8.

48. Rashmi Dyal-Chand, *Human Worth as Collateral*, 38 RUTGERS L.J. 793, 824 n.154 (2007).

49. Christy Chung Hevener, Fed. Res. Bank of Philadelphia, *Alternative Financial Vehicles: Rotating Savings and Credit Associations* at 22 (2006), available at <http://www.philadelphiafed.org/community-development/publications/discussion-papers/discussionpaper-ROSCAs.pdf>.

50. *Id.* at 6.

remain prevalent among certain immigrant communities. One-half of California's Japanese immigrants had participated in some form of rotating credit association according to a 1960s survey,⁵¹ and as late as the 1980s, more than 80% of Korean immigrants in Los Angeles had participated in RCAs.⁵²

An RCA is formed upon a "core of participants" who make "regular contributions to a fund which" are then pooled and "given to each contributor in rotation."⁵³ They differ in terms of size, criteria for membership, manner in which order of payouts are made, organizational structure, and the sanction for violations, but they share the essential characteristic of being an informal credit institution lending small lump sums.⁵⁴

RCAs rely on social trust to ensure repayment of lent funds.⁵⁵ Inevitably, some members will default (quitting the RCA before their "take" has been recouped through periodic payments). This can produce effective interest rates as high as 30%,⁵⁶ well above those charged by commercial lenders (and authorized by usury laws), even for "zero-interest" RCAs.⁵⁷ In other RCAs, early recipients of payouts "bid" for interest rates they are willing to pay for the privilege of early receipt—and such rates can be as high as 24%.⁵⁸ These suggest relatively high transaction costs in comparison to traditional credit. Still, RCAs provide a means to access credit for those unable to access it due to discrimination, immigration status, or language barriers. Moreover, RCAs provide

51. *Id.* at 22.

52. *Id.*

53. Shirley Ardener, *The Comparative Study of Rotating Credit Associations*, 94 J. ROYAL ANTHROPOLOGICAL INST. GR. BRIT. & IR. 201, 201 (1964).

54. *Id.* at 201–02, 216–17.

55. See Dyal-Chand, *supra* note 48, at 824 ("In their small, close-knit communities, borrowers cannot default because doing so would risk extraordinary shame, social degradation, and even ostracism."); Lan Cao, *Looking at Communities and Markets*, 74 NOTRE DAME L. REV. 841, 882 (1999).

56. Ivan Light et al., *Korean Rotating Credit Associations in Los Angeles*, in IMMIGRANT AND MINORITY ENTREPRENEURSHIP: THE CONTINUOUS REBIRTH OF AMERICAN COMMUNITIES 171, 179 (John Sibley Butler & George Kozmetsky, eds.) (2004).

57. In a zero-interest RCA, early recipients of funds do not pay any additional amount for the privilege of enjoying the time value of money.

58. Kumar Aniket, *Self Help Groups: Use of Modified ROSCAs in Microfinance* 22, (Edinburgh School of Economics, Discussion Paper No. 137, 2005), available at www.aniket.co.uk/research/shg.pdf.

convenience because “like numbers gambling syndicates, RCAs circumvent the slow, unfriendly, and bureaucratic channels of banks.”⁵⁹ Like P2P lending, RCAs stand in an ambiguous legal position; courts sometimes conflate them with unlicensed lotteries,⁶⁰ and practices commonly associated with RCAs, like the failure to report interest income or interest rates exceeding levels permitted under usury laws, contribute to a widespread belief that they are unlawful.⁶¹

A second well-established form of P2P lending is a numbers racket, popular at various points among African-Americans in Harlem and factory-line workers in Detroit, among others. A numbers racket depends on the identification of a number, the appearance of which could be predicted but with values that could not. For instance, an early numbers racket was based on two figures released each morning in New York City—the total daily clearances among a certain group of banks and the Federal Reserve balance.⁶² The winning number would combine, for instance, the second and third digits of the “clearings” figure with the third digit of the Fed balance.⁶³

A person could “bet” anything from a few pennies to a few dollars on a number, with odds of winning 1 in 1,000 but payoffs of 600 to 1.⁶⁴ Langston Hughes called the numbers racket “the salvation of Harlem, its Medicare, and its Black Draught, its 666, its little liver pills, its vitamins, its aspirins, and its analgesic balm combined.”⁶⁵

59. Light et al., *supra* note 56, at 172.

60. California law is confused on the issue of the legality of Korean *kye*, and at least one judge has found that form of RCA “an illegal lottery and also a form of security which was being sold without prior permission from the proper authorities.” Cao, *supra* note 55, at 909. *But see* Mi Bong Hong v. Chong Chin Cha, 979 A.2d 250, 258 (Md. App. 2009) (finding valid contract claims in RCA dispute); Light et al., *supra* note 56, at 179 (RCAs are “not unlawful in themselves”).

61. Light et al., *supra* note 56, at 179.

62. SHANE WHITE ET AL., PLAYING THE NUMBERS: GAMBLING IN HARLEM BETWEEN THE WARS 12–13 (2010).

63. If the clearings figure was \$589,000,000, and the Fed balance was \$116,000,000, then the “winning” number would be 896.

64. WHITE ET AL., *supra* note 62, at 13–14.

65. GEORGE EATON SIMPSON & J. MILTON YINGER, RACIAL & CULTURAL MINORITIES: AN ANALYSIS OF PREJUDICE AND DISCRIMINATION 122 (1985). Blackdraft and 666 were popular laxatives. *Id.* Hughes’s statement was

Dismissing a number racket as a form of illegal gambling would be a mistake; the “whole enterprise” has an “essentially economic nature.”⁶⁶ Those running the racket were referred to as “bankers,” and those who played as “investors.”⁶⁷ Those who played did not think of themselves as gamblers; they took the term “investing” literally.⁶⁸ Hitting the winning number was not the equivalent of today’s Powerball lottery, where a winner is set for life.⁶⁹ Instead, it would provide a windfall “that allowed debts to be paid off.”⁷⁰ Investing a few coins a day made sense, even in the face of long odds (the expected rate of return being slightly above one dollar for every two played).⁷¹ According to retired NYPD detective Rufus Shatzberg, the numbers racket was a “financial institution” that “substituted for mainstream organizations that could not and would not provide financial services in poor communities.”⁷² Due to a “vacuum where there were few banks, credit associations, loan and realty enterprises, numbers gambling emerged [and] became a source of capital and, ironically, a means of savings, a device for personally accumulating some resources.”⁷³

The primary appeal of the numbers game was its convenience. Numbers “runners” made circuits of their customers, who “thus do not have to go out of their way to bet.”⁷⁴ Numbers stations were “located in newsstands, pool halls, cigar stores, and groceries”—locations people visited for other reasons on a typical day.⁷⁵ Even those with traditional savings accounts found “it convenient to lay a dollar on a number while at the barber shop rather than risk making no ‘investment’ at all in the day.”⁷⁶ The numbers rackets

published in a front page article in the *New York Times* on March 1, 1971. *Id.*

66. WHITE ET AL., *supra* note 62, at 23.

67. *Id.* at 200.

68. *Id.* at 223.

69. *Id.* at 225.

70. *Id.*

71. *Id.* at 223–24.

72. RUFUS SHATZBERG & ROBERT J. KELLY, *AFRICAN AMERICAN ORGANIZED CRIME: A SOCIAL HISTORY* 71 (1996).

73. *Id.*

74. Ivan Light, *Numbers Gambling Among Blacks: A Financial Institution*, 42 AM. SOC. REV. 892, 897 (1977).

75. *Id.*

76. *Id.*

have now “almost completely disappeared” thanks to competition from government-sanctioned lotteries.⁷⁷

A third form of noncommercial lending is a hybrid between P2P and institutional lending. Pawnbroking has been around since the 1850s or 1860s. A pawnbroker takes personal property from borrowers as security for cash loans; if the loan is not repaid, the pawnbroker resells the item held as security.⁷⁸ One nineteenth century commentator referred to pawn shops as the “salvation of the wage-earner in bad times.”⁷⁹ Since its early days, unlike the illicit numbers racket or the shadowy rotating credit association, pawnbroking has been subject to fairly tight regulation.⁸⁰ A pawnbroker needs little overhead and administration,⁸¹ and the simple nature of the transaction makes it a rapid way to obtain credit and minimize transactions costs. Pawnbroking thus provides “essential access to credit for people experiencing financial shocks who may have nowhere else to turn.”⁸²

These three examples provide insight into the emergence of online P2P lending. Like each of these forms of nontraditional lending, convenience is a primary selling point for online P2P sites. No physical appearance at a bank is necessary; one can apply for a loan on a laptop computer while sitting on the couch.

On the other hand, some concerns should arise as a result of the divergence between online P2P and these other forms of informal credit. There is no family, cultural or group tie-ins with online P2P that would enforce repayment, as in the case of RCAs. There is also no face-to-face interaction, as in the case of

77. Anthony N. Cabot, *The Games People Play: Is it Time for a New Legal Approach to Prize Games?*, 4 NEV. L.J. 197, 213 (2003).

78. Andrew Martin Fisher, *Banking on the Edge: Towards an Open Ended Interpretation of Informal Finance in the Third World* (Mar. 1994) (unpublished M.A. thesis, McGill University), available at http://digitool.Library.McGill.CA:80/R/-?func=dbin-jump-full&object_id=68088&silos_library=GEN01.

79. Helen Bosanquet, *The Burden of Small Debt*, 6 THE ECON. J. 212, 213 (1896).

80. Jarret C. Oeltjen, *Florida Pawnbroking: An Industry in Transition*, 23 FLA. ST. U. L. REV. 995, 1018 (1996).

81. F.J.A. Bouman & R. Houtman, *Pawnbroking as an Instrument of Rural Banking in the Third World*, 37 ECON. DEV. & CULTURAL CHANGE 69, 74 (1988).

82. Jim Hawkins, *Regulating on the Fringe: Reexamining the Link Between Fringe Banking and Financial Distress*, 86 IND. L.J. 1361, 1391 (2011).

pawnbroking or numbers rackets, which might increase the moral hazard associated with online P2P lending.

Online P2P transactions also involve a level of “cleanliness,” thanks to the Internet, that might not be associated with predecessor forms of informal lending. The seeming sterility of the transaction might reduce the moral sanction associated with such lending/borrowing and perhaps increase adverse selection. When a potential borrower turns to a pawn shop or a payday lender, she must appear personally and may, whether due to the aesthetic environment or perceptions of social stigma attached to such borrowing, rethink the need for a loan. By contrast, an online P2P loan applicant can submit a request for a loan entirely electronically. The lack of channeling of potential borrowers might mean that those who turn to online P2P have not adequately thought through their need for a loan or the likelihood they will be able to pay it back.

C. The Emerging Importance of Online Peer-to-Peer Lending

Online P2P lending is hot. The Harvard Business Review called it a “breakthrough idea for 2009.”⁸³ In 2011, the Wall Street Journal listed Prosper as one of the top 50 “next big things,”⁸⁴ and Lending Club won a “webby” award.⁸⁵ Two reasons explain this development, one of a positive nature and one negative. The positive driving force of P2P’s popularity is the emergence of “Web 2.0” applications on the Internet. The negative driving force was the near collapse—and certainly significant contraction—of the U.S. consumer and business credit markets in 2008.

The first force driving online P2P, a positive one, is the development of Web 2.0 businesses. The term “Web 2.0” was

83. John Sviokla, *Forget Citibank—Borrow from Bob*, HARV. BUS. REV., Feb. 2009, at 25, available at <http://hbr.org/web/tools/2009/01/list-toc>.

84. *The Next Big Thing 2011: The Top 50 Venture-Funded Companies*, WALL ST. J. (Mar. 9, 2011), http://online.wsj.com/article/SB10001424052748703300904576178673309577828.html#project%3DVCrank_20110307%26articleTabs%3Dinteractive (last visited Apr. 8, 2012) (on file with the Washington and Lee Law Review).

85. *15th Annual Webby Awards Nominees*, WEBBY AWARDS, http://www.webbyawards.com/webbys/current.php?season=15#webby_entry_banking (last visited Apr. 8, 2012) (on file with the Washington and Lee Law Review).

popularized⁸⁶ by book publisher Tim O'Reilly to describe a second generation of Internet offering, "which relies on collective intelligence and action from the bottom up."⁸⁷ First-generation web activity, or "Web 1.0," treated users as passive, presenting them with information but declining to involve them actively in the generation of web content.⁸⁸ For users of Web 1.0, the "characteristic activity was surfing static Internet pages."⁸⁹

Web 2.0, by contrast, emphasizes the "architecture of participation."⁹⁰ Web sites have become organic, developing as users (rather than site planners and developers) express their preferences. Authoritarian web developers have given way to the "wisdom-of-the-crowds,"⁹¹ in which the "harnessing [of] collective intelligence"⁹² is accomplished through the use of new software tools.

Web 1.0 was EncyclopediaBritannica.com;⁹³ Web 2.0 is Wikipedia,⁹⁴ which relies on the inputs of users to create encyclopedia entries. Web 1.0 was askjeeves.com; Web 2.0 is Google,⁹⁵ which traces the behavior of search engine users to provide inputs to the site's algorithms. Web 1.0 was ofoto, where

86. The question of who actually coined the term is more complicated, and, in expected Web 2.0 fashion, heavily debated among the Technorati. Compare Dylan Tweney, *Tim O'Reilly: Web 2.0 Is About Controlling Data*, WIRED (Apr. 13, 2007), http://www.wired.com/techbiz/people/news/2007/04/timoreilly_0413 (last visited Apr. 8, 2012) (asserting that Tim O'Reilly coined it) (on file with the Washington and Lee Law Review), with Firoz Ansari, *Who Coined the Term Web 2.0?*, FIROZANSARI: BLOG (May 20, 2006), <http://www.firozansari.com/2006/05/20/who-coined-the-term-web-20/> (last visited Apr. 8, 2012) (arguing that Dermot A. McCormack coined the term in a book published in 2002) (on file with the Washington and Lee Law Review).

87. Jessica Guynn, *Tech Guru Challenges Next Generation to Get Serious*, L.A. TIMES, Oct. 10, 2008, at 1.

88. Geoffrey Christopher Rapp, *Torts 2.0*, 37 WM. MITCHELL L. REV. 1582, 1585 (2011).

89. Peter Lunenfeld, *Welcome to Web 2.0*, L.A. TIMES, June 24, 2007, at 11.

90. Steven Levy, *Farewell, Web 1.0! We Hardly Knew Ye*, NEWSWEEK, Oct. 18, 2004, at 20.

91. Steven Levy, *The Future of Reading*, NEWSWEEK, Nov. 26, 2007, at 54.

92. Dan Fost, *What Exactly Does Web 2.0 Mean? Well . . .*, SAN FRANCISCO CHRON., Nov. 5, 2006, at F5.

93. Daniel E. Harmon, *The "New" Web: Getting a Grip on the Slippery Concept of Web 1.0*, LAWYER'S PC, Jan. 1, 2006, at 1.

94. *Id.*

95. *Id.*

individuals could print their photos, while Web 2.0 is the photo-sharing site Flickr.

Online P2P lending offers the Web 2.0 alternative to Web 1.0 lending platforms such as e-loan, Lending Tree, and the like. On those sites, potential borrowers are passive. They provide information to a central website, which in turn offers potential lenders the chance to finance customers' loans. Web 2.0 P2P lending harnesses the collective intelligence of potential lenders, at least in theory, to identify which borrowers will receive loans.

However, the sites as they exist now do not fully exploit the potential of Web 2.0 interfaces to harness collective intelligence. Investors are unable, for instance, to share information or perspectives on a particular borrower or their request—for instance, by wiki (is a Honda motorcycle the best choice for an investor with X credit score?).⁹⁶ Of course, one should remember that P2P lending is not a static industry that uses a single model, and along with the rest of Web 2.0, P2P lending will continue to morph and evolve.

The second driving force behind the growth in P2P lending has been the credit market contraction following the financial instability of 2008. In 2008, liquidity crises at several major financial institutions led to widespread fears that “credit markets, and in turn the global economy, would completely seize up, causing an economic catastrophe unparalleled in modern history.”⁹⁷ Most readers are no doubt familiar with the unparalleled federal bailouts that followed.

In the wake of the crisis, even after the string of bailouts secured the health of most remaining affected institutions, consumer credit remained far more difficult to obtain than it had before. Although the financial crisis had its roots in the high default risk associated with the subprime mortgage lending industry, consumer credit constricted across the board. Total consumer lending fell by 6.10% between January 2009 and March 2010, “accelerating into a contraction the like of which has not been seen before.”⁹⁸

96. See *supra* note 42 and accompanying text.

97. Edward J. Estrada, *The Immediate and Lasting Impacts of the 2008 Economic Collapse*, 45 U. RICH. L. REV. 1111, 1111 (2011).

98. *Epic Consumer Credit Crunch Unfolding*, SEEKING ALPHA (Mar. 2, 2010) <http://seekingalpha.com/article/191517-epic-consumer-credit-crunch-unfolding>

Lenders tightened guidelines on access to mortgages and home-equity loans. Particularly for high-risk individuals seeking unsecured debt-consolidation loans, the result has been difficulty obtaining access to credit via traditional sources. Even some students have turned to other sources after being turned away by traditional sources of student loans.⁹⁹ This has driven borrowers toward emerging alternatives, including online P2P lending sites.¹⁰⁰

The pressure from credit market challenges did not solely affect individual borrowers. Even small businesses have been forced to seek alternative means to obtain credit, and some have turned to P2P sites.¹⁰¹ P2P has become one of the “fringe” banking options that has risen in importance as higher-risk borrowers have been turned away by increasingly risk-adverse traditional lending institutions.¹⁰²

(last visited Apr. 8, 2012) (on file with the Washington and Lee Law Review).

99. Kelli B. Grant, *Loan Web Sites Tapped for College Cash*, WALL ST. J., Apr. 29, 2008, at D6.

100. See Alex Brill, *Peer-to-Peer Lending: Innovative Access to Credit and the Consequences of Dodd-Frank*, WASH. LEGAL FOUND. (Dec. 3, 2010) http://www.wlf.org/publishing/publication_detail.asp?id=2215 (last visited Apr. 8, 2012) (on file with the Washington and Lee Law Review).

101. See Jean, *supra* note 7, at D01.

102. While it may have been true that in the early days of online P2P lending, those turned away from traditional lenders were able to qualify for P2P loans, it appears to be less the case now that the sites have imposed stricter eligibility guidelines. These stricter guidelines mean that the sites are no longer “tak[ing] a chance on many of the people banks turned away.” Daniel Wolfe, *Prosper Model Changes, and So Do Perceptions*, AM. BANKER, Nov. 2010, at 1. The degree to which Prosper and LendingClub rejected high risk borrowers even led to the emergence of a new site—Loanio—aimed at those with “poor or no credit profile histories.” Press Release, Loanio.com, Loanio.com Unveils Its Peer To Peer Lending Platform Today and Offers Subprime, Thin and No Credit Borrowers, the Opportunity to Get Loans Without Exposing Higher Risks to Its Lenders (Oct. 1, 2008), <http://pilot.us.reuters.com/article/2008/10/01/idUS176351+01-Oct-2008+PRN20081001> (last visited Apr. 8, 2012) (on file with the Washington and Lee Law Review). Loanio was created after borrowers with poor or no credit scores had “little luck” with the established for-profit P2P sites. *Id.* The curious thing about Loanio, of course, is that it represented a *fringe* section of a *fringe* section of the lending market. Not surprisingly, the Loanio business model was not a winner, and the site shut down in March 2011. Peter Renton, *Loanio Closing Down in Next Two Weeks*, SOC. LENDING NETWORK (Mar. 31, 2011), <http://www.sociallending.net/news/loanio-closing-down-in-next-two-weeks/> (last visited Apr. 8, 2012) (on file with the Washington and Lee Law Review). It had made only seven loans, and all of the borrowers had defaulted. *Id.*

P2P lending has also allowed capital to flow to communities that were underserved by the credit markets even prior to the retraction of those markets in 2008. Individuals who previously were mired in debt and for whom payday lending may have seemed the only option have, thanks to online P2P, been able to consolidate their loans, pay off debts, and improve their credit scores.¹⁰³ P2P lending has allowed capital to flow into economically depressed communities and created new opportunities for community development and economic growth.¹⁰⁴ Moreover, P2P lending has not only fueled domestic economic development, it has also fueled economic development abroad.¹⁰⁵ Sites such as Kiva (www.kiva.com) specialize in lending internationally to support entrepreneurship and economic growth in developing countries.¹⁰⁶

D. The Risks of Peer-to-Peer Lending

Despite the benefits of P2P lending, it also raises substantial concerns. P2P lending shares all of the risks associated with traditional “brick and mortar” lending including lending fraud, identity theft, money laundering, consumer privacy and data-protection violations, and terrorism financing.¹⁰⁷ These risks are then married to and amplified by the anonymity and ubiquity of the Internet.

The model for P2P lending used by the major for-profit lending platforms also has a variety of problematic characteristics. First, the information supplied by borrowers often is not verified, and when the information is verified, it often proves inaccurate.¹⁰⁸ As a

103. See Aleksandra Todorova, *Peer-to-Peer Lending Offers Solution for Strapped Consumers*, SMART MONEY (Oct. 15, 2007), <http://www.smartmoney.com/spend/family-money/peer-to-peer-lending-offers-solution-for-strapped-consumers-2> 1978 (last visited Apr. 8, 2012) (on file with the Washington and Lee Law Review).

104. See Chaffee, *supra* note 3, at 1439–40 (reporting on the role of peer-to-peer lending in domestic economic development).

105. See Davis & Gelpern, *supra* note 8 (discussing the use of peer-to-peer lending to facilitate foreign economic development).

106. See GAO REPORT, *supra* note 6, at 14–16 (reporting on Kiva’s peer-to-peer lending model and its role in foreign economic development).

107. See Chaffee, *supra* note 3, at 1440.

108. See Ron Lieber, *The Gamble of Lending Peer to Peer*, N.Y. TIMES, Feb. 5, 2011, at B1 (reporting that LendingClub does not verify the information

result, lenders using the sites face difficulty determining a borrower's actual creditworthiness.¹⁰⁹ Second, the credit ratings assigned by the platforms may not accurately predict how loans will perform because platforms have a limited amount of historical loan-performance data.¹¹⁰ Third, the returns on the notes that the platforms sell to individual lenders are based entirely on repayment by the individual borrowers and are not secured by any collateral or guaranteed by any third party.¹¹¹ Fourth, in the event of default by the borrowers, lenders are dependent on the P2P lending platforms and their designees for collecting on the defaulted loan, which the platforms are notoriously bad at doing. For example, as of February 2009, Prosper Marketplace had recovered just over \$800,000 of the \$39.4 million it had charged off in default.¹¹² The lenders using such sites have no independent means of pursuing collection on unpaid loans. Fifth, investments made by individual lenders are significantly less liquid than many other forms of investment because many of the loans are for three to five year terms.¹¹³ Moreover, some platforms restrict the sale and transfer of loans to other individuals, except to lenders on that particular platform.¹¹⁴ Sixth, a high degree of uncertainty exists as to what would occur in the event that a platform became bankrupt.¹¹⁵ Seventh, because models of P2P lending and the regulatory scheme associated with it continue to evolve, a high degree of uncertainty exists as to how P2P lending will evolve in the future.¹¹⁶

Because the commonly used model for P2P lending is riddled with these risks, P2P lending platforms have had a rocky start.

submitted by borrowers a large portion of the time and when it does verify the information supplied, the information is often inaccurate).

109. GAO REPORT, *supra* note 6, at 22 tbl.1 (providing a list of risks for lenders that were identified by the major for-profit P2P lending platforms).

110. *Id.*

111. *Id.*

112. *See* Hunsberger, *supra* note 12.

113. GAO REPORT, *supra* note 6, at 12.

114. *Id.* at 22 tbl.1.

115. *Id.*

116. *See id.* at 56–57 (summarizing regulatory agencies' comments, most of which noted the "evolving" nature of the industry and anticipated that regulation should proceed largely in response to this evolution).

Sites have experienced high default rates, which “rival or exceed those of credit-card borrowers at big banks.”¹¹⁷ During Prosper Marketplace’s first three years of operation, approximately one-third of the loans that it helped originate ended in default, and investors lost on average 4.95% annually during that time.¹¹⁸ In addition, as of this writing, neither Prosper Marketplace nor the LendingClub had yet turned a profit.¹¹⁹

As a result, online P2P lending, which at first appears to be a “golden goose,” may turn individual lenders into “pigeons.” In LendingClub’s defense, its prospectus, which exceeds 100 pages, states: “The Notes [, i.e. loans made via its site], are highly risky and speculative. Investing in the Notes should be considered only by persons who can afford the loss of their entire investment.”¹²⁰ And, in Prosper Marketplace’s defense, its prospectus, which exceeds 120 pages, includes the same language verbatim.¹²¹ Still, the chance of misapprehension of the risk and improper investment portfolio diversification by lenders in P2P lending transactions remains exceedingly high.

As a result, the myriad of benefits of P2P lending are matched with a myriad of risks for borrowers, lenders, lending platforms, and society at large. A robust regulatory structure on par with the regulatory structure used for traditional lending is needed to mitigate these risks.

117. See Hunsberger, *supra* note 12.

118. See Lieber, *supra* note 108.

119. PROSPER MARKETPLACE, INC., 2011 FORM 10-K, at 63, *available at* <http://marketbrief.com/prosper-marketplace-inc/10k/annual-report/2011/3/30/7786716/filing?secwatch#item6selectedfindata12310201> (last visited Apr. 8, 2012) (“We have incurred operating losses since our inception and we anticipate that we will continue to incur net losses through at least 2011.”); LENDINGCLUB CORP., PROSPECTUS DATED JUNE 10, 2011, at 23, *available at* https://www.lendingclub.com/extdata/Clean_As_Filed_20110610.pdf (“We have not been profitable since our inception.”); Hunsberger, *supra* note 12.

120. LENDINGCLUB CORP., *supra* note 119, at 70.

121. PROSPER MARKETPLACE, INC., PROSPECTUS DATED JULY 14, 2011, at 47 *available at* http://www.prosper.com/Downloads/Legal/Prosper_Prospectus_2011-07-14.pdf.

III. The Current Regulatory Regime for Online Peer-to-Peer Lending

The current regulatory structure for online P2P lending involves multiple overseeing agencies. Responsibility for regulating such lending potentially falls within the purview of a wide variety of federal and state regulators, including the new CFPB, the Federal Trade Commission, the United States Department of Justice, the United States Securities and Exchange Commission, various federal bank regulators, and the state counterparts of all these entities.¹²² Two things inhibit the development of a coherent regulatory regime for online P2P lending. First, such lending is a relatively new phenomenon that has only recently attracted public attention, and therefore, regulators are still trying to puzzle through its implications. Second, a variety of models exist for P2P lending, and models continue to be created and evolve, which means that developing a single coherent regulatory regime for P2P lending will be extraordinarily difficult.

Because banks are involved in the most prominent model of P2P lending, such lending is already the subject of significant regulation. As previously explained, the major P2P lending sites in the United States, Prosper Marketplace and LendingClub, use a model in which a bank originates loans to individual borrowers, and notes are then sold to individual lenders with payment on the notes being contingent upon repayment of the underlying loan. Because a bank is involved in the lending process, both companies admit that a myriad of federal statutes apply directly or indirectly to their lending activities.¹²³ These statutes include the Bank Secrecy Act,¹²⁴ the Electronic Fund Transfer Act,¹²⁵ the Electronic Signatures in Global and National Commerce Act,¹²⁶ the Equal

122. See GAO REPORT, *supra* note 6, at 3–7 (discussing the myriad of federal and state regulators that potentially share some responsibility for regulating P2P lending).

123. See GAO REPORT, *supra* note 6, at 33 tbl.2 (listing federal lending and consumer protection laws that officials from LendingClub and Prosper Marketplace admitted are applicable to P2P lending).

124. 12 U.S.C. §§ 1829b–31, 1951–59 (2006); 31 U.S.C. §§ 321, 5311–14, 5316–22 (2006).

125. 15 U.S.C. §§ 1693–1693r (2006).

126. *Id.* §§ 7001–7006, 7021, 7031.

Credit Opportunity Act,¹²⁷ the Fair Credit Reporting Act,¹²⁸ the Fair Debt Collection Practices Act,¹²⁹ the Federal Trade Commission Act,¹³⁰ the Gramm–Leach–Bliley Financial Modernization Act,¹³¹ the Servicemembers Civil Relief Act,¹³² and the Truth in Lending Act.¹³³

With that said, federal and state securities regulators have likely taken the most aggressive action in regulating P2P lending. All regulators who have confronted the issue agree that the notes in the prominent model for P2P lending are securities.

A. Federal Securities Regulation and Peer-to-Peer Lending

The United States Securities and Exchange Commission has taken an aggressive role in regulating P2P lending because the most commonly used model of such lending involves the offer, sale, and purchase of securities. On the Prosper and LendingClub sites, banks issue loans to individual borrowers, and notes are then sold to individual lenders with payment on the notes being contingent upon repayment of the underlying loan.¹³⁴ The notes that are being offered, sold, and purchased in this model constitute securities under both the Securities Act of 1933 (Securities Act)¹³⁵ and the Securities Exchange Act of 1934 (Exchange Act).¹³⁶ Section 2(a)(1) of the Securities Act¹³⁷ and

127. *Id.* §§ 1691–1691f.

128. *Id.* §§ 1681–1681x.

129. *Id.* §§ 1692–1692p.

130. *Id.* §§ 41–58.

131. Pub. L. No. 106-102, 113 Stat. 1338 (1999) (codified as amended in scattered sections of 12, 15, 16, and 18 U.S.C.).

132. 50 U.S.C. app. §§ 501–596 (2006).

133. 15 U.S.C. §§ 1601–1667f (2006).

134. *See supra* notes 20–25 and accompanying text.

135. 15 U.S.C. §§ 77a–77aa (2006).

136. *Id.* §§ 78a–78pp.

137. *See id.* § 77b(a)(1)

The term “security” means any note, stock, treasury stock, security future, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil,

Section 3(a)(10) of the Exchange Act¹³⁸ provide definitions of a “security.” Because both sections include within the definition of a security the terms “investment contracts” and “notes,”¹³⁹ their applicability to online P2P lending is identical. Importantly, if the notes in online P2P transactions are either “investment contracts” or “notes” under federal securities law, then the notes in P2P transactions are securities, even if they qualify as only one of the two classes of securities.¹⁴⁰

The notes used in the most common model of P2P lending constitute securities for purposes of federal securities law because they are investment contracts. In *SEC v. W.J. Howey Co.*,¹⁴¹ the Supreme Court established the test for identifying an investment

gas, or other mineral rights, any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or, in general, any interest or instrument commonly known as a “security”, or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.

138. *See id.* § 78c(a)(10)

The term “security” means any note, stock, treasury stock, security future, bond, debenture, certificate of interest or participation in any profit-sharing agreement or in any oil, gas, or other mineral royalty or lease, any collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or in general, any instrument commonly known as a “security”; or any certificate of interest or participation in, temporary or interim certificate for, receipt for, or warrant or right to subscribe to or purchase, any of the foregoing; but shall not include currency or any note, draft, bill of exchange, or banker’s acceptance which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited.

139. *See* Securities Act of 1933, 15 U.S.C. § 77b(a)(1) (2006) (“The term ‘security’ means any note . . . [or] investment contract.”); Securities Exchange Act of 1934, 15 U.S.C. § 78c(a)(10) (2006) (same).

140. *See* *Reves v. Ernst & Young*, 494 U.S. 56, 64 (1990) (determining that both “investment contracts” and “notes” qualify as securities).

141. *SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946).

contract under federal securities law.¹⁴² In that case, W.J. Howey Company (Howey) sold tracts of land containing citrus groves to the public.¹⁴³ Potential customers were offered both a contract for the sale of the land and a contract for servicing the citrus groves.¹⁴⁴ The service contract was to be performed by Howey-in-the-Hills Service, Inc. (Howey-in-the-Hills), a corporation with the same management and ownership as Howey.¹⁴⁵ Although the purchasers of the land contract could arrange for other service companies to tend their groves, Howey-in-the-Hills serviced approximately 85% of the land that was sold.¹⁴⁶ The service contracts had a ten-year duration without option of cancellation and gave Howey-in-the-Hills “full and complete” possession of the land that was being serviced.¹⁴⁷ Howey-in-the-Hills pooled fruit from all of the land that it serviced and then made an allocation of the net profits to the land owners, most of whom were not residents of Florida, where the groves were located.¹⁴⁸

The Supreme Court held that Howey and Howey-in-the-Hills were offering and selling securities under the federal securities laws because they were offering and selling investment contracts.¹⁴⁹ The Court reached this holding by examining the definition of a security in Section 2(1)—now 2(a)(1)—of the Securities Act.¹⁵⁰ After noting that the definition includes the term “investment contract,” the Court explained that the term “investment contract” is not defined in the federal securities laws,

142. *See id.* at 298–99 (“[A]n investment contract for purposes of the Securities Act means a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party.”).

143. *Id.* at 295.

144. *Id.*

145. *Id.*

146. *Id.*

147. *Id.* at 296.

148. *Id.*

149. *See id.* at 299–300 (concluding that the “transactions in this case clearly involve investment contracts” and thus holding that Howey and Howey-in-the-Hills were offering and selling securities).

150. *See id.* at 297 (“The legal issue in this case turns upon a determination of whether, under the circumstances, the land sales contract, the warranty deed and the service contract together constitute an ‘investment contract’ within the meaning of [section] 2(1).”).

but that the term was commonly used in many state “blue sky” laws and broadly construed by state courts prior to the passage of the Securities Act and Exchange Act.¹⁵¹ The Supreme Court adopted this broad approach and determined that the test for an investment contract is “whether the scheme involves an investment of money in a common enterprise with profits to come solely from the efforts of others.”¹⁵² The Court then found that the land and service contracts were investment contracts because Howey and Howey-in-the-Hills were offering and selling the opportunity to invest money in a common enterprise to grow citrus fruit that they fully operated and managed.¹⁵³ The Court also found it irrelevant that the purchasers of the land could have found someone else to service the citrus groves, concluding that the test for a security was still met because Howey and Howey-in-the-Hills were “offer[ing] the essential ingredients of an investment contract.”¹⁵⁴

The *Howey* test is usually broken down by courts into three distinct elements.¹⁵⁵ First, a common enterprise must exist that sufficiently intertwines investors’ interests with those of other investors and/or the promoters of the investment.¹⁵⁶ All courts have held that horizontal commonality, which exists when a pool of investors is created whose fortunes are tied to the overall success of the venture, satisfies the *Howey* test.¹⁵⁷ Some courts have held that vertical commonality, which focuses on the relationship between the investor and promoters alone, satisfies the *Howey* test.¹⁵⁸ Second, for an investment contract to exist, an investor must also have an expectation of profits based upon the

151. *Id.* at 298.

152. *Id.* at 301.

153. *See id.* at 299 (finding that the “transactions in this case clearly involve[d] investment contracts” because “[Howey and Howey-in-the-Hills were] offering an opportunity to contribute money and to share in the profits of a citrus fruit enterprise managed and partly owned [by them]”).

154. *Id.* at 301.

155. *See* MARC I. STEINBERG, SECURITIES REGULATION 28 (Rev. 5th ed. 2009) (“The *Howey* analysis applied by the courts in these cases can usually be broken down into three issues.”).

156. *Id.*

157. *Id.* at 36.

158. *See id.* (noting that courts disagree as to whether “vertical commonality” is sufficient to meet *Howey*’s common enterprise requirement).

investment.¹⁵⁹ Third, the expectation of profit must come solely from the efforts of others.¹⁶⁰

The notes in the most commonly used model of P2P lending constitute investment contracts. First, a common enterprise exists. Horizontal commonality is likely present in the note-based model of P2P lending because a pool of investors is created who want to lend money to a pool of lenders. A counterargument might be that horizontal commonality does not exist in the note-based model of P2P lending because such lending is connecting individual lenders with individual borrowers. However, because investors are paying fees that support both the bank and P2P lending platform, a court is likely to hold that horizontal commonality does exist in the note-based model. Moreover, an individual borrower on these sites receives funds tied to the investment of multiple “lenders,” so each loan is in a real sense a common enterprise.

Even if horizontal commonality does not exist, vertical commonality may also meet the common enterprise requirement of the *Howey* test.¹⁶¹ Although not all courts allow vertical commonality to satisfy the *Howey* test, a strong argument exists for allowing it in the case of note-based P2P lending because individual investors are not linked to a single issuer but are linked to an individual borrower, a bank, and a lending platform through a P2P lending transaction.

Howey's second element, the expectation of profits, is also met. Individuals and entities use for-profit P2P lending sites as a means of investing money and gaining a return. There is no plausible argument—at least in the case of for-profit online P2P (as opposed to microfinance/development P2P)—that a profit element is not central.

Howey's third element is also likely satisfied because investors' expectation of profits in note-based P2P lending is based solely on the efforts of others. The investor relies on the individual borrower to pay the loan and the bank and the P2P lending site to collect from the borrower, pay the lender, and institute default proceedings in the event that the borrower fails to pay. Current

159. *Id.* at 28.

160. *Id.*

161. See STEINBERG, *supra* note 155, at 36 (stating that some courts have determined that vertical commonality alone satisfies the *Howey* test).

models of online P2P lending, unlike even the investment at issue in *Howey*, provide no alternative to having the sites service the loan and handle collections. An investor is unable to retain an alternative agent to collect on an unpaid loan.

Although it seems clear that the *Howey* test for an investment contract is satisfied, investments in online P2P sites are also likely securities under federal law because they qualify as “notes.” In *Reves v. Ernst & Young*,¹⁶² the Supreme Court established the test for what constitutes a note within the definition of a security under federal securities law.¹⁶³ In that case, the Farmer’s Cooperative of Arkansas and Oklahoma (the Co-Op) sold promissory notes that were payable on demand by the holder in order to support its business operations.¹⁶⁴ The notes paid a variable rate of return that was adjusted monthly to keep it above the rate paid by other local financial institutions.¹⁶⁵ After the Co-Op declared bankruptcy, the plaintiffs in the case brought a class action against Arthur Young & Co. (Arthur Young), the predecessor to Ernst & Young, claiming that Arthur Young had intentionally ignored generally accepted accounting principles in its outside audit of the Co-Op to inflate the Co-Op’s assets and net worth.¹⁶⁶ As a result, the plaintiffs asserted that Arthur Young had violated various antifraud provisions of the Exchange Act and Arkansas state securities law.¹⁶⁷ The plaintiffs won a \$6.1 million judgment in the district court, which was reversed by the United States Court of Appeals for the Eighth Circuit.¹⁶⁸

The Supreme Court reversed the Eighth Circuit and held that the notes in the case constituted securities under both the Securities Act and Exchange Act.¹⁶⁹ The Court began by examining Congress’s intent in defining the term “security” under federal

162. *Reves v. Ernst & Young*, 494 U.S. 56 (1990).

163. *See id.* at 64–65 (adopting the “family resemblance test” whereby a note is presumed to be a security unless it “bear[s] a strong family resemblance” to an item on the judicially crafted list of exceptions, or [the issuer] convinces the court to add a new instrument to the list”) (citations omitted).

164. *Id.* at 58.

165. *Id.* at 58–59.

166. *Id.* at 59.

167. *Id.*

168. *Id.*

169. *Id.* at 73.

securities law.¹⁷⁰ The Court noted that Congress “enacted a definition of ‘security’ sufficiently broad to encompass virtually any instrument that might be sold as an investment.”¹⁷¹ The Court then adopted a “family resemblance” test for differentiating whether a particular note was an investment and covered by federal securities law or whether a note was commercial in nature and not covered.¹⁷² Application of the “family resemblance” test begins with a rebuttable presumption that every note is a security.¹⁷³ This presumption can be rebutted if the note at issue bears a resemblance to certain judicially created categories of instruments that are commonly referred to as “notes” but nonetheless fall outside the definition of a security under federal securities laws.¹⁷⁴ These judicially created categories of notes that are exempt from federal securities law include notes that are delivered in consumer financing, notes that are secured by mortgages on homes, and notes that evidence loans by commercial banks for current operations of businesses.¹⁷⁵

The Supreme Court also created a list of factors for determining whether courts should exclude additional categories of notes from the federal definition of security.¹⁷⁶ First, the motivations of the buyer and seller must be assessed.¹⁷⁷ If the buyer is primarily interested in profit and the seller seeks to raise capital for business purposes, then the note is likely a security under federal securities law.¹⁷⁸ Second, the plan of distribution of the instrument must be examined.¹⁷⁹ If the plan of distribution includes the creation of common trading for investment or speculation, then the note is likely a security.¹⁸⁰ Third, the

170. *Id.* at 60–61.

171. *Id.* at 61.

172. *Id.* at 64–65.

173. *Id.* at 65.

174. *Id.*

175. *Id.* (citing *Exch. Nat’l Bank of Chicago v. Touche Ross & Co.*, 544 F.2d 1126, 1138 (2nd Cir. 1976)).

176. *See id.* at 66–67 (stating four factors to be used in determining whether a “note” meets the federal definition of a security).

177. *Id.* at 66.

178. *Id.*

179. *Id.*

180. *See id.* (“[W]e examine the ‘plan of distribution’ of the instrument . . . to

expectation of the public must be analyzed.¹⁸¹ If the public would view the note at issue as a security, then the note likely is a security, even if the realities of the transaction might suggest otherwise.¹⁸² Fourth, the risks created by the note at issue must be assessed.¹⁸³ For example, a court will be substantially less likely to hold that a note is a security if another regulatory regime significantly reduces the risk.¹⁸⁴

The notes in the commonly used model of P2P lending are securities under the *Reves* test. The default presumption is that any note is a security, although this presumption can be rebutted if the notes fall within certain judicially defined categories of notes that are not securities.¹⁸⁵ The notes in the most commonly used model of P2P lending are unlikely to fall within any of the currently existing categories of notes that are exempt from federal securities law for two reasons. First, online P2P lending has only gained the attention of the public within the past half decade, and courts have yet to address whether the notes used in the most common model of such lending are securities. Second, the notes in the most common model of P2P lending are investments, while the notes in the judicially created categories of notes exempt from federal securities law are all consumer or commercial in nature. A major distinction between these notes and excluded consumer notes is that the person providing funds associated with the P2P note is not also seeking to facilitate the sale of real or personal property to the borrower.

In addition, courts are unlikely to hold that the notes in the most common model of P2P lending should be recognized as a new category of notes that do not constitute securities. All of the factors for creating new categories of notes that do not constitute

determine whether it is an instrument in which there is ‘common trading for speculation or investment.’”).

181. *Id.*

182. *Id.*

183. *See id.* at 67 (“Finally, we examine whether some factor such as the existence of another regulatory scheme significantly reduces the risk of the instrument, thereby rendering application of the Securities Acts unnecessary.”).

184. *Id.*

185. *See id.* (“A note is presumed to be a ‘security,’ and that presumption may be rebutted only by a showing that the note bears a strong resemblance (in terms of the four factors we have identified) to one of the enumerated categories of instrument.”).

securities implicitly ask the same question: Is this note an investment?¹⁸⁶ Although the loans that are made by the bank to the individual borrowers in the most common model of P2P lending may not be investments, the securitized loans (i.e., the notes) that are sold to the individual lender definitely are investments. Arguing that the notes that are sold in P2P lending transactions to individual lenders are exempt from federal securities law would be similar to arguing the mortgage-backed securities that were at the heart of the most recent financial crisis are not securities. The concept behind both is the same, and a court is extraordinarily unlikely to rule that either is exempt from federal securities law.

Moreover, since the SEC and other regulatory agencies have deemed these notes securities, administrative deference would also apply to this issue. On November 24, 2008, the SEC issued a cease-and-desist order against Prosper Marketplace for selling unregistered securities.¹⁸⁷ The SEC alleged that Prosper Marketplace had violated Section 5(a) and (c) of the Securities Act by offering and selling securities without either filing an effective registration statement or having an exemption from registration.¹⁸⁸ The SEC determined that the notes at issue in the action were securities by applying the *Howey* test for investment contracts and the *Reves* test for notes covered by the Securities Act and Exchange Act.¹⁸⁹ Put another way, the SEC employed an approach similar to the analysis discussed above.

An even stronger argument that the notes in the most common model of P2P lending are securities is based upon the fact that the major for-profit P2P lending platforms have begun registering the notes that they sell as securities. At the time that the SEC issued its cease-and-desist order, Prosper Marketplace had already submitted a settlement offer, which the SEC had

186. *See id.* at 66–67 (stating four factors to be used to determine whether a note qualifies as a security).

187. Order Instituting Cease-And-Desist Proceedings against Prosper Marketplace, Inc., Securities Act Release No. 8984, 94 SEC Docket 1913 (Nov. 24, 2008) (cease-and-desist order).

188. *Id.* at *2.

189. *See id.* at *4–6 (applying both the *Howey* investment contract analysis and the *Reves* note analysis).

accepted.¹⁹⁰ Although the Order states that Prosper Marketplace had entered the settlement agreement “without admitting or denying the findings [in the Order], except as to the Commission’s jurisdiction over it and the subject matter of [the] proceedings,”¹⁹¹ one can hardly imagine any circumstance under which Prosper Marketplace would sacrifice the time and expense of registration, unless it believed the notes that it was offering and selling were securities subject to the Securities Act and the Exchange Act. Both Prosper Marketplace and LendingClub currently register the notes that they sell to individual lenders as securities.¹⁹² Because Prosper Marketplace and Lending Club have a strong financial incentive to avoid the costs of registration by finding any valid argument that the notes are not securities, questioning whether the notes are subject to federal securities law seems little more than an academic exercise.

One author, in a forthcoming article, has argued that the SEC could have decided that the notes sold in the note-based model of P2P lending should not be deemed securities.¹⁹³ In *The Misregulation of Person-to-Person Lending*,¹⁹⁴ Andrew Verstein argues that policy favors exempting P2P from securities regulation and that “[g]iven P2P’s potentially tremendous benefits, an ideal regulator would strive to expand and improve the industry.”¹⁹⁵ Verstein’s article is both thoroughly researched and well written. All of the arguments he makes are plausible and have some grounding in existing law.

The authors of this piece, however, dispute several aspects of Verstein’s analysis. First, he begins with the conclusion that online P2P should be allowed to develop unfettered by securities regulation.¹⁹⁶ Beginning with this policy conclusion weakens his

190. *Id.* at *1.

191. *Id.*

192. *See* Verstein, *supra* note 9, at 25 (stating that after the SEC’s cease-and-desist order against Prosper Marketplace that most P2P platforms registered with the SEC).

193. *See id.* at 62–67 (arguing that “P2P notes should be removed from the scope of the Securities Acts”).

194. *Id.*

195. *Id.* at 24.

196. *See id.* at 26 (stating that “SEC regulation of P2P lending was both unnecessary and harmful”).

case that existing law could have permitted the SEC to issue a finding that online P2P instruments are *not* securities.¹⁹⁷ He chides the SEC for sticking to law in its cease-and-desist order against Prosper Marketplace for selling unregistered securities because the SEC “did not offer policy justifications for [its] positions.”¹⁹⁸ The starting point in regulating a new financial product, however, is what the law says, not what one wishes policy would be. Although Verstein does make some valid points in his analysis of the *Howey* and *Reves* tests,¹⁹⁹ his analysis runs counter to the conclusions of regulators and the admissions of the industry that securities are being sold to individual lenders in P2P transactions.

Verstein does admit that his argument that P2P notes should be *legally* exempt from securities law may not be convincing.²⁰⁰ He ultimately advocates that P2P notes should be exempt from the federal securities acts.²⁰¹

As the GAO pointed out in its report, however, even if a new Congressional enactment excluded online P2P from the scope of *federal* securities regulation, state regulators could still decide the sites offered securities under *state* law.²⁰² The next section discusses the challenge online P2P has faced in the states, a regulatory concern Verstein does not engage.

B. State Securities Regulation and Peer-to-Peer Lending

State regulators have also been extremely active in the regulation of P2P lending. States have taken three basic approaches to regulating P2P sites. First, some states have prohibited online P2P sites from soliciting “investors” (lenders) in their states. Other states have allowed the sites to operate within

197. *See id.* at 27–34 (arguing that the SEC overreached when determining that online P2P instruments qualified as investment contracts or notes).

198. *Id.* at 25.

199. *See id.* at 27–34 (analyzing the online P2P instruments under the *Howey* and *Reves* tests).

200. *See id.* at 26 (stating that “it is plausible that P2P notes were either ‘investment contracts’ or ‘notes’ for the purposes of the Securities Acts”).

201. *See id.* at 62 (“P2P notes should be removed from the scope of the federal Securities Acts.”).

202. GAO REPORT, *supra* note 6, at 44.

their borders according to the business models provided by those sites. A third approach has been to authorize such sites but limit “investment” to sophisticated investors.

1. Prohibiting States

Most of the states that have restricted online P2P lending have targeted only the “investor” or lender side of the P2P equation. Currently, twenty-one states ban Prosper.com from soliciting investors.²⁰³ A few states have gone further, prohibiting both investing and borrowing via the sites.²⁰⁴ LendingClub does not service borrowers in eight states.²⁰⁵

Rather than discussing each of the states’ approaches, this section discusses one “representative” prohibiting state to illuminate the foundation of the prohibition approach. Ohio, through its Department of Commerce, Division of Securities, blocked Prosper.com from accepting “investors.” The Chief Registration Counsel for the Division published a conference presentation discussing the state’s reasoning.²⁰⁶

Ohio requires “merit review” for securities registrants, in which the Division of Securities must find that “the business of the issuer is not fraudulently conducted . . . that the plan of issuance and sale of the securities . . . would not defraud or deceive.”²⁰⁷ Prosper.com’s registration statement included among identified “risk factors” the statement: “Information supplied by borrowers

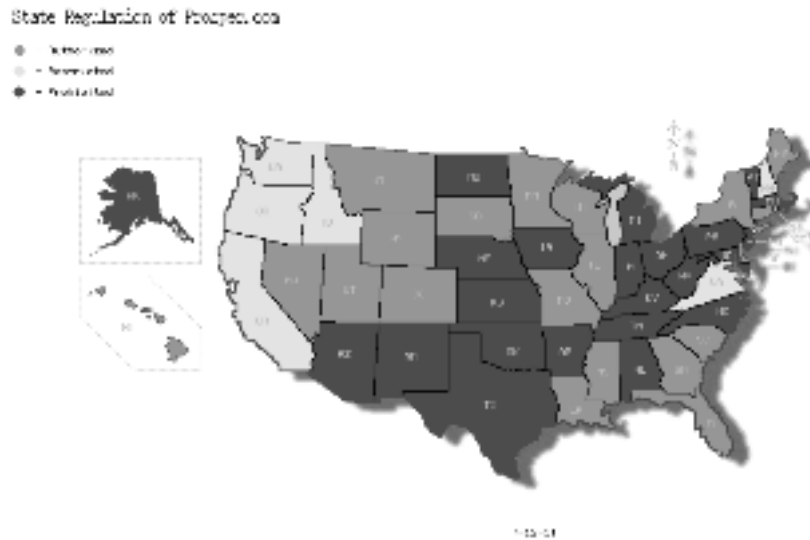
203. Those states are Alabama, Arizona, Arkansas, Indiana, Iowa, Kansas, Kentucky, Maine, Maryland, Massachusetts, Michigan, Nebraska, North Carolina, North Dakota, Ohio, Oklahoma, Pennsylvania, Tennessee, Texas, Vermont, and West Virginia. Prosper.com, *Legal Compliance*, <http://www.prosper.com/legal/compliance.aspx> (last visited Apr. 8, 2012) (on file with the Washington and Lee Law Review).

204. Borrowing is prohibited in Iowa, Maine, and North Dakota. *Id.*

205. Those states are Idaho, Indiana, Iowa, Mississippi, Nebraska, North Carolina, North Dakota, and Tennessee. See LENDINGCLUB CORP., PROSPECTUS DATED JUNE 10, 2011, at 90, available at https://www.lendingclub.com/extdata/Clean_As_Filed_20110610.pdf.

206. See generally Mark R. Heuerman, Ohio Division of Securities, *Peer-to-Peer (P2P) Lending and Internet Platforms: Ohio Securities Act Implications*, available at <http://com.ohio.gov/secu/docs/Conference2010/MarkHeuermanP2P.pdf>.

207. OHIO REV. CODE ANN. § 1707.09(G)(2) (West 2012).



may be inaccurate or intentionally false. Information regarding income or employment is not verified in the majority of cases.”²⁰⁸ This led the Division to conclude that it was unable to find the business was not fraudulently conducted as required by Ohio law.

Other issues that led to the Ohio decision include the possibility that Prosper “itself may fall within the definition of a dealer by charging a fee for listing the notes on the platform,”²⁰⁹ which would require it to comply with broker–dealer regulations. The Division also worried that Prosper might be considered an “exchange,” in which case it would have to comply with the requirements for an exchange.²¹⁰

Of course, prohibiting a site from operating within a state may not stop some enterprising would-be site users from finding a way on to the site. In the brick-and-mortar world of yesterday’s securities regulation, regulators knew where to go to stop a fraudster from bilking investors. Responding to their denial of access to Ohio residents, the sites could (and may indeed have) limited access to investing options based on an Ohio Internet protocol address being associated with the would-be user. But by

208. Heuerman, *supra* note 206, at 5.

209. *Id.* at 8.

210. *Id.* at 8–10.

crossing in to a neighboring state and setting up an account with a “fake” out-of-state address, a person might be able to evade well-meaning regulators’ reach.²¹¹

2. Authorizing States

Twenty states, and the District of Columbia, authorize both borrowing and lending via Prosper with no restrictions.²¹² Twenty-eight states authorize investment and borrowing via LendingClub.²¹³ These states tend to be ones that mirror the SEC’s approach to securities offerings, which does not involve merit review but simply requires disclosure.²¹⁴

3. States Authorizing with Conditions

A third group of six states authorize investing via online P2P sites but only for sophisticated investors meeting “suitability”²¹⁵

211. See *Forum Post* by “HornzUp,” LENDING CLUB PEER-TO-PEER LENDING THREAD (Jan. 1, 2011, 11:31 AM), <http://www.shaggybevo.com/board/showthread.php/79967-Lending-Club-lt-peer-to-peer-lendinggt?s=1fd327778284852e50eebc3fa1f818&p=2378532&viewfull=1#post2378532> (last visited Apr. 8, 2012) (“I created an account, with a fictional out of state address. No errors in account creation and I am getting emails asking me to go through with the set up and move money over from my checking account.”) (on file with the Washington and Lee Law Review).

212. Those states are Colorado, Delaware, Florida, Georgia, Hawaii, Illinois, Louisiana, Maine, Minnesota, Mississippi, Missouri, Montana, Nevada, New York, Rhode Island, South Carolina, South Dakota, Utah, Wisconsin, Wyoming, and the District of Columbia. *Legal Compliance*, *supra* note 203.

213. Peter Renton, *Which States Are Open to Lending Club and Proper Investors*, SOC. LENDING NETWORK (May 11, 2011), <http://www.sociallending.net/investing-lending/which-states-are-open-to-lending-club-and-prosper-investors/> (last visited Apr. 8, 2012) (on file with the Washington and Lee Law Review).

214. See GAO REPORT, *supra* note 6, at 28 (noting that more disclosure-based states than merit-based states authorize investment and borrowing via Prosper and LendingClub).

215. Investor “suitability” describes “the duty of licensed securities dealers to recommend investment products that are suitable to their clients, in light of the clients’ investment objectives and financial means.” Michael Bennett, *Complexity and its Discontents: Recurring Legal Concerns with Structured Products*, 7 N.Y.U. J. L. & BUS. 811, 817 (2011).

requirements.²¹⁶ In most of these states, Prosper lending is limited to \$250,000-net-worth individuals (excluding home) or individuals with a \$70K income and \$70K net worth.²¹⁷ California imposes less stringent requirements and does so only for Prosper investors who put in more than 10% of their net worth (to do so, investors must have a net worth of \$85,000 and an income of \$85,000 during the last tax year or a net worth of \$200,000).²¹⁸ LendingClub is limited to soliciting loans in Kentucky only for individuals with \$200,000 income in the past two years or \$1 million in net worth.²¹⁹

Among the reasons states impose such restrictions are the financial health of the platforms themselves. States imposing such restrictions have cited “the risks lenders face, particularly related to their reliance on the platforms to screen borrowers and service the loans, the companies’ limited verification of information supplied by borrowers, and the novelty and untested nature of person-to-person lending.”²²⁰ Both sites have faced concerns about their profitability; Prosper, which has lost money since its inception and which, in SEC filings, stated that it might not “continue as a going concern.”²²¹

IV. Creating a Coherent Regulatory Scheme for Online Peer-to-Peer Lending

The current regulatory regime for P2P lending is arguably a paper tiger. As explained in the previous section, under the most commonly used model for P2P lending, the borrower is protected by robust banking regulations that are designed to protect that individual from the bank that originates the loan.²²² Lenders are

216. Those states are Idaho, New Hampshire, Virginia, Oregon, and Washington. *Legal Compliance*, *supra* note 203.

217. Hunsberger, *supra* note 12.

218. *Legal Compliance*, *supra* note 203.

219. *Supplement to Prospectus Dated July 30, 2009*, LENDINGCLUB, available at https://www.lendingclub.com/extdata/ky_prospectus.pdf.

220. GAO REPORT, *supra* note 6, at 29.

221. Prosper Marketplace, Inc., Quarterly Report (Form 10-Q), at 51 (Nov. 12, 2010), available at <http://www.sec.gov/Archives/edgar/data/1416265/000141626510000490/p10q9d30d2010.htm#notestofinancialstatementsq32010>.

222. See *supra* notes 124–33 and accompanying text (listing various statutes that are applicable to the most commonly used model of P2P lending because of

protected by robust federal and state securities regulation because notes, i.e., securities, are sold to individual lenders with payment on the notes being contingent upon repayment of the underlying loan issued by the bank.²²³ If a P2P lending platform wanted to remove itself from this robust regulatory regime, the answer is simple: Remove the bank. For example, a platform could avoid having to comply with banking laws and securities regulation simply by providing a service that connects individual lenders to individual borrowers for a fee. Providing such connections between individuals interested in borrowing and individuals willing to lend is a valuable service, even if a platform provides nothing else.²²⁴

If a P2P lending platform opted to provide a service that connected individual lenders to individual borrowers, although some additional laws might apply, such a model of P2P lending would be chiefly regulated by civil and criminal antifraud laws. On the federal level, for example, the United States Department of Justice would likely take a leading role in regulating P2P lending through the use of the federal mail fraud²²⁵ and wire fraud²²⁶ statutes and through the use of the Racketeer Influenced and Corrupt Organizations Act²²⁷ (RICO), under which mail fraud and wire fraud are predicate crimes.²²⁸ Under this type of model, a robust and narrowly tailored system of regulation would be replaced by a thin and loosely tailored system of regulation. In addition, under such a model, most of the mandated *ex ante* disclosure of information that is required under the current commonly used model would be foregone in favor of *ex post* relief from wrongdoing under civil and criminal antifraud laws.

Because models of P2P lending can vary so drastically, creating a new coherent regulatory regime for such lending will be extraordinarily difficult. Congress has shown some interest in

the involvement of banks in the lending process).

223. See *supra* Part III (discussing the application of federal and state securities law to the most commonly used model of P2P lending).

224. See *supra* notes 15–17 and accompanying text (discussing valuable service that P2P lending sites provide by connecting individual borrowers with individual lenders).

225. 18 U.S.C. § 1341 (2006).

226. *Id.* § 1343.

227. *Id.* §§ 1961–1968.

228. *Id.* § 1961.

modifying the existing regulatory regime for P2P lending, but Congress may take a substantial amount of time before it addresses the issue. Ultimately, Congress should adopt an approach that allows P2P lenders to be regulated in a similar manner as traditional banking entities. Multiple regulators should have oversight over P2P lending with each regulator being empowered to regulate the specific aspects of P2P lending that fall within its purview and areas of expertise. Such an approach would allow the regulatory regime to grow organically as P2P lending continues to morph and evolve.

A. Peer-to-Peer Lending and the Dodd–Frank Act

Section 989F of the Dodd–Frank Act mandated that the Comptroller General of the United States and the United States Government Accountability Office (GAO) conduct a study to “determine the optimal Federal regulatory structure” for P2P lending.²²⁹ In conducting the study, the Comptroller General and GAO were required by section 989F to consult with a wide variety of entities including, “[F]ederal banking agencies, the [United States Securities and Exchange] Commission, consumer groups, outside experts, and the person to person lending industry.”²³⁰ Congress specifically mandated that the content of the study include an analysis of:

(A) the regulatory structure as it exists . . . , as determined by the [Securities and Exchange] Commission, with particular attention to—

(i) the application of the Securities Act of 1933 to person to person lending platforms;

(ii) the posting of consumer loan information on the EDGAR database of the Commission; and

(iii) the treatment of privately held person to person lending platforms as public companies;

229. Dodd–Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 989F, 124 Stat. 1376, 1947 (2010) (to be codified at 5 U.S.C. app. 3 § 11).

230. *Id.* § 989F(a)(2).

(B) the State and other Federal regulators responsible for the oversight and regulation of person to person lending markets;

(C) any Federal, State, or local government or private studies of person to person lending completed or in progress on the date of enactment of this Act;

(D) consumer privacy and data protections, minimum credit standards, anti-money laundering and risk management in the regulatory structure . . . , and whether additional or alternative safeguards are needed; and

(E) the uses of person to person lending.²³¹

Congress also required that the Report analyze “alternative regulatory options . . . [and] whether the alternative approaches [would be] effective.”²³²

Mandating a study represented a compromise between the United States House of Representatives and the Senate. Prosper Marketplace had lobbied both the House and the Senate extensively to make the CFPB the primary regulator of P2P lending and to exempt P2P lending from securities law.²³³ Representative Jackie Speier, a Democrat from California, sponsored a provision in the House version of the financial regulatory reform bill that would have placed P2P lending under the supervision of the CFPB and removed it from SEC oversight.²³⁴ The Senate refused to pass a similar provision.²³⁵ By the time that the Dodd–Frank Act was signed into law on July 21, 2010, lawmakers had reached the compromise embodied in Section 989F of the Act requiring a study.²³⁶

Dodd–Frank’s Section 989F offers several lessons. First, Congress has a genuine interest in creating a coherent system of regulation for P2P lending. Second, Congress is in need of

231. *Id.* § 989F(a)(3).

232. *Id.* § 989F(b)(2).

233. See Silla Brush, *Online Lender Lobbies Congress for Industry Consumer Regulator*, THE HILL (June 9, 2010, 6:23 PM), <http://thehill.com/business-a-lobbying/102323-online-lender-lobbies-congress-for-industry-consumer-regulator> (last visited Apr. 8, 2012) (detailing Prosper’s lobbying efforts) (on file with the Washington and Lee Law Review).

234. *Id.*

235. *Id.*

236. See Brill, *supra* note 100, at 3 (noting that the negotiators reconciling the House and Senate bills “reached a compromise” before the Act was signed into law).

sophisticated information about P2P lending and how to regulate it. Third, Congress, or at least the Senate, is unwilling to take radical steps in regulating P2P lending, e.g., assigning the regulation of such lending to a new and untested CFPB, until more information is available.

B. The GAO Report on Online Peer-to-Peer Lending

On July 7, 2011, the GAO issued the mandated report.²³⁷ The Report is aptly titled *Person-to-Person Lending: New Regulatory Challenges Could Emerge as the Industry Grows*.²³⁸ The title reflects both that P2P lending continues to grow and evolve and that any regulatory regime will need to continue to grow and evolve along with it.

The Report is divided into three main sections.²³⁹ The first section details the lending models for the major for-profit (LendingClub and Prosper Marketplace) and nonprofit (Kiva) P2P lending platforms operating in the United States.²⁴⁰ The second section discusses the potential benefits and risks of P2P lending and the current regulatory regime governing such lending.²⁴¹ Finally, the third section of the Report discusses options for regulating P2P lending going forward.²⁴²

The first and second sections of the Report are thorough and well written. This is little surprise considering the access, resources, and expertise of the Controller General and the Government Accountability Office. Notably, the drafters of the Report had extensive access to a wide range of industry participants and regulators during the drafting process.²⁴³

The third main section of the Report, however, is a disappointment. The Report addresses only two possible models for

237. See generally GAO REPORT, *supra* note 6.

238. *Id.*

239. See *id.* at i (Table of Contents).

240. *Id.* at 7–17.

241. *Id.* at 18–42.

242. *Id.* at 42–56.

243. See *id.* at 60–63 (discussing the objectives, scope, and methodology in compiling the Report).

regulating P2P lending, which can be boiled down to the following single, lengthy sentence:

We identified two primary options for regulating person-to-person lending that differ primarily in their approach to lender protection: (1) continuing with the current bifurcated federal system—that is, protecting lenders through securities regulators and borrowers primarily through financial services regulators, which will include the newly formed CFPB—or (2) consolidating borrower and lender protection under a single federal regulator, such as CFPB.²⁴⁴

The drafters of the Report do provide some additional analysis of these models in the remainder of the section, but at an unfortunately high level of abstraction.²⁴⁵

This level of abstraction is in a sense unsurprising given the current state of the P2P industry. As the drafters of the GAO Report note, “The continuing evolution and growth of person-to-person lending could give rise to new regulatory concerns or challenges, making it difficult to predict what the optimal regulatory structure will be.”²⁴⁶ Although the drafters could have suggested a variety of radical approaches to regulating P2P lending, they discussed the two models that offer the most flexibility and likely the best use of existing expertise. However, one cannot help but be disappointed that the drafters did not discuss a wider range of regulatory options.

C. Choosing Among a Myriad of Regulatory Options

A myriad of options exist for regulating P2P lending. Some of the more radical options include:

- Allowing the Online P2P Lending Industry to Self-Regulate
- Creating an Administrative Agency to Specifically Regulate P2P Lending
- Regulating P2P Lending Similar to Online Gambling

244. *Id.* at 42.

245. *See id.* at 42–56 (providing abstract analysis of both a bifurcated and a consolidated regulatory regime).

246. *Id.* at 54.

- Developing a Harmonized International System of P2P Lending Regulation
- Creating an International Entity to Regulate P2P Lending²⁴⁷

All of these options would likely prove too radical for an industry that continues to grow and evolve and entails so many diverse models of lending. Instead, the two options identified in the GAO Report are the most likely paths forward.

Even among the two choices examined in the GAO Report, however, placing P2P lending under the purview of a single regulatory entity, such as the CFPB, would also be a radical step because it limits the regulatory supervision of the industry, excludes various regulators from using their specific expertise, increases concerns about regulatory capture, and creates concerns about inhibiting the evolution of a growing and changing industry. Prosper Marketplace may have lobbied the House and Senate extensively to place P2P lending under the auspices of the CFPB,²⁴⁸ but one has to wonder about its motives. This is especially true because both Prosper Marketplace and LendingClub admit that they are selling “highly risky and speculative” securities.²⁴⁹ Prosper Marketplace wants all

247. One of the authors of this Article has argued extensively for the international harmonization and centralization of securities regulation. *See, e.g.*, Eric C. Chaffee, *Contemplating the Endgame: An Evolutionary Model for the Harmonization and Centralization of International Securities Regulation*, 79 U. CIN. L. REV. 587 (2010); Eric C. Chaffee, *Finishing the Race to the Bottom: An Argument for Harmonization and Centralization of International Securities Law*, 40 SETON HALL L. REV. 1581 (2010); Eric C. Chaffee, *The Internationalization of Securities Regulation: The United States Government's Role in Regulating the Global Capital Markets*, 5 J. BUS. & TECH. L. 187 (2010); Eric C. Chaffee, *Evolution, Not Revolution, in International Securities Regulation: A Modest Proposal for a Global Securities and Exchange Commission* (forthcoming); Eric C. Chaffee, *A Moment of Opportunity: Reimagining International Securities Regulation in the Shadow of Financial Crisis*, 15 NEXUS 29 (2010). Neither of the authors, however, would argue for the international harmonization and centralization of P2P lending regulation at this point. Both authors agree that both the industry and national regulation need to develop further before international coordination could possibly be attempted in any meaningful way.

248. *See* Brush, *supra* note 233 (detailing Prosper's lobbying efforts to have P2P lending regulated solely by the CFPB).

249. *See supra* notes 120–21 and accompanying text (containing language from Prosper Marketplace's prospectus and LendingClub's prospectus stating that the notes that they sell are “highly risky and speculative”).

the benefits of selling securities without the robust regulatory protections for investors that come along with it. Frankly, by involving banks and selling securities in its model of P2P lending, Prosper Marketplace opted into supervision by both banking and securities regulators, and it should not be allowed to cry foul because it does not like the model that it chose. Regulation solely by the CFPB is defensible if the only or primary concern with online P2P lending is the protection of would-be borrowers from excessive interest rates or the extension of credit that they would be unable to repay. But with online P2P lending, an equally important concern is the protection of investors, who purchase securities and sink funds in what are likely risky and dangerous investments. The new CFPB, unlike federal and state securities regulators, lacks a proven track record of protecting and educating individuals purchasing securities.

Verstein and others assert that the emerging online P2P industry is being stifled by overregulation,²⁵⁰ but the industry is continuing to grow. Perhaps, the industry is not growing as fast as it might be, but traditionally, underregulated financial services industries grow quickly until they suffer a dramatic crash.²⁵¹

This is not to say that the CFPB should play no role in the regulation of P2P lending. In a multiple regulator model, the CFPB would obviously be one of the regulators with oversight of the P2P lending industry. In the event that a pure model of online P2P lending gains popularity, i.e., one in which platforms connect individual borrowers to individual lenders for a fee without involving a bank, the CFPB would likely play a very robust role in regulating both borrowers and lenders. That type of model, however, is not the one commonly used in P2P lending today, and the issue of a more robust role for the CFPB is not ripe for consideration.

250. See Verstein, *supra* note 9, at 59 (arguing that P2P lenders may be a “mere victim” of SEC over-regulation).

251. See Eric C. Chaffee, *Standing Under Section 10(b) and Rule 10b-5: The Continued Validity of the Forced Seller Exception to the Purchaser-Seller Requirement*, 11 U. PA. J. BUS. L. 843, 851 (2009) (stating that Congress promulgated the Securities Act and Exchange Act in the wake of the stock market crash of 1929 because state securities statutes were “largely ineffective in preventing fraud”); see also Eric C. Chaffee, *Beyond Blue Chip: Issuer Standing to Seek Injunctive Relief Under Section 10(b) and Rule 10b-5 Without the Purchase or Sale of Security*, 36 SETON HALL L. REV. 1135, 1138–40 (2006) (discussing the rise of federal securities law in the United States in the wake of the stock market crash of 1929).

The ideal approach to regulating online P2P lending should be organic and multifaceted. Multiple regulators should continue to have oversight and use their individual expertise from regulating traditional lending and securities investments to create and adapt regulation to the evolving world of online P2P lending. Such an approach will allow the regulatory scheme for P2P lending to grow and evolve along with the industry.

D. The Path Forward

In the short-term, Congress should adopt a wait-and-see approach to regulating P2P lending. The lending model used by both Prosper and LendingClub is adequately regulated by existing law. Individual borrowers are protected by a thick and robust system of lending regulation,²⁵² and individual lenders are protected by a thick and robust system of securities law.²⁵³ Regulatory agencies should be given an opportunity to use their expertise to determine how existing statutes and regulations should be applied to P2P lending and the opportunity to promulgate new regulations based on their existing statutory mandates.

Assuming that Prosper and LendingClub continue to be the dominant players in the P2P industry, and assuming that they continue to use the same model for P2P lending, Congress may need to modify existing statutes to better protect the parties in P2P transactions. With that said, however, P2P lending remains a nascent industry, and if Congress acts too quickly, it may stifle its ability to evolve in healthy and useful ways. In the long-term, the CFPB may be the correct entity to regulate P2P, but it is far too early to decide this issue. Placing P2P within the purview of any agencies, including the CFPB, would be a mistake because flexibility is needed to regulate an industry that continues to morph and reinvent itself.

252. See *supra* notes 124–33 and accompanying text (discussing some of the federal lending regulations that are applicable to the model of P2P lending used by Prosper and LendingClub because of their use of a bank in the P2P lending process).

253. See *supra* Part III (discussing the applicability of federal and state securities regulation to the model of P2P lending used by both Prosper and LendingClub).

V. Conclusion

While Section 989F of the Dodd–Frank Act evidences Congress’s interest in regulating P2P lending, Congress may take a substantial amount of time to promulgate such regulation. The Dodd–Frank Act mandates a plethora of studies for purposes of potential future regulation, and the study required by Section 989F is just one among dozens mandated to be conducted under the Act.²⁵⁴ Although the

254. See, e.g., Dodd–Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 123, 124 Stat. 1376, 1412 (2010) (mandating a study of the effects of size and complexity of financial institutions on capital market efficiency and economic growth) (to be codified at 12 U.S.C. § 5333); *id.* § 202(f) (mandating a study of international coordination relating to the bankruptcy process for financial companies) (to be codified at 12 U.S.C. § 5382); *id.* § 215 (mandating a study of secured creditor haircuts) (to be codified at 12 U.S.C. § 5394); *id.* § 216 (mandating a study of the bankruptcy process for financial and nonbank financial institutions) (to be codified at 12 U.S.C. § 5394); *id.* § 217 (mandating a study of international coordination relating to the bankruptcy process for nonbank financial institutions) (to be codified at 12 U.S.C. § 5394); *id.* § 415 (mandating a study of the criteria for accredited investor status and eligibility to invest in private funds) (to be codified at 15 U.S.C. § 80b-18c); *id.* § 416 (mandating a study of a self-regulatory organization for private funds) (to be codified at 15 U.S.C. § 80b-18c); *id.* § 417 (mandating a study of short selling) (to be codified at 15 U.S.C. § 80b-18c); *id.* § 526 (mandating a study of the nonadmitted insurance market) (to be codified at 15 U.S.C. § 8205); *id.* § 603(b)(1) (mandating a study of the treatment of credit card banks, industrial loan companies, and certain other companies under the Bank Holding Company Act of 1956) (to be codified at 12 U.S.C. § 1815); *id.* § 620 (mandating a study of bank investment activities) (to be codified at 12 U.S.C. § 1851); *id.* § 750 (mandating a study on oversight of the carbon markets) (to be codified at 12 U.S.C. § 4421); *id.* § 913 (mandating a study regarding the obligations of brokers, dealers, and investment advisers) (to be codified at 15 U.S.C. § 78o); *id.* § 914 (mandating a study on enhancing investment adviser examinations) (to be codified at 15 U.S.C. § 80b-1); *id.* § 917 (mandating a study regarding financial literacy among investors) (to be codified at 15 U.S.C. § 78s); *id.* § 918 (mandating a study regarding mutual fund advertising) (to be codified at 15 U.S.C. § 78s); *id.* § 919A (mandating a study of conflicts of interest within the investment industry) (to be codified at 15 U.S.C. § 78o); *id.* § 919B (mandating a study on improved investor access to information regarding investment advisers and broker-dealers) (to be codified at 15 U.S.C. § 80b-10); *id.* § 919C (mandating a study on financial planners and the use of financial designations) (to be codified at 15 U.S.C. § 80b-10); *id.* § 929Y (mandating a study on the extraterritorial application of private rights of action under the Securities Exchange Act of 1934) (to be codified at 15 U.S.C. § 78o); *id.* § 929Z (mandating a study on securities litigation) (to be codified at 15 U.S.C. § 78o); *id.* § 939C (mandating a study on strengthening credit-rating-agency independence) (to be codified at 15 U.S.C. § 78m); *id.* § 939D (mandating a study on alternative business models for compensating statistical-rating

Comptroller General and Government Accountability Office completed its study of P2P lending on time, Congress may take years to react to it.

When Congress does ultimately address P2P lending, hopefully it will take an approach that mirrors traditional lending and allows the P2P lending industry to continue to evolve. P2P lending is not a static or fixed concept, and the regulatory regime will need to be able to grow and evolve along with it.

organizations) (to be codified at 15 U.S.C. § 780-9); *id.* § 939E (mandating a study regarding creating an independent professional organization for rating analysts employed by nationally recognized statistical-rating organizations) (to be codified at 15 U.S.C. § 780-9); *id.* § 939F (mandating a study of assigned credit ratings) (to be codified at 15 U.S.C. § 780-9); *id.* § 946 (mandating a study of the macroeconomic effects of risk-retention requirements relating to asset-backed securities) (to be codified at 15 U.S.C. § 77g); *id.* § 967 (mandating a study relating to organization reform within the SEC) (to be codified at 15 U.S.C. § 78d-4); *id.* § 968 (mandating a study relating to the “revolving door” between the SEC and private sector financial institutions) (to be codified at 15 U.S.C. § 78d-4); *id.* § 976 (mandating a study regarding increased disclosure to investors by issuers of municipal securities) (to be codified at 15 U.S.C. § 780); *id.* § 977 (mandating a study of the municipal securities markets) (to be codified at 15 U.S.C. § 780); *id.* § 989 (mandating a study of proprietary trading by various financial institutions) (to be codified at 12 U.S.C. § 1790d); *id.* § 989F (mandating a study of person-to-person lending) (to be codified at 5 U.S.C. app. 3 § 11); *id.* § 989I (mandating a study regarding the exemption for smaller issuers from Section 404(b) of the Sarbanes–Oxley Act of 2002) (to be codified at 5 U.S.C. app. 3 § 5); *id.* § 1074 (mandating a study on ending the conservatorship of Fannie Mae and Freddie Mac and reforming the housing finance system) (to be codified at 15 U.S.C. § 1757); *id.* § 1076 (mandating a study on reverse mortgage transactions) (to be codified at 12 U.S.C. § 5602); *id.* § 1078 (mandating a study on credit scores) (to be codified at 12 U.S.C. § 5602); *id.* § 1406 (mandating a study of shared-appreciation mortgages) (to be codified at 15 U.S.C. § 1601); *id.* § 1446 (mandating a study on default and foreclosure of home loans) (to be codified at 12 U.S.C. § 1701x); *id.* § 1476 (mandating a study on the effectiveness and impact of various appraisal methods, valuation models and distributions channels, and on the Home Valuation Code of conduct and the Appraisal Subcommittee) (to be codified at 12 U.S.C. § 2603); *id.* § 1492 (mandating a study on government efforts to combat mortgage foreclosure rescue scams and loan-modification fraud) (to be codified at 12 U.S.C. § 1437f); *id.* § 1494 (mandating a study on the effect of the presence of drywall imported from China during the period beginning with 2004 and ending at the end of 2007 on foreclosures) (to be codified at 12 U.S.C. § 1715z-25); *id.* § 1506 (mandating a study of core deposits and brokered deposits) (to be codified at 15 U.S.C. § 78m).