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Mainstreaming Social Finance: The Regulation of the Peer-to-Peer Lending Marketplace in the United Kingdom

Chris Rogers and Chris Clarke

Abstract

The paper provides one of the first political economy accounts of the regulation of peer-to-peer (P2P) lending in the UK, drawing on interviews with platforms representing the vast majority of the market at the beginning of the regulatory process. The article links the regulation of P2P lending with debates about regulatory capture. It challenges conventional understandings of its consequences by showing how the regulation of P2P lending displays characteristics of regulatory capture, but appears to have realised several aspects of regulators' visions for a 'socially useful finance', rather than facilitating the kind of rent-seeking behaviour that has been identified in the case of other areas of finance. P2P lending is found to represent one of the latest forms of consumer and small business finance that works towards so-called 'financial inclusion', with ambiguous social outcomes that necessitate further critical investigation.

Keywords: Peer-to-Peer Lending; regulatory capture; socially useful finance; marketplace lending; financial innovation.

Introduction

In recent years, a great deal of attention has been paid to the regulation and re-regulation of financial activity, especially in the UK. This scholarship has included critical analyses of the financial system as a whole (Ertürk et al 2012) and studies of the shift towards a macroprudential regulatory agenda (Baker 2012), which in combination have brought to the fore the importance of questioning the social purpose of finance. However, as Baker (2014, 43) has noted, 'there has been a singular reluctance in the technocratic macroprudential community to connect to wider questions concerning the

social purpose of finance.' Similarly, much academic literature has left a blind spot with regards to potentially more 'socially useful' types of finance. This omission is striking given the rapid growth of various forms of finance attempting to offer meaningful alternatives to high street banks, including 'fintech' in general and the peer-to-peer (P2P) lending sector in particular.

In this article we address that blind spot by considering the ways in which the regulation of P2P lending in the UK has contributed to the growth of socially useful finance, as defined by leading regulatory figures. We build upon critiques of financial regulation, which have suggested it is characterised by 'capture' (Baker 2010) or 'elite collusion' (Cerny 2013) to make three core arguments. First, the transition from self-regulation to formal regulation in the P2P lending sector can be interpreted as an instance of 'regulatory capture' characterised by a degree of elite collusion. To make this case, we engage with literature outlining the conditions under which influential policy communities are formed and regulatory capture is understood to occur (*inter alia* Grant 2005; Mattli & Woods 2009; Tsingou 2009; Pagliari 2012), and suggest that core conditions for capture can be identified in the case of the emerging P2P sector. Second, the key outcome of the regulatory moment was performative, reflecting the view that regulations not only manage but also render objects as governable (Aitken 2015, 132). This performativity is manifested in the fact that formal regulation granted the P2P industry 'a sanctioned claim to formal legitimacy', which has been described as 'key to financial power' (ibid., 129). Finally, regulatory capture has been a key driver in allowing the sector to meet some of the regulators' aspirations for socially useful finance, as *they* define it.

The final point alludes to the ambiguous notion of public interest, which, as Mattli and Woods (2009, 13) note, is subject to 'no generally agreed meaning'. We provisionally

mobilise an understanding of socially useful finance—a proxy for the public interest in finance—directly from a set of debates about the links between finance and society in general, and its ability to 'lubricate the flows of capital and trade' and connect 'savers to productive investments' (Turner 2009b), which has been stimulated by key UK regulatory figures. These figures include Adair Turner, former Chairman of the Financial Services Authority (FSA), Mark Carney, Governor of the Bank of England, and Andrew Haldane, Executive Director of Financial Stability at the Bank. We suggest that the recent growth of P2P lending meets some of *their* criteria for constituting a more socially useful finance. On this basis, we suggest that it may be legitimate to think of 'constructive' regulatory capture in instances where the aims of financial innovators align with broad conceptions about the social purpose of finance, especially given the importance of regulation for legitimating financial practices in the eyes of users.

Our aim, of course, is not to *endorse* regulatory capture in general, but to identify some *potential* benefits in this specific case, and we suggest that whether or not such regulation does in fact produce 'socially useful' outcomes could only be assessed in light of further reflection on what socially useful finance is, and through historical reflection about the role of P2P lending in realising it. We therefore point to the fact that the criteria outlined by regulators are limited in ambition, and that the notion of what is 'socially useful' requires further consideration. We are also conscious that it is not necessarily helpful to artificially juxtapose socially useful alternative forms of finance with 'socially useless' banking, but suggest that emphasising 'social usefulness' represents one way to think differently about the way in which we *do* finance. Our conclusions draw attention to the nature of the sector's potential to realise socially useful finance and offers a research agenda that can help explore this aim, while cautioning against some of the consequences of mainstreaming another form of consumer debt within the UK's financialised economy.

The article is a qualitative study. It draws on material from trade bodies, the press, think-tanks, and interviews with the founders of the UK's three largest P2P lending platforms (Funding Circle, Ratesetter, and Zopa), and the Executive Director of the industry's trade association, the Peer-to-Peer Finance Association (P2PFA).[1] While the absolute number of interviews is small, the firms discussed represented almost 100 per cent of the market share at the beginning of 2011 when the regulatory process began, and despite a number of new entrants, still account for nearly 62 per cent of the market.[2] In the first section, we review literature discussing the social purpose of finance and discussions of financial regulation that show how it has often been characterised as subject to capture, which is usually associated with the development of socially useless finance. In the second section, we review the transition from self-regulation to formal regulation of the P2P sector. We show how the primary drivers of formal regulation lie within the sector itself and how it closely mirrors the self-regulation that went before it. We argue that this reflection can be interpreted as a form of regulatory capture. In the final section, we argue that, in contrast to where regulatory capture has been associated with rent-seeking, in the case of P2P lending it appears to provide reputational value to a form of finance that meets some of the criteria for socially useful finance, as defined by regulators. The conclusion summarises the argument and briefly reflects on areas for future research into the P2P lending sector.

1. The State of Regulation

[1] All participants were sent information sheets prior to interviews and transcripts of interviews after they had taken place. They have provided written confirmation that transcripts are accurate reflections of the meetings and that they are happy to be cited as such.

[2] see http://www.altfi.com/data/indices/UKvolume

Since the Global Financial Crisis (GFC) much of the discussion about financial regulation has focused on the form that regulation has taken, and engaged in critique by demonstrating the ways in which regulatory responses to periods of crisis have not historically served to create systemic stability. Perhaps more significantly, it has been argued that powerful financial actors have been able to capture regulation in order to facilitate rent-seeking opportunities that give finance the characteristic of what some have labelled a 'club good'—a good that is artificially scarce and allows benefits to be realised by particular actors in a system that tends towards monopoly rather than competition. This section briefly reviews this literature in order to frame our core argument: the regulation of the P2P lending marketplace in the UK can be characterised by capture but has granted reputational value to a form of finance that delivers on some regulators' aspirations for a more socially useful type of finance, rather than facilitating the kind of rent-seeking that has been identified in the case of other areas of financial activity.

In the immediate aftermath of the GFC, one of the most significant debates about financial regulation related to the balance between microprudential and macroprudential concerns. As Alessandri and Haldane (2009, 9-10) noted, microprudential, firm-level approaches to regulation made sense for firms in isolation, but made many financial institutions more alike and therefore amplified 'the system's sensitivity to aggregate fluctuations.' In contrast, 'a macro-prudential approach to regulation considers the systemic implications of the collective behaviour of financial firms' and generates stability from 'the heterogeneity of the financial system' (Warwick Commission 2009, 13). The extent to which an acceptance of the macroprudential paradigm became quickly established in policy-making circles has been described as a rapid ideational shift (Baker 2012).

At a superficial level, macroprudential regulation attempts to create a more stable financial system. However, at a more substantial level, it also directs attention away from questions about the purpose of finance, because it does not discuss the origins of crisis in relation to the kinds of financial activity proliferated, but simply in terms of the way in which they are managed. This analysis opens the door to a major critique of financial regulation: that it focuses on regulative rather than constitutive rules, and that it takes a synchronic rather than a diachronic perspective (Rethel and Sinclair 2012). As Rethel and Sinclair (2012, 24) argue, constitutive rules are those that define new forms of behaviour, geared towards defining the purpose of an activity, whereas regulative rules are focused on existing forms of behaviour and relate to the conduct of that behaviour. Synchronic perspectives, they note, focus on regulation at a single point in time, while diachronic perspectives on regulation take account of much more complex social processes over a period of time (Rethel and Sinclair 2012, 25). Rethel and Sinclair's analysis therefore juxtaposes the ideal constitutive/diachronic form of regulation with the sub-optimal regulative/synchronic form of regulation. Ultimately, the tendency for regulation to take the latter form has raised the question of whether or not bank-based finance 'actually serves a purpose other than to enrich the bankers involved' (Rethel and Sinclair 2012, 127).

Echoing this critique of regulative/synchronic regulation, Adair Turner made a series of public interventions that questioned the social purpose of finance following the crisis (see Turner 2016, xiii-xiv). In August 2009 he stated: 'It is hard is to distinguish between valuable financial innovation and non-valuable … I think that some of it is socially useless activity' (Turner 2009a). These remarks proved controversial within the City – particularly given that Turner was the Chairman of the FSA at the time – yet he went on to defend them a month later in his Mansion House speech: 'some financial activities which proliferated over the last ten years were "socially useless", and some

parts of the system were swollen beyond their optimal size', and cited Stephen Green, Chairman of the British Bankers' Association, who said that the chasing of short-term profits had led to 'complex products of no real use to humanity' and that 'some parts of our industry have become overblown' (Turner 2009b). In a recent book, Turner (2016, 11) elaborated this thinking further to suggest that public policy should aim to produce 'potentially more socially valuable forms of credit allocation' than that which results from 'purely private decisions'. The main argument of the book is that it is possible to have 'too much finance' and that the 'excessive scale' of some financial activity is what leads to moments of crisis (Turner 2016, xiv; 43).[3]

The thrust of Turner's interventions on the question of social usefulness have been echoed by other key regulatory figures. For instance, Haldane (2012) suggested that whereas British banks were once part of the 'social fabric', that fabric has now been 'torn' and banks 'need to rediscover their social usefulness'. Similarly, Carney (cited in Inham 2013) has suggested that when finance 'only talks to itself … [it] becomes socially useless'. Despite these claims and the short-term alarm of the City when they were first made, the early regulatory position outlined in 2009 and addressed by the Coalition Government since 2010 has, if anything, left this debate about social purpose behind. Indeed, the Independent Commission on Banking Standards, the Financial Services Act 2012, the Financial Services (Banking Reform) Act 2013, and a number of official consultations did very little in terms of delivering on the specific issue of social purpose. Instead, the focus tended to be on regulatory and prudential issues in the name of financial stability, diluting calls for urgent reform to make finance meet a social purpose.

[3] It is noteworthy that Turner does not elaborate precisely what he takes to be 'social usefulness' but instead seems to rely on basic points about finance having become too large and 'swollen', and it is somewhat unusual that Turner does not substantially address recent developments in alternative forms of credit allocation, such as P2P lending. In fact, in February 2016 Turner explicitly warned that losses on P2P loans had the potential to 'make the worst bankers look like absolute lending geniuses' (Rovnick 2016), suggesting a degree of tension between his prior ideas about the social usefulness of intermediation and his position on and emerging forms of intermediated finance like P2P.

This dilution of aims can be understood primarily in terms of the institutional market power of financial actors.

Baker (2010) identifies a key driver of this process in the form of regulatory capture. This capture happens 'when bureaucrats, regulators and politicians cease to serve some notion of a wider collective public interest and begin to systematically favour specific vested interests' (Baker 2010, 648). Baker (2010, 649) notes how this process was particularly prevalent in the US and the UK in the 1990s and 2000s as a 'largely unregulated shadow banking sector' was allowed to emerge on the basis of 'originate to distribute' models of risk management, which were managed by financial institutions in-house. In the case of banking, Baker (2010, 651) argues that the material resources of financial institutions, in combination with the political importance of regulation, a 'revolving door' between regulators and financial institutions, and the establishment of an intellectual paradigm about banking all went increasingly unchallenged.

This critique has been echoed by Cerny (2013, 12), who has argued that 'national states are caught up in a quasi-corporatist bargaining process that privileges the best resourced and entrenched private interests', which produces regulation formed on the basis of intellectual capture (Cerny 2013, 16). He suggests that while the financial sector has been traditionally characterised as a 'private good', it should in fact be characterised as a 'club good', which is non-rival (a key characteristic of public goods), but also excludable (a key characteristic of private goods) such that it can be subject to elite collusion and institutionalised rent-seeking. Cerny (2013 16-7) argues the 'collusive character' of such club goods is intensified because they are often 'provided under the aegis and "constitutive" charter of the state' and which results in 'pro-market regulation' that is amenable to 'collusion, market manipulation, and increased rent-seeking'.

Discussions of financial regulation since the GFC have therefore placed emphasis on the way in which the privileged position of financial institutions has allowed them to extract benefits for themselves, resulting in systemic instability and the socialisation of the costs of failure. The implication is that regulatory capture not only had a significant role to play in the origins of the GFC, but that it is also playing an important role in the restoration of the *status quo ante* (Tsingou 2009) and by implication, institutionalising future instability. In order to prevent such outcomes, it is necessary to go back to Turner and other regulators' considerations of what a socially useful finance might look like, and how it should be regulated to ensure it is able to meet that social purpose.

While such discussions have been somewhat sparse, the statements of regulators such as Turner suggests that they view it as finance constituted by activity that is traditionally conceived as financial intermediation, narrowly defined. As Turner (2009b) puts it, the socially useful functions of finance are 'linking savers to productive investments, allocating capital to efficient use, [and] lubricating the flows of capital and trade'. He recognises of course that it is not straightforward to distinguish this supposedly socially valuable element from 'pure speculation' and that market making requires 'some position taking' (Turner 2009b). Yet, there is still a sense that, on these terms, socially useful finance is about something to do with linking savings with borrowers and productive investments according to a model of traditional financial intermediation. As Carney (cited in Inham 2013) claims, the question of social purpose is one of what finance 'does for businesses making investment, what ultimately it means for jobs in the economy'.

The image of socially useful finance regulators present is clearly limited. For instance, it does not explicitly address the kinds of banking activity that might be described as socially useless, and while it might be assumed this is a reference to developments in

securitisation and of banks' highly leveraged positions, it says little about other core functions of banks, such as their role in money creation. Equally, the vision of social usefulness presented by regulators fails to seriously address questions about the social character of money and debt and in particular questions about what money 'is' and what it is 'for' (*inter alia* Dodd 2014; Graeber, 2011; Zelizer 1994). On the one hand, the position of regulators on socially useful finance makes it difficult to distinguish a meaningful critique of financial activity from generalised 'bank-bashing', while on the other, to accept the premise that 'finance' has a 'function' or 'purpose' may serve to blunt critique of 'it' (Scott 2013, 20). It is clear then, that the notion of 'socially useful finance' is presently underdeveloped and requires further research that is beyond the present scope of this paper.

Our intention is not, therefore, to endorse regulators' views about what constitutes 'socially useful finance', but to show how the dynamics of regulatory capture that have so often been criticised for producing socially useless finance have, in the specific case of the P2P sector in the UK, unintentionally helped to realise regulators' visions of what constitutes socially useful finance. Therefore, our argument that the emergence of socially useful finance defined in these terms has emerged from regulatory capture suggests that in certain instances, it may be useful to think of instances of 'constructive' capture, which could only be confirmed through historical enquiry. The next section of the paper reflects on the conditions that lead to capture, and the extent to which the regulation of the P2P sector meets these criteria.

2. From Self-Regulation to Formal Regulation

It is broadly accepted that there are some common conditions that lead to the formation of policy communities, which can result in policy monopolies or regulatory capture.

These include asymmetries of information between the regulated industry and regulators and society more broadly, a lack of widespread public interest in regulation in a given sphere, the apparently technical nature of the subject of regulation, as well as particular institutional and political contexts (Grant 2005; Mattli and Woods 2009; Tsingou 2009; Pagliari 2012). In particular, Mattli and Woods (2009, 5) have suggested that the tendency for regulatory capture can be thought of as a function of the relationship between the institutional supply of and social demand for regulation. This section of the paper will show how it is possible to observe limited institutional supply and weak social demand for the regulation of the P2P marketplace in the UK, and therefore demonstrates that the regulation of the P2P marketplace in the UK can be characterised as an instance of regulatory capture.

In recent years there has been impressive growth in various alternative forms of financial activity that exploit new technologies in order to connect lenders and borrowers outside established banking and investment practices (Nesta 2014). For the purposes of this article, we are concerned with P2P lending only. This form of crowdfunding, if it can be called that, is distinct from many others because it is the only form that focuses on lending and borrowing specifically. In contrast, 'donation crowdfunding' can be characterised as philanthropy, while both 'reward' and 'equity crowdfunding' can be characterised as a form of purchase. While these forms of crowdfunding clearly have potential to realise socially useful goals in their own right, the distinctive character of the activities they facilitate places them beyond the scope of this article. As Sam Ridler (Interview 6/11/14), Executive Director of the P2P Finance Association (P2PFA) notes, P2P lending is not the same as crowdfunding because 'there are entirely different motivations in the model'.

The UK P2P market is dominated by four firms: Funding Circle, Market Invoice, Ratesetter, and Zopa. Until 2010, these four platforms had a 100 per cent market share, and as of January 2016, still accounted for around 70 per cent of the market.[4] The cumulative total of funds lent across the sector stood at just below £5.5 billion in January 2016, having risen from a cumulative total of just over £1 billion in January 2014 and a cumulative total of just over £400 million January 2013.[5] While the sums involved are small in relation to the financial sector as a whole, the sector's growth is exponential, with Morgan Stanley (2015) predicting that the UK sector will reach £15 billion of annual origination by 2020. Such rapid growth raises inevitable questions about its sustainability. For instance, it remains to be seen whether P2P lending will be able to continue enjoying the competitive advantage over the banking sector it has had in a post-crisis context defined by a low central bank interest rate, although P2P operators are optimistic on this point. Ryhdian Lewis (Interview 11/07/13), founder and Chief Executive of Ratesetter, for instance, suggested 'banks have relative advantages over us and we have relative advantages over banks', such that 'even in a steady state situation when interest rates are normalised […] we are still going to be seriously competitive'.

However, in order for P2P lending to continue to grow, participation in P2P lending must be *normalised* as a form of financial practice in the eyes of consumers. Thus far, it has benefitted from being, and has actively marketed itself as, a substitute for bank-based finance when market conditions limit access to credit and offer negative real savings-rates. Yet as Lewis (ibid) notes, 'there is still a stage where people need to begin to hear that this makes sense [and that] it is a perfectly fine thing to do.' This difficulty, as is often the case in matters of money and credit, is a problem related to the

[4] http://www.altfi.com/data/indices/UKvolume

[5] http://www.altfi.com/data/indices/UKvolume

development of trust between counter-parties. This trust is something that the UK P2P sector is still in the process of developing.

As The National Endowment for Science, Technology, and Arts (Nesta) (2013a, 3) states in its report on Funding Circle, the investor base is narrow and typically made up of those who are 'male, highly educated and relatively wealthy, with a science, business or finance degree', and an expansion of the sector is contingent on perceptions of security among a broader base of investors. However, such perceptions have not been broadly adopted. For instance, one recent survey by the consumer advice service uSwitch (2014) suggested that 84 per cent of savers were wary of lending through a P2P platform. Media representations have not assisted in expanding the potential pool of investors using P2P platforms, as various outlets emphasised the lack of regulation in the sector, and in particular the fact that it is not covered by the Financial Services Compensation Scheme (FSCS) (e.g. Cambridge News 2013; What Investment 2014; Dunkley 2014). As one article phrased it, 'the biggest concern [...] is that as yet no P2P lender is covered by the Financial Services Compensation Scheme [and] that unlike banks and building societies, should the lender go under, you won't be compensated' (Cambridge News 2013). The same uSwitch (2014) survey found that 39 per cent of respondents identified a lack of regulation as their major concern.

This debate about regulating the sector is interesting, particularly because concerns about coverage under the FSCS are anachronistic since P2P lending platforms are *not* themselves lenders, but brokers. This distinction is significant because the limited social demand for regulation of the sector that has been evident was based on a misunderstanding of what P2P lenders do. As Andrew Mullinger, co-founder of Funding Circle (Interview 20/5/13) noted, 'as we are not a lender and contracts are between the lender and the borrower, in the unlikely event that Funding Circle went out

of business those contracts would stand and there would be no greater risk of default by borrowers.' Zopa likewise notes that contracts it arranges between lenders and borrowers would stand should it cease to trade and that

> while your money is waiting to be lent out it is held in a trust account at RBS, which remains entirely separate from the Zopa business. This means that if RBS were to fail, any money you have in the trust account is covered by the FSCS guarantee. (This is Money 2014)

On this view, then, regulation can play an important role in normalising participation in P2P lending by endorsing it as a reputable and secure financial practice. This position has been reflected in the fact that the UK market leaders have expressed qualified pro-regulation views. Andrew Mullinger (Interview 30/5/13) of Funding Circle, for instance, noted that his firm 'is very much in favour of having its activities incorporated into the regulatory framework where regulation is appropriate and proportionate, because this will be extremely beneficial in building the kind of trust that is necessary for platforms such as ours to succeed'. Rhydian Lewis (Interview 11/7/13) likewise noted that Ratesetter sees an important place for regulation, because it 'will give more confidence, the fact that there's a hygiene factor', and that as a result it favoured regulation because 'ultimately […] people expect it [and] the right regulation does add value and is the right thing to do.'

Similarly, the CEO of Zopa, Giles Andrews (Interview 23/7/13) has said that Zopa has been calling for regulation because 'on balance, we think it will be a net good', and is hoping that any problems regulation causes for P2P operators will be 'less than the benefit they gain.' In particular, he noted that even in a general context where public trust in regulatory authorities has been shaken by the crisis, there is still a dominant

tendency for people to trust regulated financial products over non-regulated financial products (ibid.). He also noted that there was an acceptance that

> at some point someone will say you can't have an activity on this scale, with this much consumer money involved which isn't regulated … We thought we ought to try really hard to be ahead of the curve on that one, try and pre-empt it and be in a position where we are proactive in trying to get the right regulation and not just reactive (ibid.).

The positions of the three leading firms, constituting 99.98 percent market share of the P2P marketplace at the time regulatory processes began, can therefore be described as pro-regulation. Moreover, these firms were also keen on taking a proactive approach in order to ensure that any regulation imposed was not stifling. As Rhydian Lewis (Interview 11/7/13) noted, 'the impetus [for regulation] has come from the industry', because 'in January 2012 we were told by the government the industry was too small and understandably they were worried in a period of great innovation of regulating too early.' It is clear, therefore, that there was a firm intention on the part of P2P lending platforms to shape the form of the industry's regulation.

This intention was substantially realised, as the early regulation of P2P lending platforms occurred largely because of sustained and effective lobbying on behalf of the P2PFA (2011), which was formed in August 2011. The P2PFA focused on protecting the industry's consumers by setting targets for capital reserves to cover operational risk and advocating prudence in the assessment of credit risk on behalf of lenders. The P2PFA's self-regulation also included commitment to comply with anti-fraud measures, and aimed to ensure that firms made adequate arrangements for the management of customer complaints, and the orderly run-down of any firm that ceases to operate.

Following the establishment of the P2PFA, Giles Andrews (Interview 23/7/13) suggested that, 'on balance we think regulation will be a net good [and hope it will] formalise everything we do already […] while giving us some kind of tick saying we are responsible'.

In essence, FCA regulation introduced in April 2014 has attempted to amend existing consumer finance protection rules to incorporate P2P lending (FCA 2014a, 64). This approach is viewed as appropriate given that the three largest P2P platforms in the UK operated according to the 'client segregated account' business model, in which all funds from lenders and borrowers are separated from the platform's own balance sheet (Kirby and Worner 2014, 17). Essentially, the FCA (2014a, 13) has produced rules for P2P platforms all designed around pre-existing consumer protection standards and the content of the regulations bears a strong resemblance to the program of self-regulation that the UK's leading P2P platforms had been advocating.

Significantly, the FCA (2014b, 6) report on the consultation period for crowdfunding regulation noted that new rules on capital requirements were the 'principal concern' of respondents. This position was to ensure that firms hold a minimum amount of regulatory capital so 'they behave prudently in monitoring and managing business and financial risks' (FCA 2014b, 6-7). However respondents to the consultation, including a number of P2P platforms, are reported to have 'felt that the proposed requirements were too high or suggested an alternative calculation method' (FCA 2014b, 7). Notably the FCA (2014b, 20) amended its approach so as to lower capital requirements for P2P lending firms, while also stressing its commitment to a prudential regime 'that is not overly complex […] especially as we are designing a regime for firms that are new to prudential standards'.

This aspect of FCA regulation reflects the P2P platforms' concern that regulation not be overly burdensome. Another area in which FCA regulation has reflected the existing practices of current P2P lenders is the new regimes' requirement that platforms make arrangements to ensure that loans continue to be administered should a P2P lending platform cease to trade (FCA 2014b, 27). In essence, this FCA (2014b, 28) stipulation is light-touch, with the rule merely requiring that platforms 'take reasonable steps' to put these arrangements in place as part of a 'proportionate framework', which 'balances regulatory costs against benefits'. The regulator is thus not setting prescriptive obligations that firms must fulfil, but rather allowing them 'to design systems and controls that are appropriate to the needs of their business model and consumers' (FCA 2014b, 28). Such a light-touch approach was also evident in the regulator's introduction of a 'disclosure-based regime' that requires all communications from P2P lending platforms are 'fair, clear and not misleading.' Notably, it does not 'consider it appropriate to mandate specific disclosures or the form and content of those disclosures since business models vary across the market' (FCA 2014b, 31). Nor does it 'ban specific terms of disclosure practices' as long as firms only use terms such as 'protected' or 'secure' when this is not misleading' (FCA 2014b, 31). In the absence of prescriptive practice, there is little sense in which these rules are likely to stifle existing practices of P2P platforms in the UK.

Perhaps of most importance was the FCA's (2014b, 18) decision not to include P2P platforms under the FSCS on the grounds that this move would 'impose additional regulatory costs, which may be quite significant'. Despite the fact that emerging nature of the sector means that attempts to define it are relatively new, the position of the FCA on the FSCS indicates an ability to understand the nature of the activity: it is an appropriate response to the fact that P2P lenders do not lend themselves. In other words, regulators acknowledged and endorsed the P2P sectors' view that the public

demand for regulation addressing issues relating to financial services compensation—which was in any event of relatively low political salience given the size of the industry in 2011—was anachronistic based on a misunderstanding of the P2P sectors' activities. This approach to regulation can therefore be described as having a *constitutive* character, because it endorses or 'mainstreams' a form of finance that emulates the traditional intermediary function by bringing it under the state's regulatory umbrella. As Jonathon Moules and Elaine Moore (2014) have noted, regulation provided 'implicit backing for an alternative funding market eager to move beyond its image as an interesting but niche activity.'

Both the views of market leading P2P platforms in the UK and moves towards self-regulation, spearheaded by the P2PFA, indicate that elites operating in the sector have been keen to drive regulatory developments and shape their form. As Ridler (Interview 6/11/14) explains, 'we were actively calling for it', and 'we're very pleased it came into force' as regulation was 'very similar to what we already had as guidance for new platforms and for our members'. The substantive similarity between self-regulation and formal regulation of the UK P2P marketplace in the context of clear intentions on the part of the subjects of regulation to shape its form, suggests a degree of capture as it has been conceptualised in the academic literature. It is clear that the demand for regulation came principally from a narrow sector of society—most notably the industry itself. This process occurred in a context where participation in the industry was limited to a relatively small sector of society making regulation a matter of low political salience, where there was limited understanding of the technical aspects of the industry, and where there was initially little appetite on the part of regulators to supply it. As an issue of low political salience with a technical character where there has been reasonably narrow social demand for and institutional supply of regulation, the case meets many of

the criteria for regulatory capture outlined in the literature (Grant 2005; Mattli and Woods 2009; Tsingou 2009; Pagliari 2012).[6]

3. From Regulatory Capture to Socially Useful Finance

In the previous section we argued that the limited social demand for and limited institutional supply of regulation in the UK P2P sector meets criteria for regulatory capture, which is commonly associated with the 'privileging of narrower interests (the "haves") at the expense of broader interests (the "have-nots")' (Mattli and Woods 2009, 16). In this section, we suggest that while capture appears to have benefitted the industry by granting it reputational value by providing it with a claim 'to formal legitimacy' (Aitken, 2015, 129), that it has also contributed to realising a number of the socially useful goals as they have been defined by key regulators. We discuss how the sector has: (1) played at least some role in sustaining demand in tight credit conditions: 'lubricating the flows of capital and trade', as Turner puts it; (2) provided the basic function of transferring money from lenders to borrowers in such a way that essentially emulates traditional financial intermediation: 'linking savers to productive investments'; and (3) introduced a relatively novel mechanism to refashion finance through a process we describe as the 'crowdsourcing of interest rate decision making'. These claims raise questions about whether, under certain circumstances, it may be possible to think in terms of 'constructive regulatory capture'. We suggest that such outcomes are

[6] One area in which the P2P sector clearly stands out in relation to this literature relates to its size, as many studies of capture focus on mature industries. However, while the P2P sector is not a mature industry, there has been substantial private equity and venture capital investment in the industry which means that the lack of maturity does not necessarily translate into a lack of resources, which is identified as another key component for contributing to regulatory capture (Mattli & Woods 2009; Tsingou 2009; Baker 2012; Pagliari 2012; Cerny 2013)

contingent on our understanding of 'social usefulness', which requires further research, and could only be confirmed through historical enquiry.

The first socially useful goal that can be related to the emergence and growth of P2P lending platforms is based on their contribution to sustaining aggregate demand following the GFC. As data from the Bank of England (2014a, 4) show, lending to UK businesses fell from an average rate of £7.4 billion per month in 2007 to -£1.1 billion per month in November 2013. For individuals, in the period to November 2013, the annual growth rate of consumer credit, including credit cards and other unsecured loans, had recovered to 3.3 per cent from lows of 1.8 per cent, -0.8 per cent and -0.3 per cent recorded in 2010, 2011, and 2012 respectively, however this remains some way short of the 4.9 per cent and 5.1 per cent rate of increase in 2007 and 2008 (ibid., 6 table 1c). Despite the Bank's program of quantitative easing, which has involved its purchase of £375 billion of gilts in order to provide a monetary stimulus (Bank of England 2014b), the conjuncture since 2008 is one in which there are few outlets for borrowing for individuals or SMEs, concurrently stifling both investment and demand.

In the context of effective zero interest rate policies set by the Bank of England and tight credit conditions, the economic context after the GFC clearly helped to create a supply of lenders eager to gain a better rate of return and borrowers who had been denied access to affordable credit elsewhere. These circumstances have therefore allowed for P2P lenders to set competitive interest rates and allowed the platforms to grow. In 2013, P2P lending platforms facilitated loans to individuals and businesses in the amount of £480 million (P2PFA 2014). In 2014, it was predicted that P2P lending to business would reach £749 million and lending to consumers £547 million (Nesta 2014, 12), and crucially, Nesta (2014, 28) found that a third of businesses using P2P lending believed that they were unlikely to get funds elsewhere. Moreover, in the first

three quarters of 2014, UK P2P lending provided credit to more than 62,000 consumers in the UK (Nesta 2014, 13).

Put simply, the idea is that in providing loans to those who would otherwise not have had access to them, the rise of P2P lending can aptly be described as socially useful. This is not to suggest that the expansion of consumer credit is an *a priori* social good. Rather, it is a recognition of the fact that maintaining levels of aggregate demand in the economy is an essential *a priori* condition for avoiding economic stagnation and depression, in a context where the tight credit conditions that have prevailed following the GFC had the potential to exacerbate deflationary tendencies, and the P2P lending has provided an outlet to make a contribution to offsetting this tendency. In this sense, the P2P marketplace can be understood to meet Turner's objective of 'lubricating the flows of capital and trade'.

In turn however, tensions emerge on the grounds that the dynamics of P2P lending represent a consolidation of the role that financialisation plays in welfare provision and it could face the same set of criticisms levelled at both 'privatised Keynesianism' (Crouch 2009) and the 'debtfare state' models (Soederberg 2014), in which state provision of welfare is effectively replaced as individuals are increasingly expected to provide for their own well-being through participation in various kinds of financial markets. However, P2P lending in the UK effectively links credit and debt relations to the productive economy, on both the demand and supply sides. On the supply side, this is because funds available for lending are dependent on a realised surplus—the excess savings—of lenders. On the demand side, borrowing is linked directly to the consumption of goods, services and investment, rather than investment in underlying assets that can be inflated unsustainably. While the desirability of debt-financed consumption for debtors may be subject to debate, in this form at least it serves to

stimulate the productive economy by contributing to aggregate demand. In Turner's terms, this is effectively the 'linking of savers to productive investments'. Furthermore, the P2P business model, which is commission-based, means that the platforms themselves have an incentive to engage in sustainable lending, since in the event of widespread defaults, their own profits will be threatened.

While the scale of P2P lending activity is currently small in relation to the whole financial sector, its apparent ability to 'lubricate the flows of capital and trade' and 'link savers to productive investments' in a way that, at this stage, appears more sustainable than the disintermediated finance of the 1990s and 2000s, appears to fulfil some of Turner and other regulator's visions for a socially useful finance. The P2P market place therefore represents a cultural challenge to the way in which finance is practiced. However, P2P lending cannot genuinely be described as non-capitalist—Funding Circle, Zopa and Ratesetter have each been backed by private equity consortia of various kinds—and the extent to which the industry's reputational value appears to have been enhanced by the capture of regulation, suggests a strong degree of sectional influence. Nonetheless, the close connection between elements of this influence and socially beneficial outcomes more broadly defined suggest this cultural challenge to the way in which finance is practiced is substantial.

Such a cultural challenge is perhaps even more likely in light of the way that P2P lending challenges existing relationships of power within finance through the relatively novel means by which creditor-debtor relationships are negotiated in the ways that P2P lending platforms facilitate, but do not execute, financial intermediation. Until Septeber 2015, for instance, Funding Circle allowed lenders to decide the interest rate at which they want to lend, while borrowers can select the best rate available from a range of offers. In effect, Funding Circle's interest rates were set through a crowdsourcing

process in which negotiations between individuals come to reflect the prevailing market price of borrowing. This system is particularly noteworthy as it offers a potential model of the 'crowdsourcing of interest rate decision making', which in a sense means that institutional power is minimised while local control over negotiation of contracts is maximised.

In each case, the price of borrowing is not a function of the seigniorage privilege afforded to banking elites, but to the decisions of a broader range of customers. Of course, P2P platforms do not operate outside of the price system. Indeed the crowdsourcing of interest rate decision-making depends on a reverse auction system. However, as Brett Scott (2013, 222) puts it, they are 'a world away from the centralised oligopoly of high street banks that refuse to disclose what they are using my money for'. Likewise, Nigel Dodd (2014, 316 emphasis in original) picks up on this idea by suggesting that P2P lending is part of the 'progressive *de*centralization of money'. Put simply, in this regard our claim is that the technology associated with P2P lending platforms offers a relatively novel means through which to negotiate the creditor-debtor relationship, one which could further help the sector to grow as an alternative to the socially useless aspects of banking.[7]

The technological infrastructure provided by these P2P lending platforms is crucial to how they facilitate intermediation. On the one hand, they very much look like they are enabling the function of traditional banks: directing savings to productive investments.

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[7] We are grateful to a reviewer from *BJPIR* for emphasising the fact that the role that technology might play in realising 'socially useful' objectives, both in finance and more broadly, is a question that is contested by those who see the gains from recent technological change to be more limited than those of the second industrial revolution (Gordon, 2016), and those who see its potential to transcend prevailing capitalist structures (Mason 2015). We agree with the reviewer that this debate is highly significant, and we regret that space dictates we are not able to engage more thoroughly with it here.

On the other hand, the ethos on which the whole crowdfunding movement is built depends on a rather different model of organisation than the image conjured up by the traditional banking institutions. In general terms, 'network-thinking' has reconceptualised how hierarchies are understood and challenged. Thus the platforms can be seen as a crucial nodal point in this network: *facilitating* lending decisions by the crowd, but not actually *making* those decisions. In this regard, their activity essentially builds upon the growth of what Yochai Benkler (2006) identifies as the 'networked information economy'. This set of practices is associated with technological and communication advances that enable a more 'decentralized individual action', which utilises 'radically distributed, nonmarket mechanisms that do not depend on proprietary strategies' (Benkler 2006, 3). One of the aspects of the 'enhanced autonomy' that the networked information economy brings is that people have a greater capacity to act in 'loose commonality with others, without being constrained to organize their relationship through a price system or in traditional hierarchical models of social and economic organization' (Benkler 2006, 8). Through these processes, it is possible to view the mainstreaming of P2P lending through regulation as a significant challenge to the power relations that have underscored the cultural practices of financial activity that have recently been described as socially useless.

The extent to which this challenge constitutes an example of regulatory capture producing positive outcomes remains to be seen, particularly as the growth of P2P lending might serve broader and often problematic 'financial inclusion' agendas. It is contingent on our understanding of the social purpose of finance and could only be confirmed by historical enquiry. However, where innovators in financial services—like P2P lenders in the UK—pursue business models that facilitate ends broadly agreed to be socially useful, there is a case to be made that drives to capture regulation *could*

produce constructive outcomes, especially in light of financial services' reliance on 'sanctioned claims to formal legitimacy' (Aitken 2015, 129) for their expansion.

Conclusions

This article has argued that regulatory capture has often been understood as a way of facilitating rent-seeking by financial elites, resulting in socially useless finance. We argued that in the case of the regulation of P2P lending in the UK, a similar process of regulatory capture can be identified, but appears to be contributing to the construction of regulators' views of socially useful finance by 'lubricating the flows of capital and trade', 'linking savers to productive investments', and facilitating the 'crowdsourcing of interest rate decision-making'. In particular, we suggested that by bringing it under the regulatory umbrella, the FCA contributed to mainstreaming and granting respectability to this form of financial activity, which has the potential to help expand the constituency participating in it. In light of financial services' reliance on the endorsement of the state in order to foster their expansion, it may be appropriate to think in terms of constructive outcomes for regulatory capture in instances where the goals of innovators are closely aligned with broad understandings about the 'social purpose' of finance, however that may be conceived. Our aim, of course, is not to *endorse* regulatory capture in general, but to identify some potential benefits in this specific case, and which will need to be the subject of historical enquiry before a judgement about those benefits might be authoritatively made.

Despite these potential benefits, we are aware that P2P lending is not a palliative for all of the problems that debt relations create or for financial stability more broadly, and it is clear regulators need to engage with a number of other issues if they were to further endorse the sector in the name of socially useful finance. For instance, the sector's

reliance on credit-scoring as its primary way of assessing creditworthiness means that a significant proportion of the population are excluded from P2P lending, while individual the benefits it provides are likely to be limited to those with surplus savings. There might be ways of overcoming such exclusionary practices, either through developments of the P2P lending system itself or the development of other kinds of social finance, such as credit unions, so that these benefits might be realised more broadly. At present though, these are areas where further research is required.

We suggest there are at least six sets of issues derived from our discussion in this article that should constitute the heart of a new research agenda in this increasingly significant area of financial activity.

1) *Conceptualising socially useful finance*. Throughout this paper we have drawn on a definition of social usefulness outlined by regulators. However, this definition operates within a narrow framework that neither clearly articulates what specific aspects of banking are socially useless, nor engages with the complex social relations of money. Both issues, we suggest, require further consideration.

2) *P2P lending infrastructures/technology*. Our notion of the crowdsourcing of interest rate decision making depends on the new infrastructures that P2P makes available. As yet, little has been said about the political economy of these technological developments in relation to money and credit.

3) *Market segregation.* The crowdfunding landscape in general is evolving rapidly and to complement our analysis, more needs to be said about the types of business models available and the specific way they may, or may not, address the questions of social purpose we raise here.

4) *The sociality of P2P lending*. As part of this analysis, much more empirical study is required on the aspects of P2P lending that are labelled as 'social'. Indeed the label

'social lending' often applied to the sector should be deconstructed and subjected to sustained analysis.

5) *The historical antecedents of P2P lending.* It is often all too easy to assume because of the 'newness' of the P2P infrastructures that the practices enacted on the platforms themselves are new, but of course they are full of historically and culturally produced forms of human action. P2P lending and its potential social purpose should be located within this cultural history.

6) *Financialisation and P2P lending.* Finally, these practices also need to be located and analysed within existing discussions about the nature of money and debt, and their relationship to processes of financialisation in UK society more broadly. We think as these issues are addressed larger questions can be asked about the potential of P2P lending beyond the regulatory notion of socially purposeful finance outlined here.

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