

REGULATION OF CROWDLENDING IN THE EUROPEAN UNION

Understanding the suitability of EU legislation
for crowdlending.

Thesis – LL.M International Business Law

Aleix Vidal Monés

Tilburg University

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Student name	Aleix Vidal Monés
Supervisor	Gil-Lemstra, P. (LLM)
SNR	233888
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ABSTRACT

This paper works about the added value of crowdlending as a source of funding, its characteristics opportunities, risks and regulatory implications for the European Union (EU).

In concrete, the thesis' research is mainly focused on discovering whether the European fragmented regulatory scenario it is an appropriate playground for the crowdlending sector development.

The conclusions are clear. They point out that the current EU regulatory panorama does not fit the needs of the crowdlending sector. In this sense, legislative action from the EU institutions is required to turn the "state by state" based crowdlending sector into a common European industry.

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I.- INTRODUCTION

A) Presentation of the topic:

Crowdlending is a new model of financing based on online platforms through which internet users can lend certain¹ amounts of money to or companies.

Crowdlending platforms can be defined as virtual places where lenders and borrowers have the opportunity to “meet” and match their respective demands and offers. Therefore, platforms work as intermediaries. They facilitate virtual places where lenders can get a credit claim to receive interest and redemption payments in the future from borrowers.

This new model allows funding directly from the crowd, presenting itself as an alternative or complement² to the traditional bank financing system. individuals

Depending on a country-based approach, or on the scholar’s preferences, crowdlending can be referred to either “marketplace lending” or “peer-to-peer lending (P2P)”, indicating this last term that platform’s users are directly lending money to their peers. However, for the purposes of the present thesis I will use the term “crowdlending”.

Crowdlending can help restoring the close connection between the financial world and the “real economy”³. The emergence of certain types⁴ of investment banking and financial activities has moved away credit entities from financing the traditional productive fabric. Crowdlending cuts unnecessary complexity as well as the bank presence, features that lead to economic efficiency and investor’s attraction.

Some authors⁵ foresee crowdlending prevailing as an economically superior form of lending organization compared to the traditional banking business model. A similar idea holds Mark

¹ Loan amounts can be filled by either small amounts and many lenders or big amounts from few investors. Would be possible the presence of just one investor lending the whole borrowed quantity. The amount of money lent per each loan, and the number of investors might be limited by the same platforms and by law.

² The same platforms consider crowdlending as a complement to the traditional bank financing system by the moment. However, it is foreseen as a credible alternative in the long-term. LOANBOOK CAPITAL; “*Crowdlending ¿Como conseguir financiación complementaria ágil y transparente?*” and GABISON Garry A, “*Understanding Crowdfunding and its Regulations*”, Joint Research Center and Policy Report, European Commission (2015) .

³ “Real Economy” is a concept used by the financial scholar Eugenia Macchiavello in her research paper MACCHIAVELLO, E; “*Peer-to-Peer Lending and the Democratization of Credit Markets: Another Financial Innovation Puzzling Regulators*”, 21 Columbia Journal, HeinOnline p.580 (2015) . The FINANCIAL TIMES on-line lexicon dictionary defines this term as: “the part of the economy that is concerned with actually producing goods and services, as opposed to the part of the economy that is concerned with buying and selling on the financial markets”. Definition available in <http://lexicon.ft.com/term?term=real-economy>.

⁴ The connection between the “Real Economy” and the financial world has been weakened due to the rise of certain types of investment banking, a much greater focus on real state and derivatives, as well as the rise of speculative and high frequency trading activities among others. LENZ, R; “*Peer-to-peer: Opportunities and Risks*” European Journal of Risk and regulation, Cambridge University Press, HeinOnline (2016) Page 700.

⁵ LENZ, R; “*Peer-to-peer: Opportunities and Risks*” European Journal of Risk and regulation, Cambridge University Press, HeinOnline (2016) Page 699. And BORELLO. G, DE CRESCENZO. V, PICHLER. F; “*The Funding Gap and The Role*

Carney⁶, who defines crowdlending as one of the new financial technologies (FinTechs)⁷, which are capable to deliver a more resilient financial infrastructure, more inclusive, with people better connected and users more informed and empowered. He considers FinTech to be the tool to re-shape the financial system.

When looking for more yields, retail and institutional investors are switching from traditional banking systems to crowdlending⁸. However, the lending world is still a business, and lenders do not get higher returns⁹ for nothing in exchange. In that sense crowdlending represents a much more risky investment than traditional deposits¹⁰.

Crowdlending shows features and risks from traditional financial models, as well as presents new platform-specific risks. It is important to briefly outline the following examples¹¹:

- High borrower's default risk (unsecured loans).
- Risk of platform closure (temporary or permanent) or failure.
- Risk of fraud (money laundering, identity theft, terrorism financing, consumer privacy and data protection violations).
- Risk of illiquidity (no secondary market for most platforms).
- Risk of cyber-attack.
- Risk of information asymmetry harming the investor position.
- Risk of investor inexperience.

In accordance with the above mentioned risks, regulation arises as one of the key tools to create a solid framework for crowdlending development.

of Financial Return Crowdfunding: Some evidence from European platforms" Journal of Internet Banking Commerce, page 19.

⁶ Bank of England Governor's Speech; *"Enabling the FinTech transformation: Revolution, Restoration or Reformation?"* (16th June 2016). Speech available at <http://www.bankofengland.co.uk/>

⁷ *"Financial technology—FinTech for short— describes the evolving intersection of financial services and technology. (...) The term can refer to startups, technology companies, or even legacy providers. The lines are blurring, and it's getting harder to know where technology ends and financial services begin."* CARR. M; PRICEWATERHOUSECOOPERS LLP; *"What is FinTech?"*, PRICEWATERHOUSECOOPERS LLP, A publication of PwC's Financial Services Institute (2016).

⁸ LENZ, R; *"Peer-to-peer: Opportunities and Risks"* European Journal of Risk and regulation, Cambridge University Press, HeinOnline (2016), page 681.

⁹ Crowdlending gives higher rate of return than through traditional investments, such as a savings account or government bonds. KIRBY. E, and WORTNER. S; *"Crowd-funding: an infant industry growing fast"*. OICV- IOSCO (2014), page 14.

¹⁰ The art. 6 Directive (EU) 2014/49 on Deposit Guarantee Schemes, forces member states to ensure that the coverage level for the aggregate deposits of each bank depositor is 100 000€, in the event of deposits being unavailable. In contrast, the money invested in crowdlending platforms do not have any guaranty in case of borrowers or platforms bankruptcy.

¹¹ ENRIA. A; *"Opinion of the EBA on lending-based crowdfunding."* EUROPEAN BANKING AUTHORITY, London (2015), page12.

However, focusing on the EU level, it is shocking the passivity of the European Authorities in addressing any kind of regulatory activity to embrace such a promising technology. Indeed, the EU passivity has favored member state's legislators to lead the way in crowdlending risks mitigation.

United Kingdom (UK) was the first country to create a legal system surrounding Crowdlending. The UK government promoted the crowdlending sector since it realized that could be a good choice for SMEs to achieve easier financing.

Following the path opened by the UK, many other European countries started developing regulation addressed to crowdlending activities, such as France, Portugal or Spain. However, it does not exist a common regulatory pattern within EU. Therefore, the different legislative approaches adopted by every EU jurisdiction, constitute a "state by state" regulatory map.

Consequently, the EU has not addressed to the crowdlending industry any bespoke regulatory action yet. Nevertheless, a likely EU legislative activity would be determinant for the future development of crowdlending within one of the principal worldwide financial markets (the EU).

General numbers of the industry:

According to the most optimist sources, the size¹² of the crowdlending phenomenon it is expected to reach in 2018 a worldwide transaction value of crowdlending lending loans of €455,124 billion. The leading country is China with almost 90% of the total transaction value, followed by United States 9% and UK 1%.

Less optimist sources¹³ are projecting a global crowdlending market reaching €374 billion by 2022, growing at a compound annual rate of 50% from 2016 to 2022.

In the European scenario, the UK crowdlending industry has lead the sector exchanging more than £3 billion in 2017, and it is expected to see much more activity during the present 2018¹⁴.

However, the UK more than doubles the transaction value of the top 5 successful crowdlending EU countries. Therefore, the EU as an economic entity (excluding UK) is proportionally far away from the worldwide strongest crowdlending markets (China, USA and UK).

¹² The website portal STATISTA distinguishes between: I) Crowdlending, such as the on-line based activity to raise money from the crowd to provide loans for funding business, and II) Market Place Lending, such as the on-line based activity to raise money from the crowd to provide loans for financing individuals. The amounts referred in the paragraph constitute the sum of Crowdlending (347,345 € B) and Market Place Lending (107,779 € B) transaction values. Information available in <https://www.statista.com/outlook/295/100/fintech/worldwide#>

¹³ FINTECHNEWS SWITZERLAND; "CROWDLENDING: Europe's Peer-to-Peer Lending Market", (2017).

¹⁴ The Director of UK Peer to Peer Finance Association Robert Pettigrew, states the positive trends of growth for crowdlending in the UK. ALOIS. JD; "Peer to Peer Lending tops £3.1 Billion in 2017, Q4 Sees Considerable Growth as Borrowers Shift to Online Lending". Crowdfund Insider (2018).

B) Prior work on this subject:

Prior works on this subject principally referred to the following aspects of interest in crowdlending, such as:

- The role of regulation and investor's risk assessment:

REINER LENZ (2016)¹⁵, understands that crowdlending leads finance and capital back to their original function as facilitators of real economic transactions. This author distinguishes between the inherent risks of traditional banking sector and the specific ones of crowdlending not yet covered by regulation. LENZ concludes outlining the need for regulators to safeguard a fair and transparent loan facilitation process in which every crowdlending platform should keep lenders widely informed and able to assess the risk taken in their investment decisions.

KIRBY and WORNER (2014)¹⁶ counterpoise a huge variety of crowdlending benefits for the "real economy", with the risks in which retail investors are exposed in using these platforms. As such, an appropriate regulation and wider investment's risk disclosure requirements should be established. The authors conclude that there is no reason yet for concern about potential systemic risks of crowdlending. However, they also state that the potential grow to a sizeable market in the short-term, the lack of liquidity and some recent examples of crowdlending unsecured loans securitization might arouse our awareness.

MACCHIAVELO (2015)¹⁷ jointly with KIRBY and WORNER (2014), they have assessed the crowdlending regulatory needs and different legislative approaches to mitigate crowdlending risks, considering appropriate a minimum common legal framework to strengthen crowdlending activities on the European level.

WARDROP (2015)¹⁸ performed a survey related to EU countries' crowdfunding regulation and the industry's perception. It is noticeable that the 45% of the respondents believe that national regulations were excessive and too strict, burdening the of the alternative financing industry growth's projections.

DASKALAKIS (2016)¹⁹ analyzed the answers of people from all over the EU which were registered and active-investing in crowdlending platforms. The survey respondents were asked about the relevancy of regulating crowdlending platforms. About 40% of them were subscribed

¹⁵ LENZ, R; *"Peer-to-peer: Opportunities and Risks"* European Journal of Risk and regulation, Cambridge University Press, HeinOnline (2016).

¹⁶ KIRBY. E, and WORNER. S; *"Crowd-funding: an infant industry growing fast"*. OICV- IOSCO (2014).

¹⁷ MACCHIAVELLO, E; *"Peer-to-Peer Lending and the Democratization of Credit Markets: Another Financial Innovation Puzzling Regulators"*, 21 Columbia Journal, HeinOnline (2015).

¹⁸ WARDROP. R, ZHANG. B, RAU. R, and GRAY. M; *"Moving Mainstream, The European Alternative Finance Benchmarking Report"*, University of Cambridge and EY (2015) page 24.

¹⁹ DASKALAKIS. N; *"Update on crowdfunding user's awareness"*, 4th ECSF Meeting, EUROPEAN COMMISSION (2016), page 2.

in regulated platforms by law, 28% on self-regulated markets²⁰ and 24% were not aware of any regulation. However, 86% of them ascertained the importance, and direct relationship between the regulation of crowdlending and their level of trust in this new web-based financing system.

- The key role of crowdlending in the “financial inclusion”²¹ for SMEs, which have seen their financing sources harmed after the 2008 crisis:

WARDROP (2015) introduces another “hot topic” by aligning the vitality of crowdlending on the same level of SMEs and StartUps as an effective source of funding.

The European Central Bank (2015)²² agreed on the potential of crowdlending platforms in providing financing for the needs of small entrepreneurs.

However, these previous ideas contrast with the conclusions obtained by BOITAN (2016)²³. The author’s conclusions remarks that in countries with high rates of “financial exclusion” people are reluctant in borrowing or lending money through crowdlending while in countries with higher rates of “financial inclusion” there have been set many platforms and larger amounts of transactions have been done through crowdlending platforms. Summarizing, rather than a matter of “financial exclusion”, the success of crowdlending might be related to a higher degree of financial sophistication and knowledge by costumers/investors, wishing to diversify their investment away from conventional finance.

C) Purpose and methodology research:

EU member states’ regulatory activities have kept crowdlending as a local phenomenon from each EU jurisdiction. Therefore, it does not exist a real single crowdlending sector for all the European countries. Furthermore, the EU crowdlending market holds the weakest trading values among the world class economies such us China, USA or the same UK.

The purpose of the present thesis is to assess whether the EU legislative intervention can improve the regulatory European scenario and strengths the crowdlending sector in Europe.

²⁰“When there is not governmental regulation for the industry, the largest platforms create a self-regulatory body in order to create trust and credibility” KIRBY. E, and WORNER. S; *“Crowd-funding: an infant industry growing fast”*. OICV- IOSCO (2014) page 48.

²¹ “Financial inclusion” is a term used by the scholar Iustina Alina Boitan, referring to a “(...) process whereby people or companies does not encounter difficulties in accessing and/or using financial services and products in the mainstream market that are appropriate to their needs and enable them to lead a standard life in their society. BOITAN. IA; *“Crowdlending and Financial Inclusion Evidence from EU Countries”*) Economic Alternatives Issue (2016), page 427.

²² ENRIA. A; *“Opinion of the EBA on lending-based crowdfunding.”* EUROPEAN BANKING AUTHORITY, London (2015) page 34.

²³ BOITAN. IA; *“Crowdlending and Financial Inclusion Evidence from EU Countries”*) Economic Alternatives Issue (2016), page 430.

Based on this approach I set the following research question:

To what extent there is a need for an EU crowdlending legislative action?

The methodology will be based on: I) Literature's research about the benefits and risks of crowdlending. II) European legal analysis of the already implemented EU Directives and member state regulations, as well as the implications of the European crowdlending legal panorama for the EU single market. III) Research about the most appropriate ways to legally approach financial technologies, and a "peer comparison" with the regulatory systems of the principal worldwide crowdlending markets. Lastly, the adoption of conclusions and proposals to strengthen the EU crowdlending market.

D) Chapters overview:

The thesis is structured in five chapters. From the first to the last one, it is explained the crowdlending as a source of funding and the footprint which is leaving on a worldwide level.

For a further understanding about the topic, the thesis starts with the basics of crowdlending; its business models, the differentiation with the traditional banking financing system, its risks and the opportunities it might bring.

The crowdlending is a disruptive financial technology which have developed itself faster than the legislators could think it was possible. Starting from an after crisis unregulated panorama in Europe (2008), the situation has turned to an heterogenic map of European jurisdictions trying to regulate the crowdlending through different regulatory approaches. In this sense, the "chaotic" fragmented European scheme it is assessed in the third chapter.

The fourth chapter analyzes the implications of an European fragmented regulatory scenario for the EU single market. Moreover, it is exposed a deep assessment of scholars and public authorities opinions, about the most appropriate regulatory policies to approach the crowdlending industry, among the other financial technologies. Ending up with a conclusion and a regulatory proposal for the EU.

The last part of this thesis basically focuses on briefly answering the investigation goals, as well as summarizing the main elements found during the research.

II.- CROWDLENDING AS AN ALTERNATIVE SOURCE OF FUNDING.- Risks and opportunities.

A) Crowdlending into crowdfunding world:

Crowdlending technology refers to online platforms facilitating the provision of loans from the crowd to project promoters²⁴. Contractually speaking, on one side individuals and legal

²⁴ The Spanish Rule 5/2015, when regulating crowdlending in their articles 49 b) and c), includes within the definition of "project promoter" to any individual or legal entity raising money to fund their own projects. In this

entities from the crowd assume the lender's position. On the other side, project promoters become borrowers obliged to pay back the loans disbursed to them, plus financial return.

The crowdlending sector has reached a relevant notoriety at present, and its provisions of growth are as much exceptional as unpredictable. The online characteristics from crowdlending activities, are seen as one of the key factors for its simplicity and success. Moreover, the crowdlending clarity opposes to the complexity of mainstream sources of financing.²⁵

However, as many other disruptive technologies from the recent post-crisis era, the crowdlending is part of a bigger successful phenomenon, in this case called crowdfunding.

1. Crowdfunding:

Crowdfunding is an umbrella term describing the use of small amounts of money, which are raised from a large number of individuals, in order to fund: a project, a business or personal loans and other needs through online platforms.

The crowdfunding has its origins in the creative industries where it was a successful pioneer in the financing of albums and concerts. Since its beginning funding independent music, the model expanded into industries. This fast development was helped by the growth of large platforms such as Kickstarter and Indiegogo. In the recent era, the crowdfunding has been adapted to mainly fund projects with a specifically social aim or business projects²⁶

It is generally accepted to distinguish 4 different categories within crowdfunding. On one side; social lending/donation and reward crowdfunding, classified both of them as "community crowdfunding".

On the other side, we can find the crowdlending and equity crowdfunding, jointly defined as "financial return crowdfunding (FR Crowdfunding)".²⁷

Community crowdfunding does not provide any financial return in the form of a yield or return on investment. It is based on a way of funding charitable causes or pre-paying for a product of a business.

In FR Crowdfunding, investors give money in the form of debt or equity, wishing to receive a financial return which is based on interest and principal or dividend, respectively. The online

sense, individuals and legal entities raising money from the crowd to fund thirds projects, do not qualify as "project promoters" for the purposes of the present thesis.

²⁵ A sole and simple structure constituted by Lender, Crowdlending Platform and Borrower. In contrast, the traditional lending industry, is characterised by involving: I) big Commercial Banks, which impose tough conditions and highly regulated procedures to achieve financing, II) the presence of third parties such as notaries, which triggers the cost of lending, as well as III) the optional requirement to bring collateral in order to secure the loan.

²⁶ COLLINS. L and PIERRAKIS. Y; *"The Venture Crowd: Crowdfunding equity investment into business."* NESTA, (2012), page 9.

²⁷ "FR Crowdfunding" is a term originally used by financial renowned organizations such as; NESTA or IOSCO in their papers and commonly accepted by the sector.

aspect cuts costs and allow project promoters, as borrowers, to spread their demands of funding through a larger crowd of potential investors and lenders.

In the crowdlending activities, lenders normally provide with small amounts²⁸ of the overall loan required by the borrower and they obtained a credit claim against this last one. Although equity crowdfunding follows the same platform-based nature of crowdlending, instead of lending money, the crowd invest money on firms' projects in exchange of a participation in the firm's share capital.²⁹

In conclusion, the crowdlending comes from a bigger family of fundraising activities in which every member holds the on-line platform characteristic. However, only two of them, the Crowdlending and Equity Crowdfunding activities, are basically focused in generating income for the participating crowd.

B) Crowdlending:

This thesis is focused on the lending side of crowdfunding, not only because is one of the top successful financial technologies³⁰, but also represents a big challenge for governments which try to approach crowdlending from a regulatory point of view. Moreover, the crowdlending industry owes the potential to hold an important position in our economies since is the real competitor of the banking sector in the lending field.

Within the global crowdlending industry, it is possible to distinguish a variety of main actors and diverse models which are explained below:

1. Models

Fundraising can take place in two ways³¹. In the first scenario, the project promoter sets a funding goal that if is not reached, then the borrower cannot keep the funds raised and the collected money should be given back to the crowd. In the second scenario, the project promoter is allowed to keep all the raised funds, independently whether the funding goals have been achieved.

²⁸ In some cases, these loan parts can be as small as 10€. Anyway, limits will be imposed regarding national legislations and platforms self-regulation. FINANCIAL SERVICE AUTHORITY; *"Crowdfunding: is your investment protected."* (2014)

²⁹ The equity crowdfunding is normally used to finance companies in early stages with no access to other forms of funding. This fundraising type is the riskiest one within FR Crowdfunding, with a market indicating that there is a 50% chance of invested business failure due to its size and maturity. Other risks such as: the dilution of the ownership participation due to later rounds of funding or the lack of a secondary market are important issues to take in account. KIRBY. E, and WÖRNER. S; *"Crowd-funding: an infant industry growing fast"*. OICV-IOSCO (2014), page 21.

³⁰ Crowdlending makes up more than 70% of all global crowdfunding activities in 2017. RUT. D ; *"2017 Peer to peer lending: the year in pictures"*. Blog Peerform (2017). Post available in: <http://blog.peerform.com/2017-peer-to-peer-lending/>

³¹ CUMMING. D, LEBŒUF. G, and SCHWIENBACHER. A; *Crowdfunding models: Keep-it-all vs. All-Or-Nothing*. (2014), page 3.

Slightly variations in the work performed by platforms have as an uncountable outcome different models of crowdlending³². The affection of specific rules in different countries broadens this variety.

As an example, small differences among the crowdlending business models can have consequences in the way lenders should exercise their economic rights. In that sense, we can find models in which the platform acts as a mere marketplace and the contractual relation is between lenders and borrowers (The “client segregated model” is explained below). In this case lenders can claim directly against the default borrower. However, there are other situations in which the contractual relation is only between lenders and platforms (I.e., the U.S. platform Prosper, listing its offers with SEC). In this last scenario, the platform carries on a more active role, like a professional intermediary. This structure, allows lenders to have claim rights only towards the platform in case of borrowers default.

With regard to the crowdlending business models, it is possible to classify three different general types³³ related to the role carried on by the platforms.

1.1: Client segregated model:

Lenders are matched to borrowers through an intermediary platform. A contract structures the relation between them, and the platform only works as a marketplace.

All the money lent to borrowers is separated from the platform’s balance sheet. These funds go from the lender to the borrower, and vice versa, through a legally segregated client account whereby the platform has not claimed. So, the contractual obligation would still being in force in case of platform’s failure.

This is the most common model, very appropriate to protect lenders from scenarios of funds misappropriation and platform’s closures. Indeed, leading economies such as the UK and China have implemented in their legislations the “client segregated account” as a mandatory measure to legally provide crowdlending services.³⁴

³² As an example of this variety of models, under the principle of investment diversification, some platforms choose to bring accurate information about the borrowers and their business projects, leaving more autonomy for investors to choose between borrowers and their diversification options. In contrast, other platforms encourage the lender to split its investment among different projects based on a pre-established matching criterion. Another example of this variety of models, is the different existent ways to fix the interest rates of return for each borrower’s project. Indeed when is the same platform who decides the borrower’s rating, it is possible to include the lender’s feedback (such as the US crowdlending platforms Lending Club and Prosper). However, in less common cases, are the lenders who are able to set the interest rate they want to be applied. Another scenario is the one in which the platform, operate as an auction, and the winner is the lender offering the lowest interest rate. (In the British crowdlending platform Funding Circle, lenders bid indicating how much they are wishing to lend and what return they would like to receive –the winners being those who propose the lowest interest rate-). MACCHIAVELLO, E; “Peer-to-Peer Lending and the Democratization of Credit Markets: Another Financial Innovation Puzzling Regulators”, 21 Columbia Journal, HeinOnline (2015) page 527.

³³ KIRBY. E, and WORNER. S; “Crowd-funding: an infant industry growing fast”. OICV-IOSCO (2014), page 16.

³⁴ YIN, H (2016) “Status quo of the US and UK’s P2P lending regulation”. Global Journal Of Economics and Business Administration (2016) page 35.

1.2: Notary model:

As it does happens in the “client segregated model”, the crowdlending platform works as an intermediary matching borrowers and lenders. In this case but, the money collected from the crowd is sent to a bank account, and is the same banking institutions who, as a lender, originates the loan to the borrower. The banking institution sells or transfers the loan to the platform, and this last one issues a note to the lenders/investors³⁵ according to their contribution to the loan. The risk of loan non-payment shifts to the lenders.

The notary model is the crowdlending version which applies to the US platforms. For the purposes of the US securities regulation, the notes issued by platforms to the lenders qualify as securities. Therefore, the US authorities have approached crowdlending as an investment activity.

1.3: Guaranteed Return Model:

In this case, a set rate of return on the investment is guaranteed by the same platform to the lender.

The most popular version of this model could be found in China³⁶. However, the Chinese version contained some off-line aspects regarding to borrowers, such as; personally catchment and creditworthiness assessment.

Nonetheless, the Chinese crowdlending industry has recently abandoned this business model. The new regulatory reforms, have forced platforms to adapt the “client segregated model” and engage partnerships with banking institutions.³⁷

1.4: Fees:

In every crowdlending model, and their almost infinite variations, the platform’s business is based on fees charged to project promoter and lenders. The fees’ structure is very similar among the three mentioned crowdlending types. However, the fees will be higher for

³⁵ This model called “notary” comes from the issuance of “notes”. The US jurisdiction, among others, considers crowdlending loans as securities. For this reason, the US main crowdlending platforms (Prosper and LendingClub) have registered their notes offerings with the Securities Exchange Commission (SEC), which is a mandatory requirement when firms go public. MACCHIAVELLO, E; *“Peer-to-Peer Lending and the Democratization of Credit Markets: Another Financial Innovation Puzzling Regulators”*, 21 Columbia Journal, HEINONLINE (2015) page 528.

³⁶ This was the model used by the largest Chinese platform “CreditEase”. There was a lack of trust from borrowers and a high demand from potential lenders. Then, platforms tried to attract potential borrowers through traditional channels creating more trust. However, recent scandals (high default rates) forced the Chinese government to implement new legislative reforms which have completely modified the crowdlending panorama in China. In advance, the crowdlending platforms will have an active role just as matchmakers between lenders and borrowers, being mandatory to have commercial banks as the custodians of funds. BARRETO. E and WONG. S; *“China’s big P2P platforms shrug off crag down.”* REUTERS (2016).

³⁷ TAO, Li “Regulation: Just few big Chinese P2P lenders seen surviving in sector tarnished by scandals”. South China Morning Post, (March,2017).

platforms using the notary model due to the extended banking institutions role³⁸. In the same way, platforms guaranteeing the investment return will normally charge higher fees to outbalance potential losses coming from likely project promoters' default.

In return for the charged fees, the platform provides with a market place structure, and other optional services such as: collecting loan repayments³⁹, creating communication channels between borrowers and lenders, and doing risk assessments on borrower's project creditworthiness.

As a general pattern, the borrower pays an origination fee regarding to its risk category, as well as fees for late payments. The lender, should pay an administration fee and an additional fee if they use any automated service offered by the platform to diversify the investment portfolio.

The loan's sale to a secondary market⁴⁰ arranged by the platform or directly to the platform can imply the charge of extra-fees to the lender.

2. Differentiation with the traditional credit banking system

The crowdlending targets to facilitate credit for individuals or legal entities in order to fund their own projects and/or daily operative. Consequently, the crowdlending industry is carrying on one of the most important activities within the banking services portfolio, the credit provision. Therefore, the irruption of crowdlending means to broaden the availability of different sources of funding for individuals and legal entities.

In this sense, relevant banking institutions⁴¹ consider that crowdlending offers a new form of intermediation with the potential to complement the traditional financing system.

Crowdlending platforms provide financial services focusing in the retail segment, a market share that may not be profitable for traditional banks, due to the high regulatory costs of

³⁸ This is the legally recognized system in the US (Worldwide major platforms use it –Prosper and Lending Club-) KIRBY. E, and WORNER. S; *"Crowd-funding: an infant industry growing fast"*. OICV-IOSCO (2014) page 18.

³⁹ In some jurisdictions, like the Spanish one, only certain payment entities can collect money and pay. Indeed, according to the Payment Services Directive (EU) 2015/2366, it is required a specific license to collect the money from the crowd in order to pay. As a result, you should obtain the mentioned license or be helped by specialized entities. I.e. ECROWD, one of the largest Spanish crowdlending platforms use the French specialist company Lemon Way to collect the money and pay back to investors. ECROWD platform's CEO speech; *"Supervision y regulacion del crowdlending"* (video) (2016).

⁴⁰ Transactions that occur on the secondary market are termed secondary simply because they are one step far away from the transaction which originally created the loan in question. Understanding the primary market as the place in which the crowdlending loan is originally created, the secondary market is the place where the lender sell their loan claim right to a third party interested in assuming the lender contractual position. More detailed information in: <https://www.investopedia.com/terms/s/secondarymarket.asp>

⁴¹ NAKAGAKI; *Online marketplace lending: an alternative to bank financing?*. CaixaBank Research (2016), page 1.

consumer protection rules compliance and low profit margins⁴². Therefore, the use of new technologies, in special the “on-line based model” feature, has helped platforms to reduce expenditures, winning competitiveness to better financing SMEs or individuals and approach retail investors offering attractive rates of return.

However, the crowdlending sector success has also caught the interest of institutional investors looking for higher returns⁴³, as well as medium and big companies wishing to quickly obtain credit with similar or even more favourable interest rates (7% to 9% average⁴⁴) as compared to commercial banks.

Generally, crowdlending platforms target to differentiate their business from traditional banks through the following competitive advantage factors: i) reduction of operational costs ii) developing new risk models and iii) improving customer experience.

The reduction of operational costs is not only related with the “platform on-line based model”. It also plays a relevant role the platform automated processes and the viability of exploiting large amounts of data⁴⁵.

Relevant actors from the US crowdlending industry⁴⁶, outline the relevance of collecting and managing data as the most valuable source of innovation. New data services, are allowing platforms to reduce the cost of acquiring customers, automate the origination of loans, and the collection of loan documentation.

Moreover, using large amounts of data allows the development of new credit risk models. Indeed, non-traditional sources such as social media as well as other online information, can help to reduce the fraud, enhancing creditworthiness assessments and speeding up the process of evaluating loan applications, which is a key feature of the customer experience.

⁴² It is not a very much profitable market share due to the tough regulatory requirements –prevent money laundering and the financing of terrorism-. NAKAGAKI; *Online marketplace lending: an alternative to bank financing?*. CaixaBank Research (2016), page 1.

⁴³ Since the beginning of this decade, platforms set in the most developed crowdlending markets have advertised higher returns to lenders than traditional bank deposits. For example; the USA Prosper and LendingClub platforms reported in March 2011 an average annualized return of 11% and 9%, while annual returns for saving accounts and certificates of deposit were ranging respectively, of 0.1%-1.2% and 1.3%-2.2%.. In the UK, as of April 2014, platform Zopa offered returns after fees and bad debts of 4.1% to 5% depending on the maturity, Funding Circle reported returns of 6.10% and before bad debts, ThinCats and Funding Knight reported 11.44% and 10% respectively. VERNSTEIN. A; *“The Misregulation of Person-to-Person Lending”*. Yale Law School Legal Scholarship Repository (2012).

⁴⁴ Info available in: <https://www.crowdlending.es/blog/prestamos-para-pymes>

⁴⁵ U.S DEPARTMENT OF THE TREASURY; “Opportunities and challenges in online marketplace lending.” (2016) page 19.

⁴⁶ Lending Tree, Lendio, and ZestFinance responses to USA Treasury research surveys. U.S DEPARTMENT OF THE TREASURY; “Opportunities and challenges in online marketplace lending.” (2016) page 20.

However, new variety of data sources have raised concerns about the negative impact of potential information inaccuracies in borrowers creditworthiness assessments.⁴⁷ Some of these concerns are related to new risks generated by “big data”.

Another possible advantage factor is that crowdlending might represent an anti-cyclical source of funding; As it provides money from regular people, it might not follow bank trends or economic policy directives⁴⁸. In this sense, the platform business model is independent of market changes in interest rates as it charges transaction fees. However, the “anti-cyclical crowdlending behaviour” is a term used by experts which has never been tested in financial crisis periods. In contrast, the bank business model depends on earning the interest margin between deposit and loan rates. Nevertheless, in an environment with high levels of non-performing loans or higher bank’s interest rates, these crowdlending platforms could see their financing flows reduced as an outcome of less investor interest⁴⁹.

In conclusion, unlike banks that fund loans with deposits, the crowdlending business depend on an investor base that demands much higher returns than the average cost of funds for a bank⁵⁰.

The appearance of crowdlending, among other financial technologies, as well as the digitalisation improvement from traditional financial institutions are currently increasing competition in the lending sector, in which achieving economies of scale is crucial. At this regard, the crowdlending industry will have to fight against the already implemented economies of scale from traditional banks and their already implemented distribution networks in order to succeed.

Rather than the economic facet, other aspects might differentiate crowdlending from banks.

Firstly, in general terms crowdlending is a much faster option to get credit than banks. Indeed, the availability of new sources of data (the internet), the use of algorithms and other technologic advantages have helped platforms to: standardise processes, speed up the borrower’s creditworthiness assessment, avoid unnecessary formalism and generally reducing the waiting period. Additionally, the more attractive the borrower’s project, the faster will attract the investors interests and fully fund raised the project. Therefore, the period of time since the project promoter has the first contact with the platform, until the project is published on the platform’s website, is much shorter than the time required for being allowed

⁴⁷ Some USA relevant actors (Such as; Centre for Finance Services Innovation, Milken Institute Centre for Financial Markets, and National Consumer Law Centre) from the crowdlending sector called for greater transparency, such as the disclosure of data sources that online marketplace lenders use to assess borrowers, noting that automating the credit decision process through algorithms does not necessarily yield fair results. U.S DEPARTMENT OF THE TREASURY; “Opportunities and challenges in online marketplace lending.” (2016) page 20.

⁴⁸ BURAND D, Microfinance Managers Consider Online Funding, (2009), CGAP page 6.

⁴⁹ MCKINSEY & CO ; “The fight for the Customer. McKinsey Global Banking Annual Review 2015”. (2016) page 29.

⁵⁰ Crowdlending platforms lower operational costs are outweighed by a higher financing cost than banks. So, the total costs for banks and platforms may not be so different. TOMLINSON. N; “*Marketplace Lending: A temporary Penomenon?*” (2016) page 21.

to receive a loan pursuant the traditional banking channels (I.e., One month for Spanish SMEs). However, once the banking institution approves to grant a loan, the money is transferred in less than 48h, while the crowdlending cannot assure a certain period of time to fully fundraise the project.

Secondly, crowdlending lenders receive a “feel-good moral or spiritual return” since they are helping somebody, who they choose, to receive a loan for any reason. Moreover, they are participating in increasing the real economy, knowing exactly where their money is going and who is benefiting from this one. In contrast, banks might use the money of your saving account to lend or invest in unknown businesses of blurred morality.

In conclusion, the irruption of crowdlending has established a new player within the financial sector. Some experts’ opinions foresee crowdlending only as a complementary way of funding to the traditional sources. However, the threatening shadow of crowdlending is forcing banking institutions to evolve and embrace the main features from the new financial technology era.

C) Crowdlending as a source of funding for SMEs:

The 2008 financial crisis contributed to the rational distrust towards banks and mainstream financial operators⁵¹. The Governments from the principal financial markets started restructuring the banking sector, which hardened credit conditions imposed by commercial banks, in special to individuals and small businesses. However the appearance of non-traditional forms of financing⁵², such as crowdlending, raised some cause for optimism within the retail credit market.

Going back to the beginning⁵³, Crowdlending started in the USA and UK within the pre-financial crisis scenario.

In the USA, crowdlending was originally linked to the microfinance movement. The main examples is the US platform Kiva, built around the idea of channelling small funds from internet users in high-income countries for ultimate transfer to individuals in poor and middle-income countries -based on the borrowers profiles and project presentations, but neither as pure charitable donations nor as pure market-rate investments-.⁵⁴

⁵¹ PIERRAKIS. Y, and COLLINS. L., “BANKING ON EACH OTHER: peer-to-peer lending to business: evidence from funding circle”. Kingston University London, NESTA (2013), page 7.

⁵² Such as: pawn shops, alternative private markets, microfinance and crowdlending. MACCHIAVELLO, E; “Peer-to-Peer Lending and the Democratization of Credit Markets: Another Financial Innovation Puzzling Regulators”, 21 Columbia Journal, HEINONLINE (2015), page 522.

⁵³ The first crowdlending platforms were Zopa in UK and Kiva in USA, both of them created in the early 2005.

⁵⁴ DAVIS, K. and GALPERN, A; “Peer to Peer Financing for Development: Regulating the Intermediaries”. N.Y.U. Journal of International Law & Politics, Vol. 42, (2010) page 1222.

In the UK, Zopa, followed by the US platforms LendingClub and Prosper, started with the facilitation of unsecured personal lending between individuals.

In the late 2000's two complementary factors triggered the crowdlending industry:

On one side, some platforms started a relatively new application of crowdlending to companies seeking debt finance.⁵⁵

On the other side, as a consequence of the financial crisis, lending to small and medium sized enterprises dropped as never before since the "the stock market crash of 1929". Although the 2008's financial crisis impacted businesses of all sizes, SMEs were particularly vulnerable to this situation as their size did not allow them accessing to other sources of finance such as bond or capital markets⁵⁶.

As an outcome, the crowdlending platforms which were seeking to expand their market into the business field, they showed up as a new opportunity to get credit for SMEs.

Within the post-crisis era, some Governments from the main economies (USA, UK and EU) realized about the potential of crowdlending to finance the funding gap for individuals and SME's. Indeed, they started encouraging its use as a channel to strength their economies through different measures. The USA introduced the JOBS Act –Jumpstart Our Business Startups Act-, which is a law from 2012 which encourages funding of small American businesses. In the UK, the government approved tax deductions for crowdlending investors returns and has recently lent large amounts of money through some British platforms⁵⁷. European institutions have also chosen crowdlending platforms as financing channels for SMEs to face the economic recovery.

Additionally, the fact that crowdlending generally offers higher rates of return than traditional investments, such as saving accounts or government bonds, has caught the investor's attention. Therefore, the crowdlending industry's development is not only an efficient tool to smooth the funding gap for SMEs, but it has also become a good investment opportunity.

⁵⁵ FundingCircle and ThinCats were launched in the UK market in 2010 and 2011, being two of the pioneers platforms in the business/company crowdlending. PIERRAKIS. Y, and COLLINS. L.; "BANKING ON EACH OTHER: peer-to-peer lending to business: evidence from funding circle". Kingston University London, NESTA (2013), page 7.

⁵⁶ In the UK, there was a 271 per cent increase in the unsuccessful loan applications between 2007 and 2010 by SMEs. It was calculated that the financial gap for all businesses in UK from 2010 to 2015 could be from 84£ billion to 191£ billion. DEPARTMENT FOR BUSINESS, INNOVATION AND SKILLS of the UK Government; 'Boosting finance option for business.' (2012) page 3.

⁵⁷ In 2012 the UK Government invested 20 million pounds addressed to British SMEs through crowdlending platforms. In 2014, the UK Government invested an additional 40 million pounds through the crowdlending platform Funding Circle. UK GOVERNMENT "New 40 £ million investment by British Business bank to support 450 £ millions of lending to smaller businesses". Press Release, (2014).

D) Opportunities and risks of crowdlending:

Crowdlending represents the financial innovation. Therefore, the parties involved in this new industry can receive relevant benefits, but also be the subject of serious issues and risks which they might ignore or not being completely aware.

Moreover, the potential of crowdlending is highly unpredictable, since the crowdlending sector is just on its beginning. For this reason, many new crowdlending opportunities and risks will be discovered soon. However, the short life-time of this alternative financing method allows us to outline the following ones:

1. Opportunities:

According the abovementioned information, we can summarize the following beneficial aspects:

1.1: Helping economic growth funding the real economy:

Crowdlending provide finance to SMEs, which play a principal role in the real economy.

According to the Office of the US Trade Representative, SMEs are the backbone of the European and American economies (SMEs accounts 2/3 of the jobs within the US private sector)⁵⁸. Therefore, the use of crowdlending as a tool at the service of the real economic growth is a basic factor of job creation and aids economic recovery.

1.2: Filling the gap left by banks. Inducing towards a situation of healthy competition in the lending sector:

The introduction of stricter regulation to improve the solvency in the banking sector pushed away the traditional financing entities from granting unsecured loans on a retail level.

As a complementary source of financing, crowdlending platforms can partially fill up this financing gap left by banks providing an attractive product that holds: higher returns for investors (within an era of low returns and scarce capital for who need it) and an efficient and quickly model of lending money for individuals and SMEs.

Additionally, the landing of crowdlending has provided investors with the possibility of a further diversification of their portfolio⁵⁹, which stimulates competition within a sector traditionally dominated by few players⁶⁰.

⁵⁸ OFFICE OF THE US TRADE REPRESENTATIVE (Executive office of the President); *"We seek to strengthen U.S.-EU cooperation to enhance the participation of SMEs in trade between the United States and the EU"*.

⁵⁹ Investment diversification reduces the risk of overconfidence on a single asset. Is it available a further explanation in: <https://www.investopedia.com/terms/d/diversification.asp>

⁶⁰ The outcome of more players in a competitive lending market is the incentive for traditional entities to innovate, reduce costs and increase efficiency. A competitive lending market would benefit borrowers and lenders –i.e; reducing the cost of contracting a loan or higher returns for investors-. KIRBY. E, and WORNERS. S; *"Crowd-funding: an infant industry growing fast"*. OICV-IOSCO (2014) page 22.

1.3: Crowdlending cost-efficiencies and convenience:

The online aspect allows crowdlending platforms to keep a relatively light infrastructure. This characteristic ensures cost efficiencies and gives the flexibility to update platform's operations and quickly adapting marketing to an evolving business model. Moreover, platform users might find easier to manage and diversify their investments through online channels than via the traditional portfolio diversification systems.

2. Risks:

Crowdlending is a new financial technology which has in its "DNA" small portions of each financial sector.

Therefore, the crowdlending activity holds, not only the opportunities and benefits, but also a compilation of risks coming from the different financial sectors, from the investment and securities field to the payment services and banking activities.

Moreover, as a common feature within the financial technologies, crowdlending is an "on-line" based activity, widely exposed to the vulnerability of the internet threats and other technologic risks.

A summary of the main crowdlending characteristics risks are exposed below:

2.1: Default Rates:

The crowdlending business model is considered a risky activity since the moment in which higher returns are linked to less solvent borrowers, and generally no guarantee exist in case of borrowers default. Investing in unsecured loans means that there is no collateral other than the ones provided by the standard bankruptcy legislation.

The borrower creditworthiness assessment made by platform's workers plays a principal role in lenders' decision-making process of selecting the lending portfolio. Indeed, providing with enough and accurate financial information to lenders is a basic feature for mitigating blur transparency and avoid insolvent borrowers. Therefore, the biggest problem lies down in platforms generally shielding themselves and denying any guarantee or responsibility in case of borrower default. This situation leave the platforms with a short-term little incentive to conduct efficient due diligences.

The brief crowdlending history has shown critic periods of high default rates due to the use of non-diligent standards on borrower's creditworthiness assessment⁶¹. One of the most showy cases was the huge US platform LendingClub, which in 2009 held a 30% of borrowers default rate. The Securities and Exchange Commission (SEC) discovered that LendingClub, among other platforms such as Prosper, only tested the borrowers' solvency in 50% of the cases. As a

⁶¹ In 2009 the giant US crowdlending platform Prosper held a 30% default rate. LIEBER, R 'The Gamble of Lending Peer to Peer' The New York Times, (2011). Prosper and LendingClub –two platform references in the industry-verified only employment and income information, and only for an average of 50% of cases. MACCHIAVELLO, E; "Peer-to-Peer Lending and the Democratization of Credit Markets: Another Financial Innovation Puzzling Regulators", 21 Columbia Journal, HEINONLINE (2015) page 540. .

consequence, the SEC issued a “Cease and Desist”, and Prosper had to suspend its activity for six months until complying with the US securities regulation.

However, governments and the same crowdlending sector reviewed their business practices and imposed rules on itself about; the minimum credit score allowed, the borrower’s repay capacity and the borrowers rating within a risk scale.

Nowadays the crowdlending sector presents a stable health, with default rates equalling and even improving in specific cases the traditional bank’s rates.⁶² Nevertheless, the EU represents a less optimistic opinion, assuring that EU platforms hold lightly higher rates of non-performing loans than banks.⁶³

In mitigating the borrower’s default risk, crowdlending platforms promote the diversification of total investments in small amounts to different projects. In some platforms, such as the South American Afluenta or the Chinese Sinolending, diversifying is a compulsory requirement⁶⁴.

Other platforms opted for the creation of a pooled insurance fund that provides compensation in the event of borrowers default. This fund is created by borrowers who contribute a percentage of their overall loan. However, it can incentivise the lender to take more risks and save time and costs in performing a diligent investment.

2.2: Platform’s risk:

Investors may consider the risk of platform insolvency or shut-down platforms operations. In these situations, lenders’ loan portfolios are at risk of not being repaid as the platform, responsible for the collection of the loan, is not being able to do it.⁶⁵

However, the “client segregated model”, which is the most used crowdlending version,⁶⁶ allows the client money to go through a separate account. Indeed, other payment institutions can manage the money collected in the separate account and carry out the lenders repayment.

⁶² The IOSCO Research Department compiled the following data at 30th September of 2013; a) Prosper platform (USA) 7.0% default rate, b) Lending Club (USA) 4.3% default rate, c) Auxmoney (Germany) 2.6% default rate, d) CreditEase (China) 2.0% default rate, e) Funding Circle (UK) 1.5% default rate,

f) Afluenta (Argentina) 1.3% default rate and g) ZOPA (UK) 0.2%. KIRBY. E, and WORTNER. S; “*Crowd-funding: an infant industry growing fast*”. OICV-IOSCO (2014).

⁶³ EU PARLIAMENT, “*Non-performing loans in the Banking Union: Stocktaking and challenges*” Briefing (March 2016).

⁶⁴ ZOPA was the first UK crowdlending platform. Its business model diversifies the risk of non-performing loans by borrowers, distributing online lenders money among at least 50 projects. ZOPA lenders can only decide the category of borrowers to lend -knowing the borrower’s creditworthiness assessment carried on by ZOPA-, the amount -between 10€ and 1£ million, even though they recommend at least 2.000€ in order to diversify- and for how long. ZOPA, HOW LENDING WORKS. Info available in: <https://www.zopa.com/about/how-zopa-works>.

⁶⁵ In 2011, the platform Quackle closed suddenly. Lending contracts couldn’t be fulfilled resulting in 100% of loss. MORRE and MOULES “*Peer to peer loans company closes*” Financial Times (2011).

Regarding the platform failure risk, some jurisdictions such as the UK, requires crowdlending platforms to have resolution plans in place so that, and loan repayments will continue to be managed.

However, the segregated account model and platform's resolution plans are not universal measures. Therefore, they cannot be found everywhere.

2.3: Liquidity risk:

Once the lender's money has been lent, this one is found locked into a contract which has a slow maturity tempo. Consequently, it will take an average of one year for the lender until he/she will get back his money –with financial yields–.

Accordingly, the invested money wouldn't be available in case of investor's lack of liquidity to pay its expenditures or some other issues that may occur until the loan maturity date. For this reason, is very important for inexperienced investors to invest a small portion of its cash wealth, even in the case of owning a huge patrimony that it is far away to be liquid.

Some platforms have created a secondary market wanting to solve the liquidity risk. This market allows investors to sell their credit claims to third parties, or to the same platform, for a stipulated price below the total amount of the returning loan –principal plus interests–.⁶⁷

2.4: Risk of fraud:

The anonymity that offers an internet portal means that there is a high chance of fraud in crowdlending platforms. Solely operating through websites gives the advantage of being more cost-efficient, but implies a big alert in related topics, such as; terrorism financing, identity theft, money laundering, privacy, data protection, etc.

Platforms are trying to avoid the above-mentioned risks through confirmation procedures which inquire in the lender and borrower real identity, obtaining personal and professional information about them. Among others, data protection is a hot topic which has been receiving a lot of attention by legislators and, that the internet-based platforms must take in to account.⁶⁸

2.5: Information asymmetry:

The few available data about the project promoter (crowdlending borrower) plus its anonymity, places crowdlending lenders in the weakest position within the crowdlending

⁶⁶ In Europe, the vast majority of P2P lending platforms adopted a "client segregated model". In the second position we can find the "notary model" and in the third the "guaranteed return model". BORELLO. G, DE CRESCENZO. V, PICHLER. F; *"The Funding Gap and The Role of Financial Return Crowdfunding: Some evidence from European platforms"* Journal of Internet Banking Commerce, page 14.

⁶⁷ Lending Club was the first peer-to-peer lending company to offer a secondary market for peer-to-peer loans. The platform established a "resale trading system" for the notes issued by the company. LENDING CLUB NEWS; *"Lending Clubs Secondary Market"*.

⁶⁸ *The General Data Protection Regulation (GDPR) (EU) 2016/679* adopted in April 2016, will supersede the Data Protection Directive and will be enforceable starting on 25 May 2018.

activity. Lenders should rely in the little available information that platforms decide to publish on their websites, such as: the interest rates, briefs about the borrower's projects or summarized company's reports, among others.

As explained above⁶⁹, crowdlending platforms play a principal role in the decision-making process of lenders. The platforms control the amount, quality and veracity of the information provided by the project promoter. So lenders will choose an investment option according to the project promoter data disclosed by the platform. Therefore, borrowers and platforms hold the ability to influence the lenders decision.

To outweigh this unfair scenario, the trend for crowdlending platforms is to broaden the published borrower's profile, outlining the projects details, risk categorization, as well as other relevant information about the borrower's solvency.

However, without any doubt the "Risk categorization" of each investment project by crowdlending platforms has the biggest influence in lenders' behaviour. In this sense, the risk categorization is the outcome of the platform creditworthiness assessment. Therefore, through a simple, visual and logic models of signs (letters or numbers, among others), platforms disclose their subjective opinion about the chances of project promoters success⁷⁰ (i.e., "A" it means a very low probability of borrower's default, while "B-" is the highest probability).

In order to assure the availability of accurate and truthfully information for lenders, some jurisdictions, such as Spain, have considered crowdlending platforms jointly liable for the veracity of the information published on their websites.

2.6: Investor's experience risks:

The general good trends and positive growth forecasts for financial technologies have placed crowdlending as one of the most popular alternative financing methods. However, this optimistic situation for the industry⁷¹ can be masking the real risks of lending unsecured loans to third parties from who is only available little financial information.

Moreover, the crowdlending activity lacks any kind of investor's protection more than the self-imposed pooled insurance funds (only for few platforms), the segregated account model or the platform's resolution plans.

Finally, crowdlending has raised itself as a democratic way of financing since individuals or small entities (crowd) are allowed to participate in financing projects that otherwise they wouldn't be allowed (due to their economic positions or banking restrictions). However, these

⁶⁹ See 2.1.- *Default rate*: classified as a crowdlending risk.

⁷⁰ I.e., In the Spanish platform LoanBook Capital, the sign "A" means a very low probability of borrower's default, while "B-" is assigned to the highest probability. Moreover, the risk categorization is directly related with the financial return. Therefore, the riskiest the investment the higher the financial return. Graphic information about LoanBook Capital rating system is available in: <https://www.loanbook.es/marketplace2>

⁷¹ A situation in which European governments and public institutions, as well as wealthy institutional investors, have recently used crowdlending to channel their billionaire investments.

retail investors may suffer higher losses than professional or institutional investors since they usually invest a bigger percentage of their wealth, through amounts that are not big enough to diversify their portfolio in many projects. In that sense, lacking the ability to diversify do not allow retail investor to mitigate the borrower's default risk.

2.7: Cyber-attack risk:

Cyber-security is a risk spread through all the internet. Platform's managers shall pay a lot of attention to this issue, because an inadequate or inefficient platform structure and/ or software may expose its users –borrowers and lenders- to on-line personal data and money thefts.

E) Chapter conclusion:

The crowdlending has irrupted as a worldwide phenomenon within the financial post-crisis period. The simplicity of its on-line based nature, allowed crowdlending platforms to focus on the credit market for individuals and SMEs, which is a market share strongly burdened by credit restrictions.

Governments and relevant institutions from the main economic unions, have realized about the potential of crowdlending as an alternative (or complementary) source of funding to strength the real economy.

However, the crowdlending is still being an activity on its first steps, so its potential as source of financing, as well as the risks that may involve, are unpredictable.

In this sense, Governmental and regulatory authorities should study and assess the best policies to approach the crowdlending industry. Indeed, the success in the creation of an appropriate regulatory base to embrace the crowdlending sector will determine its future potential.

III.- THE EUROPEAN SCENARIO –Crowdlending and its regulatory scenario in Europe.

New forms of disintermediation and democratization of finance⁷², such as crowdlending, might bring a socio-economic and cultural revolution. Crowdlending is more likely to produce these positive effects in economies where banks have had a preferential role in the financial industry, and in which SMEs have traditionally been one of the main sources of employment and gross national product.

In this sense, the European Union meets the two abovementioned conditions since is mostly composed by countries in which SMEs are the backbones of their economies, and banks have monopolized the credit sector in the recent times. The available data shows that SMEs accounted the 65% of all jobs in Europe in 2013⁷³.

Consequently, the crowdlending has found within the EU a playing field according to its characteristics. Therefore, this young method of financing is developing fast in Europe, contributing to solve the economic needs of most of the EU member state economies, and specially healing the damaged credit markets for individuals and SMEs.

Within the European crowdlending scenario, there are few countries that are leading the industry. Among others, the UK, France, Germany, Italy, The Netherlands and Spain excel for their crowdlending trading values as well as for their regulatory policies to approach this new source of financing⁷⁴.

In this sense, studies from the European Union proved that crowdlending is developing faster in these countries, which have had a specific regulatory response to the raise of this alternative financing industry⁷⁵.

Nevertheless, although the positive trends of growth for Europe in recent periods and good prospects for the next years, the global EU crowdlending trading value, excluding the UK's case, is still very far away from its traditional competitors (US, UK and China economies).

⁷² Crowdlending deletes the bank's pivotal role (monopoly) of the lending sector, giving the option for individuals and firms to become the new actors of the lending market.

⁷³ The European Commission stated that there were in 2013 more than 23 million of SMEs in Europe, accounting the 65% of all jobs and the 80% of all new jobs created in 2012. However, according to data of the European Investment Bank, only 30% of this SMEs are using bank loans due to the after-crisis restrictions in the retail credit market. As a result, there were in 2013 as many as 15 million of potential crowdlending borrowers relying on their own wealth, family, friends, etc, in order to self-financing them. Most EU member states have built a banking sector which has monopolized the lending market. EUROPEAN CROWDFUNDING NETWORK in association with OSBORNE CLARKE; *"Regulation of Crowdfunding in Germany, the UK, Spain and Italy and the Impact of the European Single Market."* (2013), page5.

⁷⁴ According to data available from 2015, the crowdlending trading values from the principal EU economies are: UK (1,350 € Billions), France (193,2 € Millions), The Netherlands (98,9 € Millions), Spain 63 € Million) and Italy (32 € Million). ROODINK Carlien; *"Current State of Crowdfunding in Europe 2016"*. CROWDFUNDINGHUB, (2016), pages 63, 33, 48, 54 and 42.

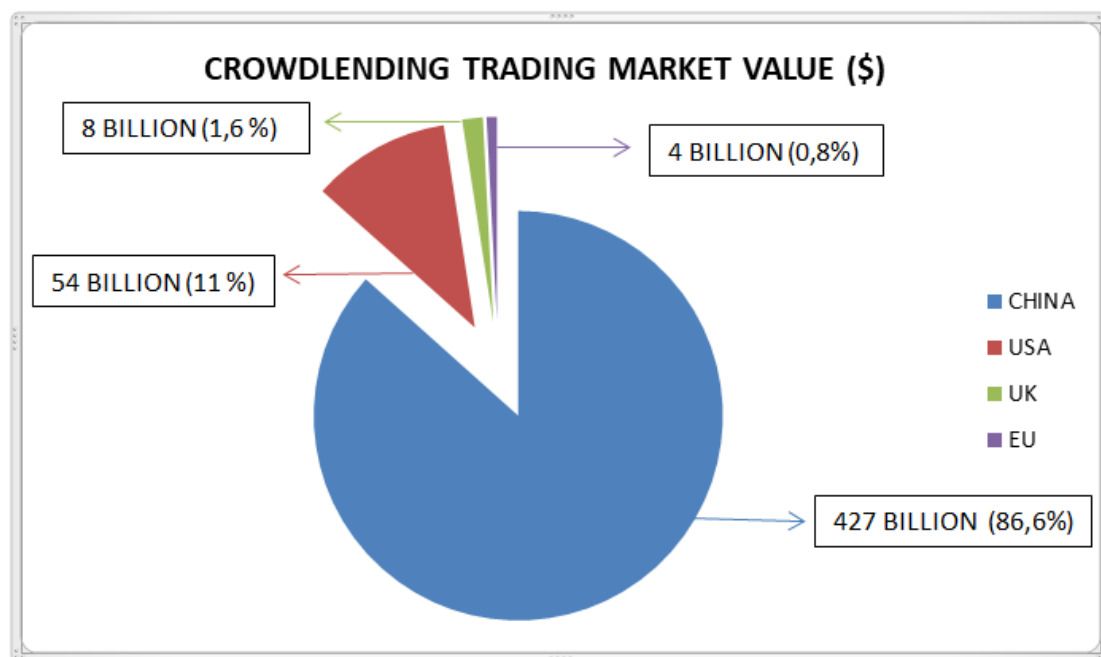
⁷⁵ DELIVORIAS. D; *"CROWDFUNDING IN EUROPE. Introduction and State of Play"*. European Parliamentary research Service, (2017) Page1.

Then, taking into account the current EU economic potential, it represents a very weak crowdlending market compared to them.

The UK plays an exceptional role in this thesis since it has a large tradition and strength as a financial market. Therefore, it is considered as an EU independent case when comparing the principal worldwide crowdlending markets. Nevertheless, from a regulatory point of view, the UK is assessed as one of many crowdlending legal frameworks coexisting within the EU.

According to the statistics portal STATISTA, the crowdlending market is globally shared as follows (The UK is not included within the EU):

Figure 1 Principal financial markets



This graph shows a shameless disproportion among the top crowdlending markets, leaving the EU in the last step.

This situation has caught the attention of the EU authorities, which have considered crowdlending as a national phenomenon from each member state, with low level of cross border-activities.

In this sense, should be outlined that the European crowdlending cross-border projects (that is, those for which the location of the project differed from the location of the platform), only represented the 7.3 % of the total EU crowdlending sector in 2014.⁷⁶ This is a very low value since crowdlending is an online based activity, which shouldn't be as much troubled by regulations as the off-line based activities.

76 DELIVORIAS. D; "CROWDFUNDING IN EUROPE. Introduction and State of Play". European Parliamentary research Service, (2017) page 5.

The European Parliament, Commission and Bank Authority have addressed their concerns about this situation, referring to the European regulatory needs for crowdlending, among other financial technologies.

On one side, the 3rd May 2016, the Commission published a working document, 'Crowdfunding in the EU Capital Markets Union', in which is assessed the weak European crowdlending sector. However, the Commission showed its opinion, considering that it does not worth any kind of EU legislative action yet, due to the local/national repercussion of crowdlending.

On the other side, the Parliament resolution of 19th January 2016 on “stocktaking and challenges of EU financial services regulation”, underlined the potential of crowdlending, among other innovative ways of funding, and the need to streamline the respective regulatory requirements and **to give priority to their cross boarder activities**. So, the Parliament opened the door for a likely EU legislation addressed to scale up crowdlending on a European level.

In conclusion, the coexistence of different crowdlending regulations across the European single market is strengthening the industry in those EU jurisdictions that have addressed a specific regulatory response. Instead, it is showing a very poor crowdlending sector from an European dimension. In this regard, the European Commission does not consider appropriate any kind of legislative action yet. Indeed, the same Commission and the European Banking Authority pointed towards the efficiency of the already implement European rules (Directives and regulations for each financial sector) to regulate crowdlending. However, the European Parliament is considering a more active role from the EU institutions in order to avoid legal fragmentation and boost the European crowdlending sector.

Consequently, the present thesis addresses in the next pages an analysis of the current regulatory European scenario, from the already established directives and regulations, to the different national legislative frameworks. Then, it will be possible to figure it out whether the European Commission lacks of action is benefiting crowdlending in Europe, or oppositely, whether there is an existent need for an EU legislative action to scale up the crowdlending industry across the European single market.

A) The current EU regulation which might affect the crowdlending industry:

As a revolutionary financial technology, crowdlending is a phenomenon difficult to categorize. Crowdlending may appear to be a mixed from different business models, from the banking or credit activities to investment and payment services.⁷⁷ Therefore, it is an undeniable fact that crowdlending may bring some risks that are inherent of each mentioned financial activity.

As said above, crowdlending has absorbed characteristic risks from different traditional financial sectors. As a regulatory response to mitigate these dangers, the European Union already created a body of rules before the crowdlending irruption, establishing a

⁷⁷ Calling platform's users as “lenders”, but talk about their money as “investment” it may show the difficulty of categorizing crowdlending. MACCHIAVELLO, E; *“Peer-to-Peer Lending and the Democratization of Credit Markets: Another Financial Innovation Puzzling Regulators”*, 21 Columbia Journal, HEINONLINE (2015). p.521.

communitarian legal framework for practically each financial sector. Directives about offering prospectus, investment services, payment institutions, electronic money, consumer credit protection and capital requirements are the outcome of this regulatory process⁷⁸.

In this situation, Member States must pay attention to the already implemented European rules when they are regulating crowdlending activities. The inherent crowdlending risks coming from each “classic financial area” may trigger the application of many EU Directives among other provisions.

Therefore, national interpretations about the nature of crowdlending (as an investment, security, financial product, credit entity, payment entity, etc.) can lead to the application of different EU directives for the same activity within a theoretical European single market.

Moreover, since most of the rules that can apply to crowdlending are Directives, even applying the same ones in every country of Europe, the freedom granted to each member state in transposing Directives may create different legal treatments for the same crowdlending activities. Furthermore, the regulatory approach and juridical traditions taken by each member state can make consider illegal some crowdlending services that would be legal in other EU member states.

Accordingly, the already implemented European body of rules may not assure an homogenous regulation of crowdlending through the whole Europe. It leaves a small but enough room for member states to create different regulations between them, which can be hardly irreconcilable within the single market.

Under these circumstances, it would be logic to doubt about the efficiency of the current European rules in regulating financial technologies, such as crowdlending, from a global and unifying European perspective.

A compilation of the most relevant EU Directives and Regulations which may have a stronger implication to the crowdlending sector is shown in the ANNEX I , jointly discussing whether they should apply to crowdlending activities or not.

B) Regulatory approaches of crowdlending from different EU member states:

The traditional boundaries of financial sectors have become blurred. The existing legal regimes can be inefficient at the time of regulating financial technologies which merge classic business models with revolutionary trends.

⁷⁸ The European Banking Authority focused its research in the crowdlending’s risks for market participants and to what extent the existing EU directives can protect project promoters and lenders. At this respect, The European Banking Authority opines that rather than creating a European *ad hoc* regulation, a common framework for crowdlending should be found in the current EU laws and Directives. ENRIA. A; “*Opinion of the EBA on lending-based crowdfunding.*” EUROPEAN BANKING AUTHORITY, London (2015); And I. Tordera; “*EBA supports Peer to Peer lending.*” DIFITEK (2015).

In this direction, some crowdlending leading countries do not understand that financial technologies involve different financing areas. Instead, they seem to continue following classical regulatory approaches widely different in every state.

This is the case of Italy and France⁷⁹, coming from strong banking regulatory traditions, in which the main objectives were: stability of the financial sector, the diligent management of banks and depositors protection⁸⁰. In contrast, a foreign EU agent such as the United States placed crowdlending within the group of firms regulated by the investment services law, which focuses on transparency allowing investors to improve the quality of their decisions. However, the investment legal approach can overload the crowdlending lender with too much information instead of focusing disclosure on relevant elements. Others, such as UK, use a more appropriate mixed regulatory approach, taking advantages from consumer protection and investment rules.

The general trend for EU countries is to advocate for including crowdlending within payment services regime. This inclusion protects lenders from platform's misappropriations, cyber-crime and empowering data protection. However, it forgets relevant aspects such as disclosure (which would be completely covered whether applying investment rules, such as MIFID or the Prospectus Directive).

In this situation, there is not "one-size-fits-all" solution. The EU member states have interpreted the European rules according to their interests when regulating crowdlending. Therefore, there are coexisting widely different regulations for the same activity within the European single market.

Furthermore, countries such as Spain opted for creating new bespoke rules to nationally regulate the crowdlending sector. Thus, increasing the European regulatory fragmentation.

To deeper assess this issue; the ANNEX II contains a brief but detailed explanation of the different regulatory approaches taken by the EU crowdlending top countries, outlining its differences and similarities.

C) European regulatory scenario assessment conclusion:

The regulation of crowdlending, which merge traditional business sectors, has become a strong headache for the European Union as a single market. The lack of legislative precedents or European Authorities resolutions can lead to broad interpretations about the "scope of

⁷⁹ Some countries like UK have established a more liberal approach, leaving space for a bigger growth of the crowdlending sector. Others like France or Italy, have been more rigid requiring crowdlending platforms to register as credit or payment institutions. In Spain platforms must operate freely, helped by payment institutions, after obtaining the registration in the CMVM (investment product and market authority) and below the supervision of the Central Bank. Others like the US uses the Securities rules to regulate the crowdlending sector.

⁸⁰ UK crowdlending platforms "facilitated" lending between lenders and borrowers as an unregulated activity. There were only few legal boundaries in concrete aspects, such as: administration and debt collection services.

application” and “legal terms” of the already implemented EU rules, promoting the regulatory fragmentation of the same sector.

In front of the legal uncertainty provided by the widely interpreted European Rules, the EU member states opted for regulating crowdlending looking for its own economic and political interest, which it does not go further than their geographic borders. Therefore, the European crowdlending scenario is characterized by a multilevel regulatory system, made by “state by state” laws.

As a result, the EU crowdlending sector is living a situation in which: the existent EU jurisdictions are regulating crowdlending through different approaches, while allowing some activities that may be illegal in other European countries.

This legal diversity raises concerns as to whether platforms can access other national markets, consumer protection rules when services are provided cross-border, and whether platforms can passport activity licenses to other member states.

In conclusion, the lack of common EU regulatory patterns for crowdlending, can be seen as the main obstacle to build up the single market for this new industry and strengthen the sector on a EU level.

IV.- THE LACK OF AN EUROPEAN CROWDLENGING SINGLE MARKET – The fragmented regulatory framework and its implications for the crowdlending sector.

A) The legal uncertainty as a main issue:

The EU crowdlending sector is suffering the burdens of a fragmented regulatory panorama. Indeed, the inefficient European rules and different member states jurisdictions, do not allow the creation of an effective European single market, in which platform users would hold similar standards of protection, and where platforms from different countries would be able to easily provide their services.

Among others aspects, “legal uncertainty” represents one of the principal troubles to achieve the mentioned crowdlending single market. Regarding the assessed EU directives and top member states’ regulations (ANNEX I and II), the legal uncertainty can come from⁸¹:

- Uncertainty about applicability of European Union rules. National interpretations of European legal provisions (i.e; as to which legal entities can raise finance from the crowd or how a security is defined) can vary across member states. Therefore, the entities, activities or individuals that can fall under the scope of application of EU rules may not coincide in every EU jurisdiction. To this extent, distinct interpretations about crowdlending’s nature and characteristics can trigger the application of different Directives and Regulations within the territory of the EU.⁸²
- The big autonomy given to EU member states in interpreting legal terms and transposing directives may have some incidence in this issue.
- National laws. They represent puzzles which platform’s CEO’s have to deal with. Nevertheless, specific and clear bespoke regulations in each country may be a better solution to the legal uncertainty issue than a European framework widely interpreted in a divergent way by each EU member state.

In any case, it is true that some directives such as the Directive (EU) 2015/2366 on payment services, has implemented an EU common license regime which is successfully used across the EU. Indeed, the practice has tested its success. However, there are still being some unbelievable situations showing an “enormous lack” of European single market within the crowdlending sector, i.e: Spanish or French platforms which cannot passport their operating licenses and disbursing loans in Germany unless they have agreed a partnership with a national German bank. Nevertheless, it is as well surprising the different legal standards of protection

⁸¹ Wardrop. R., Zhang. B; *“Sustaining Momentum: The 2nd European Alternative Finance Industry Report”*. Cambridge Centre for Alternative Finance (2016) page 21.

⁸² For example: Qualifying crowdlending loans as an investment product would imply MIFID application, with all the consumer protection, transparency and management standard conducts provisions which MIFID contains. MIFID regulation would match efficiently facing crowdlending risks. However, the EUROPEAN COMMISSION stated that crowdlending does not make use of “debt securities” at all (does not qualify as investment), so MIFID does not apply. In contrast, UK authorities (Financial Conduct Authority) categorised crowdlending agreements as “designated investment business” for the purposes of applying the key parts of the Conduct Of Business Sourcebook (COBS), to improve “fair, clear and not misleading communication”. REID. E, BLACK. J; *“The future of Peer-to-Peer lending: the proposed regulatory framework for lending platforms”*. Butterworths Journal of International Banking and Financial Law, (2014), page 37.

granted to crowdlending borrowers and lenders according to the EU member state where they are placed.

Arrived at this point, it is possible to state that the “legal uncertainty” provided by the European fragmented regulatory framework, has as its main negative implications; I) The low level of crowdlending cross-border activities. II) An unequal level of platform users’ protection within the EU. III) The non-consecution of the EU single market plans for financial technologies.

B) Legal uncertainty implications:

1. Low Cross Border activities:

The fragmentation of crowdlending legal regimes throughout the EU member states has been seen as the main barrier for platforms cross-border activities within the EU.

Although the high crowdlending cross border potential as an internet-based activity, national and protectionist interpretations of European directives made by the EU jurisdictions, plus their different regulatory approaches, burdened the crowdlending services provided across the EU single market.

At this regard, the European Institutions showed in their studies that crowdlending’s low percentage of cross border activity has as its main factor the scarce clarity about applicable regulation, as well as excessive diversity among national rules⁸³.

Nevertheless, the major problem is not about the difficulty of accessing to the EU platforms by lenders and borrowers from other member states. Instead, the issue is focused on the ability of platforms to provide their services cross-border. In this sense, the crowdlending borrower and lender, as internet users, enjoy an almost plenty freedom to lend money and raise funds through platforms from everywhere. However, is the crowdlending platform when publishing projects and tries to approach costumers from other EU jurisdictions when it find itself completely lost diving between different regulatory systems As an example of this issue, the Spanish Rule 5/2015 does not apply when Spanish lenders and borrowers invest and publish their projects in foreign platforms. Instead, it applies when foreign platforms “actively look for” attracting customers from Spain (national Spanish project promoters and lenders).⁸⁴

⁸³ “[...] The public consultation seems to indicate that the internal market work less well for financial return crowdfunding (crowdlending and crowd investing). Only 38% [...] operate cross border while almost half of them would like”. “[...] 44% of all platforms claim the lack of information about applicable rules prevents them from operating in more than one EU country [...]”. “Half of the respondents **recognised the need for EU action** on financial return crowdfunding (crowdlending and crowd investing), 49 % called on the EU to promote the single market for FR Crowdfunding and 51% saw a need for ensure appropriate investor protection for crowdlending [...] across the whole EU”; EUROPEAN COMMISSION (2014) *“Communication from the Commission to the European Parliament, The Council, The European Economic and Social Committee and the Committee of the Regions. Unleashing the Potential of Crowdfunding in the EU”*, Brussels (2014), page 8.

⁸⁴ Article 47.3 of the Spanish Rule 5/2015 understands that foreign platforms “actively look for” attracting customers in the territory of Spain when: a) The platform advertises, promotes and generally targets costumers in Spain, and b) When the platform addresses its services specifically to investors and promoters resident in Spanish territory.

2. Lack of investor's protection common standards:

As a response to the legal uncertainty, the EU member states have adopted their own rules addressed to protect borrowers and lenders from the inherent risks of crowdlending. This fact has created different levels of investor's protection within the same single market.

The European parliament issued its opinion about the "the lack of common protection standards for platform users within the EU" through the resolution of 9th July 2015. In this case, the Parliament went one step further, considering appropriate the application of the same investor's protection rules for banking and non-banking financing models ;

"in order to promote growth of non-bank financing models, including crowdfunding and peer-to-peer lending' (crowdlending), underlining that 'investor protection rules should apply to all financing models to the same extent, irrespective of whether they are part of bank or non-bank financing models'

According to the Parliament's resolution, the investor's protection "harmonisation" would promote the crowdlending growth. Therefore, the EU legislative inaction does not seem the best regulatory policy towards the crowdlending sector.

3. Non-performance of the European FinTech Plans:

The fragmented regulatory scenario is harming the EU single market. The current situation seems to be far from the targets set in the "Commission EU Plan for Financial Technologies", which includes the promotion of crowdlending among other businesses.

Those targets are mainly focused in fostering a more competitive and innovative financial sector on an EU level, in order to better embrace the opportunities brought by new technologies.

The "Commission EU Plan for Financial Technologies", is integrated within the most ambitious EU projects. These ones were created for the necessary evolution of the European single market to be ready for adopting the new business models and economic trends. Those projects are "The Capital Markets Union", the "True Single Market for Consumer Financial Services" and the "Digital Single Market"⁸⁵. The basic pillar for these European plans is to enable disruptive technologies to scale up on an EU level, through the promotion of cross-border activities. However, in an official EU report⁸⁶, the Commission has stated that "the different legal national approaches to crowdlending" are keeping cross-border activities to a limited number of transactions.

⁸⁵On one side, "The Capital Markets Union", aims to mobilize capital in Europe, channeling it to all companies (SMEs included) and infrastructure projects in order to expand them and create jobs. On the other side, "The Digital Single Market Plan" targets to make EU rules more oriented to the future and aligned with the fast evolution of technology progress. Lastly, "The True Single Market for Consumer Financial Services Plan" tries to provide EU consumers with a larger choice and more efficient access to financial services across the EU. Moreover, this last Plan is basically oriented on technology and innovative online services to lead the progress towards a more integrated European financial services. EUROPEAN COMMISSION; *FinTech: "Commission takes action for a more competitive and innovative financial market"* PRESS RELEASE, Brussels (2018).

⁸⁶ EUROPEAN COMMISSION; *"Accelerating the capital markets union: addressing national barriers to capital flows"*. Brussels (2017) page 7.

In that sense, the “current regulatory scheme” has negative implications for the EU policies, and has also officially become a trouble for the consecution of the single market European Plans.

C) The EU authorities’ role in strengthening the crowdlending sector:

The EU single market is the heart of the European project. It was created as vehicle to stimulate competition and trade, improve efficiency, raise quality, and helps cutting prices. Nevertheless, the European crowdlending market holds some regulatory obstacles, in form of national regulations, which do not allow fuelling the sector.

Since unlocking the full potential of the Single market is one of the most important duties for the European Commission, among other EU authorities, some kind of active behaviour should be expected from the EU to remove the national barriers and boost the crowdlending in Europe.

According to the last paragraph, reputed scholars⁸⁷ has stated as an evidence of their research work that the more proactive the legal response, the more attractive will be the jurisdiction as a potential location for financial technology companies. Therefore, based on scholar’s conclusions, the European regulatory response to the irruption of financial technologies would have a high probability of improving the European playing field for crowdlending.

Consequently, this is a discussion that ends up in finding out which degree of action is the most appropriate, since some kind of legislative measures should be taken by EU authorities to address the fragmented European legal framework issue.

Some expert opinions⁸⁸ advocate in favour the creation of an specific European legal framework for crowdlending. They believe that this proposal would improve legal certainty, reduces operating costs for platforms, and would push the crowdlending sector towards superior levels of growth. However, experts⁸⁹ are also aware that too strict bespoke regulations can hurt the potential development of growing financial technologies, which are constantly “mutating”, innovating and adopting features from other businesses.

⁸⁷ FENWICK. M, MCCAHERY Joseph A. and VERMEULEN Erik P. M.; *“Fintech and the Financing of Entrepreneurs: From Crowdfunding to Marketplace Lending”*. TILEC (2017) page 33.

⁸⁸ Most of the EU crowdlending platforms explain the low level of cross border activities due to the scarce clarity about applicable rules, as well as excessive diversity among national regulations. Thus, the financial expert Eugenia Macchiavello, among others, proposes the adoption of a minimum harmonization Directive about crowdfunding, including the crowdlending activity. MACCHIAVELLO, E; *“Peer-to-Peer Lending and the Democratization of Credit Markets: Another Financial Innovation Puzzling Regulators”*, 21 Columbia Journal, HeinOnline (2015). p.580.

⁸⁹ Financement Participatif France (FPF), the representative professional association of the French crowdfunding sector, is strongly supporting the implementation of a harmonized European regulation of crowdfunding, and encouraging independent regulations for crowdlending and equity funding. However, the French association recognises the specific characteristics of crowdlending, and the difficulty to regulate an activity (crowdlending) that is continuously evolving. Financement Participatif France (FPF); *“PROPOSAL FOR A REGULATION ON EUROPEAN CROWDFUNDING SERVICE PROVIDERS (ECSP) FOR BUSINESS”*. (Position paper FPF) Paris (2018).

Other relevant actors like EBA, disagree in the creation of an European common legal framework yet. Nonetheless they believe that some kind of EU legislative action would be appropriate for enabling financial technologies to scale up on a EU level⁹⁰.

1. Peers comparison:

Other mechanisms for figuring out to what extent there is the need for an EU legislative action is to check the regulatory scheme of the other three worldwide largest crowdlending markets:

- **USA:**

The US crowdlending market worth approximately 54 Billion dollars, six times higher than the European one (excluding the UK). Indeed, is the second largest and an example of success in terms of growth.

Surprisingly, the US has not addressed any new legislative action towards crowdlending yet. Instead, it has recognized crowdlending as a legal activity under the already implemented lending and securities regulations, which can be state or federal rules. Therefore, the US regulatory scenario may be similar to the EU panorama, since is fragmented by local jurisdictions.

Most experts agree that US lending platforms are burdened by regulatory challenges in a regime that has failed to keep pace with technological innovation⁹¹. The state-by-state licensing works as an anchor for crowdlending. For some firms (Specially crowdlending platforms), this means registering in each state jurisdiction in which they provide their services and comply with diverging standards for activities such as due diligence and securitization.

The USA giant platforms LendingClub and Prosper, aiming to avoid the “state by state” regulatory burdens, opted for registering their crowdlending loans offerings with the Securities Exchange Commission (SEC). As a consequence, they are mainly regulated by federal rules (SEC regulation). However, they should comply with strict prospectus requirements, such as filing quarterly and annual reports.⁹²

Although the legal framework similarities among the EU and the USA, the regulatory burdens within the EU single market come from member state regulations willing to protect their economical, traditional and political sovereign interests. Instead, the US state rules are part of a single country and have enjoyed the global coverage of a common securities framework for almost one century (I.e., Securities Exchange Commission oversight Regime, Securities Exchange Act 1934 and Securities Act 1933). In this sense, the maturity of the US financial

⁹⁰ EBA recommended that EU Institutions should clarify various already implemented laws regarding crowdfunding. Nonetheless, in more actual publications EBA is directly recommending to the EU legislators to start considering a possible crowdfunding specific regulatory framework, distinguishing among each business models. ENRIA. A; “*Opinion of the EBA on lending-based crowdfunding*.” EUROPEAN BANKING AUTHORITY, London (2015), page 33.

⁹¹ DANG. R; “*The Ebb and Flow of Marketplace Lending, and what Lendit USA suggests about the future of FinTech*”. Wharton Fintech (2017).

⁹² CNBC; “*Peer-to-Peer Lender Prosper Registers with SEC*”. (2010).

sector (including crowdlending) as an efficient single market is much more developed than the EU one.

The US Department of Treasury has researched about the crowdlending regulatory challenges. In its opinion, a clearer and more homogenised regulation through the whole US would match better the needs of the crowdlending sector. According to the data compiled in the US Treasury regulatory policy papers⁹³, crowdlending platforms are eagerly waiting for a national financial technology charter that would have one clear set of rules and ideally uniform regulators.

To sum up, from the US crowdlending legal scenario, we can conclude that other factors such as the maturity of the financial markets can outweigh the negative challenges of an “state by state”⁹⁴ federal regulatory burdens. However, a more uniform legal framework for crowdlending would allow to: I) keep pace with technological innovation, II) Implement a higher degree of legal certainty to provide cross-state border activities, III) and clearly benefit the crowdlending market.

- **UK:**

In the scholar Hang Yin’s opinion, “appropriate laws can regulate related businesses effectively, and also leave enough space for industry’s innovation”, and the UK legislators have followed the correct path.

The pure UK’s regulatory scheme it is shown in the ANNEX II. However, we must talk about the way that UK authorities, and in special the Financial Conduct Authority (FCA), have approached the crowdlending sector.

In contrast to the US scenario (which relied on its current and existing laws), the UK opted for the creation of new and specific rules for crowdlending.

On one hand, the UK crowdlending sector holds a main regulator, the FCA, who standardized the sector from six different regulatory perspectives⁹⁵. The FCA has created an understandable and clear global legal framework, leaving enough space for industry’s innovation.

On the other hand, one of the key factors for the success of the UK crowdlending market is the platforms “self-regulation”. The FCA has understood that no one else than the same UK platforms are more aware of the alternative financing sector’s needs.

Consequently, aside from the FCA’s laws, the Peer to Peer Financial Association (P2PFA)⁹⁶, as a crowdlending industry self-regulatory body, has also issued more specific rules to fill the blanks

⁹³ U.S DEPARTMENT OF THE TREASURY; “*Opportunities and challenges in online marketplace lending.*” (2016) page 26.

⁹⁴ Multilevel regulation from federal and state governments.

⁹⁵ “Financial resources requirement (1st), client money (2nd), cancellation rights (3rd), disclosure rules (4th), dispute resolution (5th), and reporting requirements (6th). YIN, H (2016) “*Status quo of the US and UK’s P2P lending regulation.*” Global Journal of Economics and Business Administration (2016) page 35.

⁹⁶ The P2PFA has published the UK industry’s self-regulation, available on its website: <https://p2pfa.org.uk/>

of the “state” regulation. Indeed, before the FCA had taken the crowdlending sector regulatory control, the P2PFA played a fundamental role establishing elementary rules and provided with basic ideas to structure the FCA’s policies, such as the use of regulatory sandboxes.

In conclusion, the UK decided to face the crowdlending disruption implementing progressive regulatory changes to support the emerging industry. Firstly, delegating almost full policy and regulatory authority to the FCA, which has given legal certainty to the sector. Secondly, embracing the industry association advices and self-regulation. According to the financial technology expert Ruhi Dang, the UK’s *“is a regime that has not failed to keep pace with technological innovation”*.

Although the UK does not share the fragmented regulatory scheme issue with the USA or the EU, the pro-active way in which has addressed the crowdlending sector is an example for the financial technologies success.

Therefore, an elaborated active regulatory response in the form of a clear legal framework seems to be the key feature for embracing the irruption of crowdlending.

- **China**

China’s crowdlending market has lived in a regulatory vacuum from its appearance in the country in 2007 until 2016. Consequently, the “super-liberalised” crowdlending market, free of any regulatory burden, boosted the sector.

However, a series of billionaire fraud scandals within the crowdlending Chinese market had as an outcome the implementation strict Government measures.⁹⁷

After the Government regulatory intervention, the creation of new platforms have strongly decreased, and crowdlending annual rates of return has moved to a more sustainable values. In this sense, the anti-fraud regulatory measures have pushed the Chinese crowdlending sector far from the chaotic expansion, going towards a more realistic growth.

In conclusion, the Chinese regulatory scenario does not present similarities with the EU. However, it can be outlined the effectiveness of the Government regulatory action to address the crowdlending industry on the right track for the purposes of investors protection, lowering default rates and mitigating the systemic risk of the sector.

2. Conclusion:

Starting from the following premise: *“the EU fragmented legal scenario it is lowering the growth of crowdlending in Europe”*. Is possible to conclude that a pro-active regulatory activity

⁹⁷ Many cases (thousands) of Crowdlending platforms advertising unusually high returns were discovered to be frauds for running off with the proceeds. Including the China’s largest crowdlending platform Ponzi, which defrauded 900.000 investors. Therefore, the Chinese Government forced crowdlending platforms to adopt strict measures, such as; partnership with qualified banking institutions as a lenders funds custodians among others. TAO, Li; *“Regulation: Just few big Chinese P2P lenders seen surviving in sector tarnished by scandals”*. South China Morning Post. (2017).

from the EU authorities, would contribute to the creation of an efficient single market and consequently strengthen the EU crowdlending sector.

In the process of obtaining this conclusion, a step by step analysis has been carried on. Beginning from the assessment of the European crowdlending regulatory scenario and its implications for the industry, to the study of experts and authorities' opinions. Moreover, it has been carried on a regulatory comparison among the worldwide strongest crowdlending markets.

According to the conclusions exposed at the end of the Third Chapter, the EU crowdlending sector holds a fragmented regulatory scenario; composed by already implemented financial European rules (Directives and Regulations) widely interpreted by protectionist EU member state jurisdictions. As a result, this regulatory diversity is not allowing the existence of an efficient single market. Moreover, the EU fragmented framework is keeping crowdlending as a national phenomenon within the borders of each member state.

The "legal uncertainty" provided by the European fragmented regulatory framework has issued as the main problem to boost the crowdlending on a EU level. The "legal uncertainty" main implications are: I) The low level of cross border activities, II) The lack of equal borrower and lender's protection standards through the whole EU jurisdictions, and III) The introduction of a big handicap for the performance of the EU financial technologies single market plans.

Arrived at this point, it is logic and widely reasoned considering that some kind of EU legislative action should be the appropriate measure to efficiently implement a real single market for crowdlending. However, a diversity of scholars and authorities opinions do not coincide in which legislative intensity should be more appropriate to apply, and that other factors than regulation, can also have a relevant impact in the crowdlending's growth.

Finally, a comparison among the regulatory systems from the worldwide crowdlending top markets (USA, UK and China) has been a key factor to confirm that there is a real need for an EU legislative action. Moreover, this "peers comparison" has been very profitable in order to better understand the most appropriate legislative ways to rule crowdlending, based on the following ideas:

USA:

- Cross regulation in the US (multilevel regulation from federal and state governments), decreases both lending and regulating efficiency of crowdlending⁹⁸.
- A national crowdlending charter that would bring one clear set of rules and ideally uniform regulators would benefit the sector.

UK:

- According to the UK scenario, is better to address new and specific-based regulation to face the issuance of new and challenging disruptive technologies, than using the already implemented one.

⁹⁸ Slattery, P; "Square pegs in a round hole: SEC regulation of online peer-to-peer lending and the CFPB alternative." Yale Journal On Regulation, Volume 30, Article 6 (2013) page 261.

- Regulatory authorities should make appropriate laws to approach the new industry, but also leaving enough space for the industry innovation.
- Regulatory authorities must cooperate with the industry players (crowdlending platforms and associations) in order to design a legal framework which will likely lead to a successful crowdlending sector.

China:

- The Government regulatory action can address a chaotic crowdlending sector towards a sustainable growth, increasing investors protection and lowering default rates.

In conclusion, the EU legislative action, through the issuance of a specific and clear legal framework, would allow the effective existence of a European Single market and consequently, boosting the crowdlending sector on an EU level. Instead, the legislative inactivity will keep the crowdlending sector as a local phenomenon from every EU member state.

3. Proposal:

As it has been reasoned above, the current EU crowdlending regulatory scenario requires a common and unified legislative action from the EU authorities'. However, the way in which this regulation should be adopted must take in to account the industry opinions and needs.

Accordingly, the EU authorities should take enough time to study the evolution of crowdlending phenomenon, its nature, risks, opportunities and regulatory implications.

3.1: Regulatory Sandboxes:

Following the UK model, a wide cooperation with financial experts and main industry actors, such as crowdlending platform associations, will be the first step to design the appropriate European legal framework for crowdlending.

In that sense, Regulatory Sandboxes emerge as one of the best tools for shaping financial technologies' legal frameworks.

Regulatory Sandboxes encourage and give space for new business technology experimentation. Its implementation as a previous step for legislating, would allow the "testing" of crowdlending sector under the supervision of the EU regulators in a "safety" space. Moreover, this regulatory approach is collaborative and dialogical, which would allow regulators and platforms to engage in an-ongoing collaboration to identify the most appropriate regulatory model.

According to the reputed scholars Fenwick, McCahery and Vermulen⁹⁹, and specialized journals¹⁰⁰, the evidences suggest that a "collaborative legal approach" that facilitates

⁹⁹ FENWICK. M, MCCAHERY Joseph A. and VERMEULEN Erik P. M.; *"Fintech and the Financing of Entrepreneurs: From Crowdfunding to Marketplace Lending"*. TILEC (2017) page 34.

¹⁰⁰ PROSER. M; *"Is Regulation coming to online lending and market place lending"*. FORBES (2017).

experimentation, such as Regulatory Sandboxes, is one of the key factors for financial technologies development.

Therefore, any EU legislative initiative targeting to regulate crowdlending should be preceded by a regulatory experimental period, such as the abovementioned collaborative mechanism Regulatory Sandboxes.

In conclusion, lawmakers first have to realize about the full potential of crowdlending before they can start legislating it. However, the EU has been gathering data, publishing reports, and making public consultations for at least half of a decade¹⁰¹. Firstly was generally addressed to crowdfunding, but later specifically to crowdlending and its unleashing potential. In this sense, the EU seems to be prepared for jumping to the next step and starts the legislative activity, according to the needs of the crowdlending sector.

3.2: Legislative proposal for an EU framework on crowdlending:

Moreover, the EU has recently made public its intention to actively regulate the crowdlending industry. Accordingly, in March 2018 the European Commission adopted a proposal for a regulation on crowdfunding, including the crowdlending business activity¹⁰². The proposed regulation is part of the Capital Markets Union Plan, having as their object the establishment and efficiently functioning of the internal market.

Through the issuance of this proposal, the legislator pretends to establish an European common legal framework which will enable crowd lending platforms to easily provide their services across the EU. Indeed, this regulation is characterized by granting “legal certainty” to the crowdlending sector by means of the following aspects:

- EU platforms will have to comply with only one set of rules, when operating in their home market and when doing it in other EU jurisdiction.
- Investors will be aware about the applicable protection rules independently where the platform or they are placed.

By the moment the EU legislative proposal is just on its first steps. In concrete, it has taken the form of an “Inception Impact Assessment”, which is a document presenting the context, problem to tackle (it refers to market fragmentation and low level of cross border activity), objectives and policy options.

The issuance of the “Inception Impact Assessment” by the Commission, aims to inform stakeholders and allow them to provide feedback and their views about the new proposal. Indeed, the proposal is exactly on this early stage.

¹⁰¹ The First European Commission Communication about crowdlending was in the early 2014, where it studied the trends in the EU for crowdfunding and crowdlending market during 2013 and 2014. “*Unleashing the potential of Crowdfunding in the European Union*”. However, related EU authorities, such as the European Bank (EBA), started gathering data and issuing reports even before.

¹⁰² EUROPEAN COMMISSION; “*INCEPTION IMPACT ASSESSMENT, Legislative proposal for an EU framework on crowd and peer to peer finance*.” Brussels (1st quarter 2018).

3.3: Proposals:

To sum up, I propose two alternative solutions. Both of them, are possible regulatory actions for addressing the inefficient EU crowdlending single market, equalizing the level of investors protection, and boost cross border crowdlending activities. These two proposals, vary on their legislative action intensity:

First proposal

- The creation of an European common legal framework, through the issuance of a single bespoke Regulation (Not a Directive) which should: A) Groups all the related provisions from directives and regulations which may apply to crowdlending. B) Unifies licenses, registers and oversight regimes. C) Clearly establishes the European allowed business models and services provided by crowdlending platforms. D) Effectively avoid EU Member States interpretations affected by local interests, such as reserving a principal role for banks within the credit market.

This first proposal is influenced by the experts and scholar's studies which demonstrate that the best way to approach the irruption of any financial technology is an active and specific regulatory response.

In my opinion, this would be the best option since it perfectly matches the needs of the EU crowdlending sector. Indeed, through the present proposal it can be structured a single and consistent regulation, which will provide required legal certainty to the EU crowdlending industry. Therefore, this measure will probably increase the number of cross border activity, strengths and standardizes lenders protection provisions across jurisdictions and help to the consecution of the EU Financial Technologies plans.

Second Proposal

- The creation of an EU crowdlending framework; keeping the already implemented rules, but issuing Guidelines, Directives or soft law, addressed to define legal terms and fixing directive's scope of application regarding crowdlending.
- This coordinated legislative activity would improve the already implemented European regulation by: I) homogenizing legal crowdlending interpretations and II) EU rules applicability. The level of harmonization to reach should be such that platforms providing cross border services shall be able to know beforehand which European rules will apply and which national interpretations can be done. Accordingly, there wouldn't be the need of creating a bespoke regulation, if not to efficiently use the already implemented one.

The second proposal is more aligned to the traditional European Commission's and EBA's views. According to their concepts, a little enlightening legislative activity over the already implemented regulation, would be enough to transform the inefficient EU fragmented framework into a more successful and clear regulation to boost the crowdlending sector.

V.- CONCLUSIONS:

Crowdlending is a new financial technology which through on-line platforms raises money from the crowd in order to fund projects by means of loans.

The crowdlending industry landed to our lives in the early 2006 in UK. Nevertheless, it started to play a relevant role during the immediate 2008's post financial crisis period. The tough measures focused on restructuring the banking sector, moved traditional banks and credit entities interests far away from the retail credit market. Therefore, SMEs and individuals found in crowdlending a complementary source of funding and the opportunity to continuous financing their projects. The "online-based" crowdlending structure allowed platforms to operate in a low-profitable market for traditional credit institutions.

In this sense, crowdlending platforms started to grow worldwide and specifically setting out in the principal financial markets.

As a merge of different classic financial activities and new technologic trends, crowdlending has always represented a regulatory challenge. The Governments from the major global economies have chosen different regulatory policies to take the maximum advantages from this new method of financing. China left the crowdlending industry completely unregulated until the recent years. The UK actively implemented specific regulation to embrace the issuance of crowdlending, while the USA legalized the activity through the already implemented securities and lending national rules.

The European Union owes its singular panorama. In this sense, the European crowdlending sector holds two main features:

Firstly, the irruption of crowdlending has had a distinct response across the EU jurisdictions. Every EU member state opted for a different regulatory approach to embrace the new industry.

Secondly, the EU crowdlending market is the weakest by far among its traditional financial competitors. The difference is widely scandalous, since the EU world class economies (excluding UK) do not even jointly amount the 1% of their crowdlending market peers.

In front of this particular European situation, the EU authorities have recognized that crowdlending is developing fast in those EU jurisdictions which have introduced tailored domestic regimes (UK, France, The Netherlands, Spain, Germany and Italy). However, they agree that there is no need for EU legislative action yet, since crowdlending remains, for the time being, a national phenomenon with practically not cross-border activity.

However, the EU official position regarding crowdlending is as clear as surprising. The lack of European rules addressed to crowdlending is one of the factors which allowed the EU legal fragmentation through national legislations. Therefore, legal intervention could contribute to build up an appropriate EU crowdlending playground, defeat national legislations burdens, trigger cross border activities and turns crowdlending into a global European industry. Instead, the EU regulatory inactivity may probably keep crowdlending as a national phenomenon from each member state.

Accordingly, after exposing the nature, opportunities and risks of crowdlending, I have focused my research work on assessing whether the current European regulatory situation is it weakening the crowdlending sector on a EU level; and consequently answering to what extent there is a need for an EU legislative action.

Regarding the research targets, the first step has been assessing the current regulatory European panorama, and figures it out whether it is an appropriate playground for the crowdlending development.

On one side, the European Bank Authority and the European Commission have stated the suitability of the already implemented European financial rules to legally approach crowdlending. On the other side, my research conclusions strongly disagree with the mentioned European Authorities' opinion, according to what is written below.

First of all, during the first half of the present decade, it has been proved the deficient outcome of regulating financial technologies through the already implemented financial rules. The problem lays down in the inability of traditional regulations to successfully approach crowdlending, which merge risks and features from a broad variety of financial sectors and new technologies.

Secondly, the EU crowdlending sector holds a fragmented regulatory scenario, composed by already implemented financial European rules (Directives and Regulations). These ones, are widely interpreted by protectionist EU member state jurisdictions. In this sense, the European crowdlending scenario is characterized by a multilevel regulatory system, made by "state by state" laws.

This legal diversity raises concerns as to whether platforms can access other national markets, lender's and borrower's protection rules when services are provided cross-border, and whether platforms can passport activity licenses to other EU member states.

Consequently, using the current EU legislation to address the crowdlending industry, may not be the best Regulatory policy to embrace the benefits from this new financial technology.

The "legal uncertainty" provided by the European fragmented regulatory framework has issued as one of the main problems to scale up crowdlending on a EU level. This regulatory scheme does not allow the performance of the EU financial technologies single market plans, lowers crowdlending cross-border activities, and offers different standards of protection through the EU jurisdictions.

In conclusion, there is not an effective EU single market for the crowdlending industry. Therefore, as it is said above, this is not the appropriate scenario to strength the European crowdlending sector.

At this regard, unlocking the full potential of the Single market is one of the most important duties for the European Commission. Therefore, some kind of active behaviour should be expected from the EU to remove the national barriers and triggers the crowdlending in Europe.

Thus, this is a discussion that ends up in finding out which degree of action is the most appropriate, since EU legislative measures are required for the purposes of boosting the European crowdlending sector.

However, there is an on-going debate about the EU pro-active approach towards crowdlending. A diversity of scholars and experts considered the effectiveness of active regulatory responses to face the irruption of financial technologies. Nonetheless, their opinions do not coincide in which legislative intensity should be more appropriate to apply.

In this sense, a “peers comparison” among the principal crowdlending markets (The UK, USA and China), showed the UK’s success in implementing new bespoke regulation to boost the crowdlending sector. In contrast, it pointed the USA’s passivity within a multilevel regulatory system, made by already implemented laws, as inappropriate to keep pace with crowdlending technological innovation.

Furthermore, the UK’s example of success and scholars’ papers evidenced the importance of ongoing collaboration between legislators and crowdlending industry actors (I.e., Regulatory Sandboxes). In accordance, the EU has carried on a policy of close dialogue with the crowdlending sector during the last five years. In special, a broad variety of EU agencies worked very hard on gathering data to better understand the sector. They have also published and financed uncountable research reports, as well as presented regulatory proposals.

In conclusion, a studied EU legislative intervention, through the issuance of a single and clear legal framework, would avoid the fragmented regulatory burdens; implement an effective single market, and boosting the crowdlending sector on an EU level. Instead, the legislative inactivity will probably keep the crowdlending sector as a local phenomenon from every EU member state.

To sum up, the conclusions of this research thesis state the current EU regulation inadequacy to approach crowdlending, among other financial technologies, as well as the existent need, for an active legislative action from the EU authorities to scale up the crowdlending industry in the European Union.

ANNEX I

A) Capital Requirements Regulation and Directive

The Capital Requirements regulation and Directive, work as a coordinated body of regulation¹⁰³. It lays down prudential requirements in accessing the activities reserved to credit institutions and investment firms.

For the purpose of applying the provisions contained in the Capital Requirements Regulation and Directive (CRR and CRD), these rules should address to entities able of qualifying as “credit institutions”.

Closely connected with the CRR and CRD, the Directive (EU) 2014/49 on Deposit Guarantee Schemes (DDGS) determines the scope of its application to only “credit institutions” defining them as “the only ones allowed to hold deposits”. Consequently, only credit institutions, holding deposits will benefit from the CRR, CRD¹⁰⁴ and DDGS¹⁰⁵ regimes. Therefore, it is a key feature to figure out whether funds collected by crowdlending platforms are deposits.

Therefore, the qualification as “deposit” would imply the protection given by the DDGS and the capital adequacy impositions of the CRR and CRD to crowdlending platforms.

Regarding expert opinions, the nature of the most common crowdlending business models (segregated account and notary model) excludes deposits as well as to directly grant the loan by the platform.

Secondly, online platforms do not normally keep or save the lent and/or returned money, but if they do it, the money it is temporally placed in bank accounts on behalf borrower’s and lender’s name. Therefore, platforms do not hold deposits or similar repayable funds.¹⁰⁶

The inability to hold deposits by crowdlending platforms; has encouraged some UK platforms to apply for banking licenses. If applications are approved, crowdlending platforms would be

¹⁰³ Regulation (EU) 575/2013 of 26th of June 2013 on prudential requirements for credit institutions and investment firms, in advance “The Regulation”, and Directive (EU) 2013/36 of 26th of June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, in advance “The Directive”. Both rules, implement the regulatory standards on bank capital adequacy accorded in the Basel III Rules.

¹⁰⁴ CRR and CRD aim to prevent firm’s illiquidity and low levels of capital reserves, setting stronger prudential requirements (for banks), requiring them to keep sufficient liquidity and capital reserves.

¹⁰⁵ The DDGS protects depositor’s savings by guaranteeing deposits of up to 100.000 €. Information available in: https://ec.europa.eu/info/business-economy-euro/banking-and-finance/financial-supervision-and-risk-management/managing-risks-banks-and-financial-institutions/deposit-guarantee-schemes_en

¹⁰⁶ In some business models, platforms are run by credit entities or have agreed in partnerships with them. In those cases, the Regulation (EU) 575/2013 and the Directive (EU) 2013/36 would apply for the credit institution. However, it doesn’t mean that funds held by platforms can be considered deposits. Opinion sustained by the EBA in the paper: ENRIA. A; “*Opinion of the EBA on lending-based crowdfunding.*” EUROPEAN BANKING AUTHORITY, London (2015).

able to hold deposits, granting investor's money with the coverage from the Financial Services Compensation Scheme.¹⁰⁷

Summarising, crowdlending activities clearly fall outside the scope of the DDGS, CRR and CRD regimes. However, the qualification of crowdlending platforms as credit institutions would benefit the sector, bringing an appropriate coverage for the purposes of lenders' protection and mitigating platforms' closure risks.

B) Payment Service Directive:

The Directive (EU) 2015/2366 of payment services (DPS) introduces a regime of transparency conditions and information requirements for entities carrying on payment services.

The DPS applies principally to credit institutions, electronic money institutions and payment institutions as providers of "payment services", among others [DPS art. 1.1 (a)]. Indeed, the relevant aspect would be whether crowdlending platforms can qualify as providing "payment services" as it is defined in the Annex I of the same Directive¹⁰⁸.

Crowdlending platforms can easily fall in the qualification of payment services providers¹⁰⁹ according to the activities defined in the Annex I. Indeed, some examples of this are: services enabling cash to be placed on a payment account (Annex 1. 1), execution of payment transactions including transfer of funds on a payment account (Annex 1. 3) and money remittance¹¹⁰ (Annex 1. 6).

The qualification of the crowdlending business model as providing payment services may protect some features such as, cyber-attacks and money misappropriation by the platform, increasing the level of business transparency. However, it leaves the investor unprotected in terms of disclosure and does not promote platform's due diligence.

¹⁰⁷ "[...]The banking licence will allow Zopa to offer deposits protected by the FSCS, and credit cards and overdrafts, in order to boost lending to individuals[...]" . DUNKLEY, E; *"Peer-to-peer lenders morph into traditional banking. Online sites such as Zopa move closer to the market they set out to disrupt."* FINANCIAL TIMES (Dec. 2016).

¹⁰⁸ The DPS protectionist regime (for the benefit of payment service's users) shall apply only when the payment services constitute the regular occupation or ordinary business activity of an entity. In this sense, EU Member States such as Spain, France or Italy, have recognized the similarity of crowdlending platform's activities and "payment services", granting the option for crowdlending platforms of registering as payment services entities to directly collect and transferred funds gotten from the crowd.

¹⁰⁹ Depending on the country and model, it is generally accepted that the nature of crowdlending business matches with the payment services activities described in the Annex I of the Directive on Payment Services. For example; the *ad hoc* Spanish crowdfunding Rule 5/2015, doesn't allow crowdlending platforms to provide payment services – *receiving funds on behalf investors or promoters with the aim to pay-* which are specified in the Rule 16/2009 (which transposes the Directive on Payment Services) , unless they hold the mandatory authorization to act as a payment service entity announced in the article 52.1 b) Rule 5/2015.

¹¹⁰ Money remittance means a payment service where the funds are received from the payer without any payment accounts being created in the name of the payer or the payee, for the sole purpose of transferring a corresponding amount to a payee or another payment service provider acting on behalf of the payee, and or where such funds are received on behalf and made available to the payee" Definition provided by the EBA.

Summarizing, the Directive on Payment Services strengthens the crowdlending sector by mitigating some inherent risks. However, it does not cover the principal crowdlending activities such as disclosure, screening borrowers or matching borrowers and lenders. Nevertheless, it is a Directive which leaves a wide autonomy to EU Member States in establishing exceptions¹¹¹.

C) Prospectus Directive

The Directive (EU) 2003/71 on the prospectus to be published (PD), enhances the mandatory publishing of a prospectus when securities are offered to the public.

As stipulated in the art. 5 of the Directive, issuing a prospectus enables investors to make an informed assessment of the assets, financial positions, profit and losses of the investment and risks associated with the issuer. The information concerning the issuer and the securities to be offered to the public shall be contained in a report (prospectus). The already mentioned information should point out the essential characteristics and risks associated of the proposed investment.

Then, the prospectus is seen as a tool to balance the information asymmetry between securities issuers and potential non-qualified investors¹¹². Indeed, in case of applying the prospectus regime to crowdlending, the lender would enjoy additional information about the borrower and its project when making the investment decision.

However, the key feature lays down on whether the financial products offered by crowdlending platforms can qualify as “an offer to the public” and as a “security” for the purposes of falling under the Prospectus Directive’s scope of application.

As an European external reference, the United States has regulated all crowdlending platforms as offering securities. In contrast, the European approach seems to be radically different¹¹³.

In that sense, as an European exception, only the CONSOB (the Italian authority supervising financial products), extended the prospectus obligation to the offer of financial products by crowdlending platforms.¹¹⁴

¹¹¹ The EBA positioned in favour of qualifying the crowdlending business as providing payment services. However, it remarks that Member States have interpreted relevant parts of the Directive in different ways –payment service definition and the scope of “regular activity” exclusion- creating uncertainty in its application. MACHIAVELLO, Eugenia; *Peer-to-peer Lending and the Democratization of Credit Markets: Another financial Innovation puzzling regulators*. 21 Columbia Journal (2015), p.564.

¹¹² The article 3 of Directive 2003/71/ EC excludes the mandatory issuing of a prospectus when the offer of securities addressed to: solely “qualified investors”, to less than 100 natural people or to investors who acquires securities for at least 50.000€ .

¹¹³ The EU PD refers to the definition of “transferable securities” provided in the Directive (EEC) 93/2 on investment services in the securities field, which gives to the Member States a wide room for interpretation.

¹¹⁴ In CONSOB’s opinion: i) Crowdlending platforms make “public offers” as it is defined in the art. 2 .1. (d) of the Prospectus Directive ii) Financial product is all kind of investment which entails the deployment of capital with the expectation of profit linked to the underlying risk. iii) Moreover, CONSOB understand “public offer of financial

However, independently whether the PD may apply or not (according to the interpretation of the “securities” definition), it grants to EU member states the faculty of excluding the mandatory prospectus regime for offers of financial instruments below 5€ million¹¹⁵. Therefore:

- I) Whether considering the borrower as the public bidder: Taking into account that platforms and national legislations normally impose lower caps (than 5 million) on borrowers demands, crowdlending products are automatically excluded from the PD regime.
- II) Whether considering the platform as the public bidder: Some of the biggest European platforms can surpass the PD exemption boundary (5 million) regarding the money raised, considering all the projects published on the platform.

Summarizing, rather than legal interpretations about the scope of the “securities” term, the “5 million euros” PD exemption is what generally establishes the non-mandatory use of prospectus in crowdlending activities.

D) MIFID Directives:

MIFID is the Directive on Markets in Financial Instruments, now repealed by MIFID II. Since the enactment of MIFID I in 2004, the European securities markets legislation’s main objective has been to increase consumer protection in investment services, specifically on a retail level.

The provisions contained in MIFID I and II have addressed the European investment activities of concrete financial instruments through a regime of: licenses –mandatory investment firm or banking license-, disclosure to investors, reporting obligations and conduct standards for the provision of investment products and services.¹¹⁶

The coverage of crowdlending activities by the MIFID rules would strengthen the lenders position keeping them more informed about the scope of their investments. Moreover, MIFID rules would help to better monitor the platform’s management conduct and its financial situation, avoiding platform’s closure risks.

The first step to know whether crowdlending may qualify for the purposes of MIFID directives, is judging the nature of the loan products offered by platforms as “financial instruments”. Accordingly, MIFID I contains a list (Annex I) detailing the different existent types of “Financial Instruments”. This list is headed by the “Transferable Securities” defining them as: securities negotiable in the capital markets. Therefore, if the crowdlending loan product can qualify; firstly as a security, and secondly as negotiable in the capital markets, the European

products” as deserving the same prospectus regime as transferable securities. CONSOB; “TESTO UNICO DE LA FINANZA, Decreto legislativo 24 febbraio 1998, n° 58.” Commissione Nazionale Per le Società e la Borsa (2018).

¹¹⁶ The key topics which addresses MIFID II are : i) Investor protection (inducements rules, product governance, best execution and disclosures) ii) Transparency pre- and post- trading, iii) Micro structure issues (trading venues) and IV) Data publication and access (consolidate tape and trade reporting) CFA Institute; “MARKETS IN FINANCIAL INSTRUMENTS DIRECTIVE II, Implementing the legislation.” London (2015)

crowdlending sector would be regulated under the scope of MIFID Directives (the crowdlending loans would constitute “financial instruments”).

At this respect, should be considered the US approach, that has addressed the crowdlending industry within the same regulation package such as for securities. Therefore, the legal consideration of crowdlending loans as “securities”¹¹⁷ by the country which hold the second largest crowdlending market in the world, should be an opinion to take into account. Thus, the consequent application of MIFID provisions should be at least slightly weighed in Europe.

However, tradable securities imply the notion of “negotiable in the capital market”. Then, the existence of a secondary market for crowdlending loans becomes a pivotal feature for the existence of a financial instrument¹¹⁸.

The European Commission has understood the notion of “capital markets” as a broad one, including all contexts where buying and selling interests in securities meet. Moreover, MIFID II expanded the notion of “capital markets” to practically any organised trading facility (OTF)¹¹⁹, which are non-regulated platforms where financial instruments are traded¹²⁰.

In that sense, the consideration of crowdlending platforms as constituting capital markets (OTFs), would support the US regulatory approach, and push crowdlending platforms towards the MIFID regulation¹²¹.

In any case, the official opinion of the European Institutions is closer to deny the application of MIFID to the crowdlending activity. Nonetheless, the interpretation of the “securities” and “capital markets” concepts¹²² by member states can condition the application of MIFID Directives, and its non-exempted features¹²³.

¹¹⁷ A properly and extended security’s definition can be found in Section 2(a)(36) of the US 1940 Investment Company Act. Nevertheless, the specialized web-portal INVESTOPEDIA, defines the term security in a more understandable way. Accordingly to this last one, a security is any “fungible, negotiable financial instrument that holds some type of monetary value. It represents an ownership position in a publicly traded corporation, a creditor relationship with a governmental body or a corporation, or rights to ownership as represented by an option.” Definition available in: <https://www.investopedia.com/terms/s/security.asp>

¹¹⁸ According to MIFID I Annex 1, (1) and art. 4.1 (18): Debt securities, which are negotiable on the capital market, are considered as “transferable securities” which qualify as a “financial instrument”. The existence of a “capital market” to carry out the “negotiation” of debt securities (crowdlending loan products) is a pivotal aspect for the existence of a financial instrument.

¹¹⁹ The scope of financial instruments will include contracts traded on an organized trading facility (OTF). Directive (EU) 2014/65 (MIFID II) “Whereas (9)”, page 221.

¹²⁰ (OTF) It is defined in a broad way to capture all forms of organized trading in non-equities. EUROPEAN COMMISSION (2015); *MIFID II: Frequently Asked Questions*. Press Release Database.

¹²¹ This is the opinion of MACHIAVELLO, E; “*Peer-to-peer Lending and the Democratization of Credit Markets: Another financial Innovation puzzling regulators.*” 21 Columbia Journal (2015), page 566.

¹²² Two general concepts: Financials Instruments and Investment Services.

¹²³ In order to create a common level on investors protection within the EU, exempted firms by national authorities shall comply minimum parameters on investor protection (Art. 3 MIFID II Directive) such as: authorization process,

E. Other relevant EU rules:

The present ANNEX I includes the rules which have a more important regulatory implication over the crowdlending sector.

However, miscellaneous European directives and regulations would be applicable to crowdlending activities due to its multidisciplinary facet within the financial and technologic sector, such as the following ones:

- Regulation (EU) No 346/2013 on European social entrepreneurship funds.
- Regulation (EU) No 345/2013 on European venture capital funds.
- Directive (EU) 2008/48 on credit agreements for consumers (Directive on Consumer Protection).
- Directive (EU) 2014/17 on credit agreements for consumers relating to residential immovable property (the Mortgage Credit Directive).
- Directive (EU) 2009/110 on the taking up, pursuit and prudential supervision of the business of electronic money institutions (the Electronic Money Directive).
- Directive (EU) 2005/60 on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing (the Anti-Money Laundering Directive).

F. Conclusion:

The crowdlending is a merge from different financial areas and an activity very difficult to categorize. Instead, the current EU Directives and Regulations are focused in specific financial fields and non-of them clearly apply to crowdlending. In this sense, interpretations about crowdlending's nature made by EU jurisdictions will determine the application of different European financial rules.

Therefore, the qualification of crowdlending activities as “securities investments”, “financial instruments”, “credit entities” or “payment services” establishes an European crowdlending industry in which every EU country can apply different legal regimes according to their national interpretations.

Nevertheless, rather than a EU legal fragmented framework, what really needs the crowdlending sector is a wide coverage from all the regimes assessed in this ANNEX I, since crowdlending cannot fit in any pure financial sector, but holds common features from all of them. (I.e., Even though crowdlending activities do not qualify as “securities investments”, the Prospectus Directive's regime coverage would be highly appropriate to keep lenders properly informed before they invest).

procedural requirements in preventing conflicts of interest, firms registration requirements, management business conduct standards (acting honestly, fairly, transparently and not misleading retail investors), among others.

ANNEX II

A) The UK:

United Kingdom was an unregulated market for crowdlending just before and immediately after the 2008's financial crisis¹²⁴. An extremely liberal approach was the essence of the crowdlending sector, which triggered its growth during this period¹²⁵.

The reason of this non-regulated situation was because platforms, solely “facilitated” credit between individuals instead of “providing” the loan. Therefore, this activity could not qualify as “commercial” in order to apply the consumer protectionist requirements contained in the Consumer Credit Act 1974 (CCA).

In 1st of April 2014, the UK legislator decided to regulate the crowdlending sector, including the activity of “operating an electronic system in relation to lending” within the situations contemplated in the Financial Services and Markets Acts (FSMA)¹²⁶.

Moreover, the FCA categorised crowdlending loans as “designated investments business” for the purposes of the “financial promotion business regime” contained in the Conduct of Business Sourcebook.

The cause-effect of this regulatory action was the oversight of crowdlending sector by the Financial Conduct Authority, the application of consumer credit rules and investment regulation among other protectionist requirements.¹²⁷ Therefore, crowdlending was for the first time: I) a regulated activity in the UK, II) presented a guaranty scheme for the rights of borrowers and lenders and III) imposed organizational, disclosure and reporting duties to platforms.

Companies lending to individuals, individuals lending to individuals or individuals lending to companies are forms of crowdlending contemplated in the regulated activity. Companies lending to companies or loans without interest return don't qualify as activities within the meaning of “operating an electronic system in relation to lending”, nevertheless they are still being legal activities but do not enjoy the individuals' protection coverage. The aim was to regulate situations in which individuals, and not professionals or firms, were lending or borrowing money using the consumer protection rules to reach higher levels of individuals' protection.

¹²⁴ The emergence of crowdlending as a credible alternative to mainstream lendings, was a principal development that the government didn't want to discourage with regulatory troubles. For that reason, until April 2014 the first bespoke regulation hadn't been enacted. REID. E, and BLACK. J; *“The future of Peer-to-Peer lending: the proposed regulatory framework for lending platforms.”* Butterworths Journal of International Banking and Financial Law (2014), page 37.

¹²⁶ Art. 36H of The Financial Services and Markets Act 2000 -Regulated Activity Order 2013.

¹²⁷ UK legislators created a new regulatory activity “operating a new regulatory activity in relation to lending”. The principal requirement is that an electronic System shall be used for matching the needs of investors and borrowers, to enable one party lending money to the other. ENRIA. A; *“Opinion of the EBA on lending-based crowdfunding.”* EUROPEAN BANKING AUTHORITY, London (2015), page 39.

In conclusion, despite the liberal origins of the UK crowdlending sector, the progressive FCA regulatory activity pushed crowdlending sector towards the consumer credit and investment regimes. Therefore, the UK regulation efficiently protects citizens and small legal entities which decide to use their saves for financing SMEs projects.

B) Italy:

The official trend in the EU is to define the business of “accepting deposits and disbursing loans” as the ordinary Banking Activity, reserved to banks and credit institutions.¹²⁸ However, EU member states enjoy some freedom when categorizing banking activities, which underlines the EU lack of homogenization in this field.

Italy, as an exception, did not follow the European trend. Its authorities considered that crowdlending platforms were collecting deposits or other repayable funds from the public to make loans¹²⁹. Therefore, crowdlending activities were declared illegal unless platforms held a banking license or had partnership agreements with them.

Italian crowdlending platforms generally acquired the legal form of payment institutions¹³⁰. However, the payment service regulation left uncovered many important aspects, such as the borrower’s creditworthiness assessment, risk categorization and the process of matching lenders and borrower’s.

In November 2016, the Central Bank of Italy recognized crowdlending as a legal activity¹³¹. Then, crowdlending platforms were allowed to provide credit in the same way it was only permitted to banks or professional lenders. However it only happens under the compliance of three conditions¹³²:

¹²⁸ The Parliament and Council Regulation (EU) 575/2013 on Prudential Requirements for Credit Institutions and Investment Firms art. 4.1.1 “Credit institution means an undertaking the business of which is to take deposits or other repayable funds from the public and to grant credit from its own account”.

¹²⁹ Defined as “banking activity” in the arts. 10 and 11 of BANCA D’ITALIA; “TESTO UNICO BANCARIO, Decreto Legislativo 1º settembre 1993, n° 385.” (2017).

¹³⁰ Crowdlending platforms transformed their juridical nature from financial intermediaries to payment institutions according to the Directive (EC) 2007/64 on Payment Services. Platforms, made profit from the advantageous regulation proposed by the Italian transposition of the payment services directive, which includes lighter requirements than for banking activities, such as: periodic disclosure, segregated clients’ accounts, minimum own funds, risk management controls and Organization, remuneration Systems, among few others. Art. 114 BANCA D’ITALIA; “TESTO UNICO BANCARIO, Decreto Legislativo 1º settembre 1993, n° 385.” (2017). Payment institutions shall use the Limited Liability Company or Cooperative legal institutions. MACCHIAVELLO, E; “Peer-to-Peer Lending and the Democratization of Credit Markets: Another Financial Innovation Puzzling Regulators”, 21 Columbia Journal, HeinOnline (2015), page 551.

¹³¹ Crowdlending (called social lending in Italy) was officially recognized by the Bank of Italy Resolution 584/2016.

¹³² The Bank of Italy didn’t provide a criteria to define the thresholds to consider certain amounts as “significant funds”. In the same way, the Italian Banking authority left opened to any interpretation the concept of “personalized negotiation” (although a minimum agreement in the amount of the lending, its conditions, amortization, maturity and interest rate should be expressly agreed by the parties) EUROPEAN COMMISSION;

- The amounts of funds lent and borrowed must not be significant.
- The funds raised to disburse loans must be determined following specific and personalized negotiations between lenders and borrowers.
- The platform management financial expertise should be under the oversight of the Bank of Italy.

Furthermore, platforms managers must respect other applicable rules when providing their services in Italy. Mandatory consumer protection provisions from the Italian Consumer Code and the Bank of Italy license and transparency regulation impose strong requirements to crowdlending.

In conclusion, crowdlending in Italy is not yet subject to specific regulation. Nevertheless, crowdlending activities are legally allowed but only upon the compliance of a complex regime of licenses and blurred boundaries, according to the Banking and Financial Italian regulation.

C) France:

The original situation in France, was very similar to the pre-reform Italian scenario. Platforms involving loans with interest rates, should had had to apply for a banking license, or make a partnership agreement with a bank or another entity qualifying as a credit institution allowed to disburse loans.

Within a general scheme favouring credit solutions for SME's, French authorities reformed the regulatory banking system and withdrew the lending reserve granted to banks. These policies, broke the monopoly in the market for loans among individuals and among individuals and firms, which was held until recently by banks.¹³³

After consulting with relevant actors in the sector, the French Government created the IFP (*intermediary participative platform*). It represents a new category of financing intermediary entity. This grants the nature of legal entities to those ones facilitating contacts through a website, between people carrying out projects and people financing such projects. Indeed, crowdlending platforms automatically qualify as an IFP due to the nature of their business activities.

Surprisingly, IFP's new reform has liberalized¹³⁴ crowdlending sector and has imposed a narrow body of requirements, much more consistent and easier to comply due to its legal certainty and regulatory simplicity.

Additionally, registration requirement is the pillar of IFP's legal framework, which is mandatory to get the IFP status for the purposes of the AMF. This registration is conditioned

"Identifying market and regulatory obstacles to cross border development of crowdfunding in the EU." Final report (December, 2017), page 52 (Annex A1).

¹³³ Whether the recipient of the loan is an individual, the loan shall be: for educational purposes or for business activities when there is a for-profit aim. In contrast, there aren't restrictions whether the borrower is a firm.

¹³⁴ FELDMAN R. and DE VAUPLANE H. FRANCE: *Liberalization Of The French Alternative Financing Regime*. Kramer Levin Naftalis & Frankel LLP, (Dec. 2016)

upon the compliance of a certain level of platform's management expertise and honourability, as well as holding a professional private insurance¹³⁵.

Lastly, a simplified Payment Institution Regime has been created for IFP's platforms which want to transfer funds between lenders and borrowers. However, as opposed to the ordinary Payments Institution Regime, the simplified one is at risk of not being recognized by other EU countries.

D) Germany:

Germany is one of the top worldwide economies, and its companies are top positioned in practically all sectors. Financial technologies are not an exception at all¹³⁶. However, the German crowdlending regulation leaves a great deal to be desired. Therefore, it is not strange to just see one German crowdlending platform among the top 60 within the crowdlending sector¹³⁷.

Under German Banking Law, only banks can grant loans, so a bank is always needed to disburse the loan, and then split and assign it to the crowd.¹³⁸

The German banking activity reserve is a protectionist measure. It can harm the single market since foreign European platforms may not be willing to modify their simple operative by reaching agreements with banks.

E) Spain:

The Spanish legislator opted in 2015 for creating a clear and detailed single rule, highly inflexible in accepting the activities which are not explicitly planned on its provisions. Renowned voices from the Spanish financial sector¹³⁹, they considered the hieratic characteristic of this rule as the consequence of pressures coming from the traditional banking sector. This characteristic inflexibility can affect the crowdlending progression towards more

¹³⁵ EUROPEAN COMMISSION; *"Identifying market and regulatory obstacles to cross border development of crowdfunding in the EU."* Final report (December, 2017), page 29 (Annex A1).

¹³⁶ The EY Ranking considered Germany the 6th leading global fintech hub, and the 2nd placed in Europe, based on ecosystem attributes, such as: Fintech market size, investment and talented staff. KELLY. J; *"These are the world's fintech hubs,"* WORLD ECONOMIC FORUM, Thomson Reuters (2016).

¹³⁷ Though Germany is one of the biggest EU credit markets, the country has only recently seen a surge in the alternative lending segment. The biggest factor for its slow growth stems from the stern and complex regulatory framework. Under German Law ('Kreditwesengesetz') only banks can disburse loans. DHIR H. and TAYLOR A; *"German alternative finance"*. Lending Times Journal, (2018).

¹³⁸ EUROPEAN COMMISSION; *"Identifying market and regulatory obstacles to cross border development of crowdfunding in the EU."* Final report (December, 2017), page 38 (Annex A1).

¹³⁹ After one year since the entrance into force of the Spanish regulation, the Rule 5/2015 is considered a hasty regulation, too protectionist and strict. Therefore, the new regulation has turned an unregulated Spanish crowdlending industry into an over-regulated and inflexible system. ÁVILA LAFUENTE. G; *"HD Joven: Luces y sombras de la Regulación del Crowdfunding"* HAY DERECHO (Fundación) (2016).

advanced models able to better compete with traditional banks. However, platforms' CEOs generally accepted the positive effects of this new regulation for the Spanish crowdlending sector.

From a juridical point of view, the Rule 5/2015 officially legalizes crowdlending in its article 50. 2), when defines crowdlending activities as “not taking deposits or other repayable funds from the crowd”. In doing this, the Spanish legislator is avoiding the European legal reserve in favour of credit institutions, who hold the monopoly on “taking deposits or *other repayable funds* and to grant credit”.¹⁴⁰

Basically, the Rule 5/2015 introduces a regime characterised by the following items:

- Strictly defines which are the allowed and the excluded activities for the purposes of the Rule 5/2015.¹⁴¹
- Imposes the “segregated model account” and the need to qualify as an European Payment Service Entity (According to the Payment Service Directive) to directly collecting and transferring funds by platforms.
- Territorial application. The rule will be applicable only if crowdlending activities are carried on by platforms within the national territory, as well as the participation of borrowers and lenders. Whether these last ones participate in foreign platforms, they are not covered by the Rule 5/2015.
- Imposes a regime of license and registration for all platforms, creating a reserve of activity and denomination.
- Delimits; i) the scope of the projects which can be financed through platforms, as well as ii) the form or methods in which the money is raised (financial instruments, securities or loans), iii) The allowed services to provide by platforms and its prohibitions.
- Introduces a code of conduct regarding platform’s information disclosure obligations, conflicts of interests, related parties and others “hot-topics”.
- Limits the promoter’s number of projects per platform, the period of time and the amounts to be raised from the crowd as well as project information requirements and liability.
- Distinguishes among accredited or non-accredited investor/lender. Accordingly, should apply a different statute regarding the maximum lent/invested amount per project, during a period within the same platform or in general (period of time stipulated in 12 months). The distinction between accredited or non-accredited investor/lender, will determine the hardness of the investor protection regime, including the Spanish consumer protection rules.
- Includes an oversight, inspection and sanction regime by the CNMV authority for all platforms qualifying for the Rule 5/2015 and individual or legal entities carrying on reserved activities, with the cooperation of the Spanish Central Bank.

¹⁴⁰ As it has explained in the Annex I (2. *Capital Requirements Regulation and Directive*), crowdlending platforms do not hold deposits from investors. However, “repayable funds” it is a concept which can be widely interpreted by legislators within the EU.

¹⁴¹ The Art. 46.2 defines crowdlending and equity funding as the only activities which fall under the scope of the Rule 5/2015, excluding any other type of crowdfunding model.

F) Conclusion:

The above assessed EU jurisdictions are the top crowdlending markets in Europe. Nevertheless, they opted to approach crowdlending in many different ways. The lack of EU bespoke regulation addressed to financial technologies has helped to broaden these regulatory differences, indeed fragmenting the legal crowdlending framework in Europe.

The diverse regulatory policies among EU jurisdictions differ according to their national and protectionist interests. In this sense, the banking sector extraordinary activity reserves are common borders which crowdlending should face in many EU countries.

Lastly, is very difficult to foresee a strong EU crowdlending sector within the current situation. However, this consideration would be different if every country would have been legislating with the purpose to build a strong European crowdlending sector through common regulatory patterns.

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