

## REGULATING ON-LINE PEER-TO-PEER LENDING IN THE AFTERMATH OF DODD-FRANK: IN SEARCH OF AN EVOLVING REGULATORY REGIME FOR AN EVOLVING INDUSTRY

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### I. INTRODUCTION

Like Congress's prior attempt to legislate a post-bubble repair and prevention strategy for the American economy, the Sarbanes-Oxley Act of 2002 (Sarbanes-Oxley),<sup>1</sup> the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank) has received a somewhat chilly response from legal academics.<sup>2</sup> As was the case with Sarbanes-Oxley,<sup>3</sup> however, even amid all of the proposals included for the sake of "doing something" rather than for a strong policy justification, a few nuggets of genuine value can be found. One of those, in the case of Dodd-Frank, is the opening effort to address the regulatory gap surrounding on-line peer-to-

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<sup>1</sup> Sarbanes-Oxley Act, Pub. L. No. 107-204, 116 Stat. 745 (2002) (codified at 15 U.S.C. §§ 7201-66). Roberta Romano lambasted Sarbanes-Oxley in a now famous article. See Roberta Romano, *The Sarbanes Oxley Act and the Making of Quack Corporate Governance*, 114 YALE L.J. 1521, 1523 (2005) (arguing that the policies included in Sarbanes-Oxley "may be . . . characterized as recycled ideas advocated for quite some time by corporate governance entrepreneurs.").

<sup>2</sup> Stephen Bainbridge recently released a paper titled in homage to Romano's Sarbanes-Oxley critique. See Stephen M. Bainbridge, *Dodd-Frank: Quack Corporate Governance Round II*, 95 U. MINN. L. REV. 1779 (2011). One of this Article's authors recently described Dodd-Frank as "at best an incomplete vision for increasing consumer protection and heightening corporate responsibility." See Eric C. Chaffee, *The Dodd-Frank Wall Street Reform and Consumer Protection Act: A Failed Vision for Increasing Consumer Protection and Heightening Corporate Responsibility in International Financial Transactions*, 60 AMERICAN U. L. REV. 1431, 1431 (2011). This Article's other author refers to Dodd-Frank as a "missed opportunity" in a forthcoming paper. See Geoffrey Christopher Rapp, *Mutiny by the Bounties: Will Dodd-Frank's New Whistleblower Law Reform Wall Street?*, 2012 BYU LAW REVIEW (forthcoming).

<sup>3</sup> See Geoffrey Christopher Rapp, *Beyond Protection: Invigorating Incentives for Sarbanes-Oxley Corporate and Securities Fraud Whistleblowers*, 87 BOSTON UNIVERSITY LAW REVIEW 91, 92 (2007).

peer (P2P) lending. Congress directed the Comptroller General of the United States and the Government Accountability Office to report on the ideal regulatory structure for this emerging and rapidly evolving segment of the fringe lending industry.<sup>4</sup> The GAO report, which contains a variety of new information and insights, was issued on July 7, 2011.<sup>5</sup>

On-line P2P lending is a booming industry,<sup>6</sup> which has caused tremendous regulatory confusion; at the same time, it has received scant attention in legal scholarship. Previous work in the area among legal scholars has primarily addressed the role of P2P lending in micro-finance for international development.<sup>7</sup> Little work has addressed the proper scope of regulation for domestic for-profit on-line P2P lending, other than a forthcoming piece that takes the debatable position that on-line P2P should be completely exempt from securities regulation<sup>8</sup>—a position we challenge in this article.

Like many GAO studies, the on-line P2P report is written at a broad level and avoids specific recommendations.<sup>9</sup> Still, it may spur some legislative action towards clarifying the regulation of P2P sites. The Report outlines two possible regulatory schemes: a continued regulation of the investors in P2P sites by securities regulators, with regulation of borrowers the responsibility of various financial services agencies; or unified regulation under a single agency, such as the new Consumer Financial

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<sup>4</sup> Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 989F, 124 Stat. 1376, 1947-48 (2010) (to be codified at 5 U.S.C. app. 11) (requiring that the Comptroller General of the United States and the United States Government Accountability Office conduct a study to “determine the optimal Federal regulatory structure” for person-to-person lending).

<sup>5</sup> See Government Accountability Office, *Person-to-Person Lending: New Regulatory Challenges Could Emerge as the Industry Grows*, July 2011 [hereinafter, GAO REPORT], available at <http://www.gao.gov/new.items/d11613.pdf> (12 July 2011).

<sup>6</sup> One leading site, the LendingClub, saw an increase in loan volume from \$16 million in 2008 to \$59 million in 2009. See Sheryl Jean, *Also on the loan menu*, DALLAS MORNING NEWS, Feb. 14, 2010, at D01.

<sup>7</sup> See, e.g., Kevin E. Davis & Anna Gelpert, *Peer-to-Peer Financing for Development: Regulating the Intermediaries*, 42 NYU J. OF INT’L L. & POLITICS 1209 (2010); Raj M. Desai & Homi Kharas, *Democratizing Foreign Aid: Online Philanthropy and International Development Assistance*, 42 NYU J. INT’L L. & POL. 1111 (2010); Molly Buetz Land, *Networked Activism*, 22 HARV. HUMAN RTS. J. 205 (2009); Sarah B. Lawsky, *Money for Nothing: Charitable Deductions for Microfinance Lenders*, 61 SMU L. REV. 1525 (2008).

<sup>8</sup> See Andrew Verstein, *The Misregulation of Person-to-Person Lending*, 45 U.C. DAVIS L. REV. (forthcoming 2011), at \*22, available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1823763](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1823763) (last visited 29 Sept. 2011) (“While it is plausible that P2P notes were either ‘investment contracts’ or ‘notes’ for the purposes of the Securities Acts, there is also a strong case that they are neither.”).

<sup>9</sup> See, e.g., Jeffery M. Johnson & Carl Jensen, *The Financing of Terrorism*, 2010 J. INST. JUST INT’L STUD 103, 109 (GAO report on terrorism provides overview but lacks discussion of specifics); Timothy Inklebarger, *DOL calls GAO target date fund recommendations vague*, PIONLINE, March 7, 2011, available at <http://www.pionline.com/article/20110307/PRINTSUB/303079977> (last visited 13 July 2011) (Department of Labor rejects GAO recommendations as too vague).

Protection Bureau.<sup>10</sup> The Report does not provide a recommendation as between these two options, leaving the future of P2P lending regulation uncertain. This Article aims to fill the current regulatory gap and provide a recommended roadmap, as well as context, for on-line P2P lending.

On-line P2P sites have faced tough scrutiny at the hands of American securities regulators, both on the state<sup>11</sup> and federal level. Applications by leading platforms to operate in particular states have been rejected, and the SEC, for a time, prohibited leading sites from soliciting new lenders.<sup>12</sup> Much of the regulatory uncertainty surrounding how these sites should be classified stems from what might be described as a “square pegs, round hole” problem. Existing structures for securities regulation have simply not envisioned an investment opportunity in which the party seeking financing provides little or no disclosure to potential sources of capital. Moreover, in a sense, on-line P2P represents the perfect securities regulation exam hypothetical, incorporating thorny and long-puzzling issues such as the definition of a security, the concept of material review used by some state regulators, and the meaning of such key identities as issuers, exchanges, and the like.

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

The remainder of this Article is structured as follows. Part II offers an overview of on-line P2P lending, discussing the structure and business model of various sites, the historical and contemporary context of P2P lending, why the recent emergence of these sites is important, and the risks these sites pose to users. Part III analyzes the current regulatory regime for

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<sup>10</sup> GAO REPORT, *supra* note 5, at 42.

<sup>11</sup> LendingClub has no authorization to sell securities in Oregon, among several other states. Prosper was licensed in Oregon but subjected to a \$15,000 fine for selling unregistered securities “and not properly disclosing their risks.” Brent Hunsberger, *Peer-to-peer lending: know the risks*, THE OREGONIAN, Oct. 4, 2009, available at 2009 WLNR 19600589.

<sup>12</sup> Prosper.com was shut down for nine months after the SEC found it had offered unregistered securities. Farhad Manjoo, *On this site, a stranger will spot you some cash*, THE WASHINGTON POST, April 24, 2011, at G04.

P2P lending, which is governed on the borrower side by banking regulation and on the lender side by federal and state securities law. Part IV discusses the struggle to create a coherent regulatory regime for P2P lending, including study of such lending and various regulatory options mandated by Dodd-Frank. Finally, Part V recommends that an organic approach be taken to regulating on-line P2P lending in which multiple regulators have oversight and use their individual expertise from regulating traditional lending to create and adapt regulation to the evolving world of on-line P2P lending.

## II. AN OVERVIEW OF ON-LINE PEER-TO-PEER LENDING

### A. The Basics of On-Line P2P Lending

In its most general form, on-line peer-to-peer (P2P) lending can be defined as any transaction arranged using the internet in which one or more individuals lend money to one or more other individuals. “Traditional” lending, by contrast, involves an institutional lender such as a commercial bank, credit union, and the like, lending money to an individual. The cornerstone of P2P lending is that individuals, rather than institutions, stand on *both* sides of the transaction.

Pure on-line P2P lending could be structured without a formal intermediary, with only the communications pipelines of the World Wide Web facilitating the transaction. For instance, a person could, legalities aside, post an advertisement on Craigslist ([www.craigslist.org](http://www.craigslist.org)) seeking a loan for a particular purpose and offering a certain interest rate.<sup>13</sup> Or a Facebook ([www.facebook.com](http://www.facebook.com)) user could send messages to distant “friends” offering to lend them money for a specified rate of return.

Of course, while such P2P lending could arise, assuming a hospitable regulatory environment, the transaction costs associated with it would be relatively high. The level of fraud and outright criminality on Craigslist and other “open” web platforms is incredibly high<sup>14</sup> and it would be safe to assume that it would make it nearly impossible to find legitimate

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<sup>13</sup> In fact, some would-be borrowers have attempted to do just that. In a June 2011 posting, a “company” advertised on a Florida craigslist site for a “loan investor for start-up purposes.” The unspecified funds would be used to start a “restaurant and sports bar.” See <http://tallahassee.craigslist.org/vnn/2420107031.html> (last visited 6 June 2011).

<sup>14</sup> Craigslist receives 200 scam complaints per month. While this number is small compared to the overall level of traffic on the site, according to its founder “the bad guys are persistent.” See Aleksandra Todorova, *A Craigslist Scam You Might Fall For*, SMARTMONEY, Aug. 10, 2005, available at <http://www.smartmoney.com/spend/family-money/a-craigslist-scam-you-might-fall-for/> (last visited 6 June 2011).

lending and borrowing partners without extensive additional investigation of potential counterparts. The Facebook alternative would be limited in that if one can only reach active participants in one's own networks, one has fewer potential partners to reach (even if a person has more "friends" than a typical law professor).

To capture profits associated with reducing such transaction costs, on-line P2P lending sites have emerged. The essential selling point advanced by P2P sites is the notion that by eliminating the "middle man" – the commercial bank in a traditional loan – investors can earn higher returns and borrowers can obtain financing at lower rates.<sup>15</sup> Such sites have been around since 2005 in Europe, where the UK's Zopa was an early leader.<sup>16</sup> The most well-known US versions of such sites are Prosper Marketplace (Prosper.com) and LendingClub (www.lendingclub.com), which represent the "heartland of P2P."<sup>17</sup>

Prosper and LendingClub are the two most prominent on-line P2P sites in the United States, and both now use a similar business model.<sup>18</sup> Prospective borrowers register with the platform and complete a loan application.<sup>19</sup> Investors then review loan requests and determine which to fund.<sup>20</sup> Investors do not make loans directly to borrowers.<sup>21</sup> Once an investor chooses to fund a loan, a separate bank issues the loan to the borrower and then sells the loan to the P2P platform.<sup>22</sup> The platform then issues a separate note to the investor with a return on the investment contingent upon the borrower repaying the original loan.<sup>23</sup> Thus, the investor has made an investment in a note, not an actual loan, and hopes that the borrower will repay so that the note will be paid by the platform.

On LendingClub, the platform charges a fee for its services, and retrading of notes prior to maturity is permitted via a web-based platform created by a separate broker-dealer firm.<sup>24</sup> The interest rate for a loan is set by the site according to its analysis of the borrower's credit history, income, debt, and other factors.<sup>25</sup> Interest rates vary between 7 and 21 percent,

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<sup>15</sup> Verstein, *supra* note 8, at \*8.

<sup>16</sup> Jeffrey MacDonald, *Web sparks person-to-person lending around the world*, CHRISTIAN SCIENCE MONITOR, Dec. 24, 2007, at 13.

<sup>17</sup> Verstein, *supra* note 8, at \*7.

<sup>18</sup> *Id.* at 5-6.

<sup>19</sup> HOWARD M. FRIEDMAN, SECURITIES REGULATION IN CYBERSPACE §503.A (3d ed. 2010 supp.).

<sup>20</sup> *Id.*

<sup>21</sup> *Id.*

<sup>22</sup> *Id.*

<sup>23</sup> *Id.*

<sup>24</sup> FRIEDMAN, *supra* note 19, at §503.A.

<sup>25</sup> Pamela Yip, *Person-to-person lending is networking its way up*, DALLAS MORNING NEWS, Dec. 10, 2007, at 1D.

borrowers may request up to \$25,000, and must meet certain credit criteria.<sup>26</sup>

Prosper.com utilizes a related model. Originally, the site used an on-line auction to “find investors willing to make loans to particular borrowers.”<sup>27</sup> The lowest bidders (that is to say, those investors willing to extend credit at the lowest interest rates) would “win” the auction, and funds from those bidders would be pooled to extend loans.<sup>28</sup> However, the site modified its approach in 2010, removing from lenders the ability to determine interest rates; instead, the site sets an interest rate based on its own analysis of applicants’ financial history.<sup>29</sup> Prosper raised its minimum FICO score for borrowers from 520 to 640 in an effort to stem defaults.<sup>30</sup>

A far more limited alternative is offered by a closed end mutual fund, National Retail Fund, operated by Perpetuity, Inc.<sup>31</sup> Under this approach, investors diversify across consumer notes via purchase of mutual fund stakes.<sup>32</sup> The consumer notes are based on loans made by the fund itself; investors can browse profiles of individual borrowers to see “why they are borrowing funds and ‘how they are doing.’”<sup>33</sup> The browsing of profiles is meant to make the site seem “hip” and connected to social networking, though the Fund in fact represents a far more traditional investment medium.

A variety of other P2P lending sites also exist or have existed. Between 2001 and May 2011, at least fourteen companies have offered on-line P2P platforms in the United States.<sup>34</sup> These sites have used a variety of models of P2P lending, including one that created direct links between individual borrowers and individual lenders without the use of a bank in the process.<sup>35</sup> The alternative sites have been geared toward a variety of different segments of the lending market, e.g. small businesses, students, or those seeking loans to purchase a home.<sup>36</sup> To date, none have received the attention that has been paid, both from a business and a regulatory sense, to the market leaders, Prosper and LendingClub.

On Prosper and LendingClub, typical borrowers are “seeking fairly

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<sup>26</sup> See Sheryl Jean, *Also on the loan menu*, DALLAS MORNING NEWS, Feb. 14, 2010, at D01 (minimum FICO of 660 required).

<sup>27</sup> Friedman, *supra* note 19, at §503.A.

<sup>28</sup> *Id.*

<sup>29</sup> Manjoo, *supra* note 12.

<sup>30</sup> Hunsberger, *supra* note 11.

<sup>31</sup> *Id.*

<sup>32</sup> *Id.*

<sup>33</sup> *Id.*

<sup>34</sup> GAO REPORT, *supra* note 5, at 17 n.39.

<sup>35</sup> *Id.* at 17.

<sup>36</sup> *Id.*

small, unsecured loans for consumer purposes—such as consolidating debts, paying for home repairs, or financing personal, household, or family purchases.<sup>37</sup> Reviewing the borrowers on LendingClub, for instance, one of the authors found that the overwhelming share of the applicants sought debt consolidation loans.<sup>38</sup> However, there were a few miscellaneous loan requests – a person with a credit score between 714 and 749 sought a \$6,000 five-year loan to purchase a Honda VTX 1800 Motorcycle and a person with a 679-713 credit score sought \$4,000 for an “engagement loan” to cover wedding expenses.<sup>39</sup>

### B. Historical and Contemporary Context of P2P Lending

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

Commercial credit’s cost for borrowers is not simply the expense associated with the bank as “middle man”. Non-traditional lending is attractive for some borrowers, even if expensive, for at least two reasons. The first is its convenience. Payday lenders, discussed elsewhere in this Symposium, for instance, though they charge seemingly excessive interest rates, offer convenience when compared to other short-term loan options.<sup>40</sup> Surveys of payday loan customers reveal that the main value they assign to such options is convenience, with locations near home or work.<sup>41</sup> In addition, commercial lending can subject potential borrowers to what might be referred to as *moral interrogation*. Walking into a bank, individuals with low incomes or credit defects may feel they are likely to be judged. By comparison, non-traditional lending can be less embarrassing,<sup>42</sup> and may even offer anonymity.<sup>43</sup>

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<sup>37</sup> *Id.*, at 10.

<sup>38</sup> Lending Club Screen Shot, on file with authors.

<sup>39</sup> *Id.* Both loans had been close to fully funded (89% and 85% respectively).

<sup>40</sup> Nathalie Martin, *1000% Interest—Good While Supplies Last: A Study of Payday Loan Practices and Solutions*, 52 ARIZ. L. REV. 563, 596 (2010).

<sup>41</sup> *Id.*

<sup>42</sup> *Id.*

<sup>43</sup> Christopher L. Peterson, *Removing the Target: Protecting Military Service Members and Veterans from Financial Predators*, 35 HUMAN RIGHTS 8, 8 (2008).



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

With that said, person-to-person lending takes a remarkable variety of forms, including some that are quite formalized. An examination of three of these forms will be useful to demonstrate just how varied person-to-person lending can be. The first is the “rotating credit association,” “RCA” or “ROSCA.” The RCA is the “basis for the peer lending methodology.”<sup>44</sup> The Chinese *hui*, Japanese *ko* or *tanomoshi*, Korean *kye*, Mexican *tanda*, and Nigerian *esusu* are all forms of this kind of lending.<sup>45</sup> In Cantonese-speaking China, they have been around for perhaps 1800 years,<sup>46</sup> and in this country they remain prevalent among certain immigrant communities. One-half of California Japanese immigrants had participated in some form of rotating credit association according to a 1960s survey,<sup>47</sup> and as late as the 1980s, more than 80% of Korean immigrants in Los Angeles had participated in RCAs.<sup>48</sup>

An RCA is formed upon a “core of participants,” who make “regular contributions to a fund which” are then pooled and “given to each contributor in rotation.”<sup>49</sup> They differ in terms of size, criteria for membership, manner in which order of payouts are made, organizational structure, and the sanction for violations, but they share the essential characteristic of being an informal credit institution lending small lump sums.

RCAs rely on social trust to ensure repayment of lent funds.<sup>50</sup> Inevitably, some members will default (quitting the RCA before their “take” has been recouped through periodic payments). This can produce effective

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<sup>44</sup> Rashmi Dyal-Chand, *Human Worth as Collateral*, 38 RUTGERS L.J. 793, 824 n. 154 (2007).

<sup>45</sup> Christy Chung Hevener, *Alternative Financial Vehicles: Rotating Savings and Credit Associations*, FEDERAL RESERVE BANK OF PHILADELPHIA, Nov. 2006, at 26, available at [www.philadelphiafed.org/community.../discussionpaper-ROSCAs.pdf](http://www.philadelphiafed.org/community.../discussionpaper-ROSCAs.pdf) (last 12 July 2011).

<sup>46</sup> *Id.* at 6.

<sup>47</sup> *Id.* at 22.

<sup>48</sup> *Id.*

<sup>49</sup> Shirley Ardener, *The Comparative Study of Rotating Credit Associations*, 94 J. OF THE ROYAL ANTHROPOLOGICAL INSTITUTE OF GREAT BRITAIN AND IRELAND 201, 212 (1964).

<sup>50</sup> Dyal-Chand, *supra* note 39, at 824 (“In their small, close-knit communities, borrowers cannot default because doing so would risk extraordinary shame, social degradation, and even ostracism.”); Lan Cao, *Looking at Communities and Markets*, 74 NOTRE DAME L. REV. 841, 882 (1999).



interest rates as high as 30%,<sup>51</sup> well above those charged by commercial lenders (and authorized by usury laws), even for “zero-interest” RCAs.<sup>52</sup> In other RCAs, early recipients of payouts “bid” for interest rates they are willing to pay for the privilege of early receipt – and such rates can be as high as 24%.<sup>53</sup> These suggest relatively high transaction costs in comparison to traditional credit. Still, RCAs provide a means to access credit for those unable to access it due to discrimination, immigration status, or language barriers. Moreover, RCAs provide convenience, since “like numbers gambling syndicates, RCAs circumvent the slow, unfriendly, and bureaucratic channels of banks.”<sup>54</sup> Like P2P lending, RCAs stand in an ambiguous legal position; courts sometimes conflate them with unlicensed lotteries,<sup>55</sup> and practices commonly associated with RCAs, like the failure to report interest income or interest rates exceeding levels permitted under usury laws, contribute to a widespread belief that they are unlawful.<sup>56</sup>

A second well-established form of person-to-person lending is the numbers racket, popular at various points among African-Americans in Harlem and factory line workers in Detroit, among others. The numbers racket depended on the identification of a number, the appearance of which could be predicted but with values that could not. For instance, an early numbers racket was based on two figures released each morning in New York City – the total daily clearances among a certain group of banks, and the Federal Reserve balance.<sup>57</sup> The winning number would combine, for instance, the second and third digits of the “clearings” figure with the third digit of the Fed balance.<sup>58</sup>

A person could “bet” anything from a few pennies to a few dollars

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<sup>51</sup> Ivan Light et al. *Korean Rotating Credit Associations in Los Angeles*, in JOHN SIBLEY BUTLER & GEORGE KOZMETSKY, EDS., *IMMIGRANT AND MINORITY ENTREPRENEURSHIP: THE CONTINUOUS REBIRTH OF AMERICAN COMMUNITIES* 171, 179 (2004).

<sup>52</sup> In a zero-interest RCA, early recipients of funds do not pay any additional amount for the privilege of enjoying the time value of money.

<sup>53</sup> Kumar Aniket, *Self-Help Groups: Use of Modified ROSCAs in Microfinance*, EDINBURGH SCHOOL OF ECONOMICS DISCUSSION PAPERS, June 2005, available at <http://www.aniket.co.uk/research/shg.pdf> (last visited 18 July 2011).

<sup>54</sup> Light et al., *supra* note 51 at 172.

<sup>55</sup> California law is confused on the issue of the legality of Korean *kye*, and at least one judge has found that form of RCA “an illegal lottery and also a form of security which was being sold without prior permission from the proper authorities.” Cao, *supra* note 45, at 909. *But see* Mi Bong Hong v. Chong Chin Cha, 979 A.2d 250 (Md. App. 2009) (finding valid contract claims in RCA dispute); Light et al., *supra* note 51, at 179 (RCAs “are not unlawful in themselves”).

<sup>56</sup> Light et al., *supra* note 51, at 179.

<sup>57</sup> SHANE WHITE ET AL., *PLAYING THE NUMBERS: GAMBLING IN HARLEM BETWEEN THE WARS* 12-13 (2010).

<sup>58</sup> If the clearings figure were \$589,000,000, and the Fed balance \$116,000,000, then the “winning” number would be 896.

on a number, with odds of winning 1 in 1,000, but payoffs of 600 to 1.<sup>59</sup> Langston Hughes called the numbers racket “the salvation of Harlem, its Medicare, and its Black Draught, its 666, its little liver pills, its vitamins, its aspirins, and its analgesic balm combined.”<sup>60</sup>

Dismissing a number racket as a form of illegal gambling would be a mistake; the “whole enterprise” has an “essentially economic nature.”<sup>61</sup> Those running the racket were referred to as “bankers,” and those who played as “investors.”<sup>62</sup> Those who played didn’t think of themselves as gamblers; they took the term “investing” literally.<sup>63</sup> Hitting the winning number was not the equivalent of today’s Powerball lottery, where a winner was set for life.<sup>64</sup> Instead, it would provide a windfall “that allowed debts to be paid off.”<sup>65</sup> Investing a few coins a day made sense, even in the face of long odds (the expected rate of return being slightly above one dollar for every two played).<sup>66</sup> According to retired NYPD detective Rufus Shatzberg, the numbers racket was a “financial institution” which “substituted for mainstream organizations that could not and would not provide financial services in poor communities.”<sup>67</sup> Due to a “vacuum where there were few banks, credit associations, loan and realty enterprises, numbers gambling . . . became a source of capital and, ironically, a means of savings, a device for personally accumulating some resources.”<sup>68</sup>

The primary appeal of the numbers game was its convenience. Numbers “runners” made circuits of their customers, who “thus do not have to go out of their way to bet.”<sup>69</sup> Numbers stations were located in newsstands, pool halls, cigar stores, and groceries – locations people visited for other reasons on a typical day. Even those without traditional savings accounts found “it convenient to lay a dollar on a number while at the barber shop rather than risk making no ‘investment’ at all in the day.”<sup>70</sup> The numbers racket has now “almost completely disappeared” thanks to

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<sup>59</sup> WHITE ET AL., *supra* note 57, at 14.

<sup>60</sup> Blackdraft and 666 were popular laxatives. Hughes statement was published in a front page article in *The New York Times* on March 1, 1971. See GEORGE EATON SIMPSON & J. MILTON YINGER, RACIAL & CULTURAL MINORITIES: AN ANALYSIS OF PREJUDICE AND DISCRIMINATION 122 (1985).

<sup>61</sup> WHITE ET AL., *supra* note 57, at 23.

<sup>62</sup> *Id.* at 200.

<sup>63</sup> *Id.* at 223.

<sup>64</sup> *Id.* at 225.

<sup>65</sup> *Id.*

<sup>66</sup> *Id.* at 223.

<sup>67</sup> RUFUS SHATZBERG & ROBERT J. KELLY, AFRICAN AMERICAN ORGANIZED CRIME: A SOCIAL HISTORY 71 (1996).

<sup>68</sup> *Id.*

<sup>69</sup> Ivan Light, *Numbers Gambling Among Blacks: A Financial Institution*, 42 AMER. SOC. REV. 892, 897 (1977).

<sup>70</sup> *Id.* at 897.

competition from government sanctioned lotteries.<sup>71</sup>

A third form of non-commercial lending is a hybrid between P2P and institutional lending. Pawnbroking has been around since the 1850s or 1860s. A pawnbroker takes personal property from borrowers as security for cash loans; if the loan is not repaid, the pawnbroker resells the item held as security.<sup>72</sup> One nineteenth century commentator referred to pawn shops as the “salvation of the wage-earner in bad times.”<sup>73</sup> Since its early days, unlike the illicit numbers racket or the shadow rotating credit association, pawnbroking has been subject to fairly tight regulation.<sup>74</sup> A pawnbroker needs little overhead and administration,<sup>75</sup> and the simple nature of the transaction makes it both a rapid way to obtain credit and minimizes transactions costs. Pawnbroking thus provides “essential access to credit for people experiencing financial shocks who may have nowhere else to turn.”<sup>76</sup>

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

On the other hand, some concerns should arise as a result of the divergence between on-line P2P and these other forms of informal credit. There is no family, cultural or group tie in on-line P2P that would enforce repayment, as in the case of RCAs. There is also no face-to-face interaction, as in the case of pawnbroking or numbers rackets, which might increase the moral hazard associated with on-line P2P lending.

On-line P2P transactions also involve a level of “cleanliness,” thanks to the internet, that might not be associated with predecessor forms of informal lending. The seeming sterility of the transaction might reduce the moral sanction associated with such lending/borrowing, and perhaps increase adverse selection. When a potential borrower turns to a pawn shop

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<sup>71</sup> Anthony N. Cabot, *The Games People Play: Is it Time for a New Legal Approach to Prize Games?*, 4 NEV. L.J. 197, 213 (2003/2004).

<sup>72</sup> Andrew Martin Fisher, *Banking on the Edge: Towards and Open Ended Interpretation of Informal Finance in the Third World*, 2004, at 8, available at [http://digitool.library.mcgill.ca/webclient/StreamGate?folder\\_id=0&dvs=1310757639704-732](http://digitool.library.mcgill.ca/webclient/StreamGate?folder_id=0&dvs=1310757639704-732) (last visited 15 July 2011).

<sup>73</sup> Helen Bosanquet, *The Burden of Small Debt*, 6 THE ECONOMIC JOURNAL 212, 213(1896).

<sup>74</sup> Jarret C. Oeltjen, *Florida Pawnbroking: An Industry in Transition*, 23 FLA. ST. U. L. REV 995, 1018 (1996).

<sup>75</sup> F.A. Bouman & R. Houtman, *Pawnbroking as an Instrument of Rural Banking in the Third World*, 37 ECON. DEV. & CULTURAL CHANGE 69, 74 (1988).

<sup>76</sup> Jim Hawkins, *Regulating on the Fringe: Reexamining the Link between Fringe Banking and Financial Distress*, 86 IND. L. J. 1361, 1390 (2011).

or a payday lender, she must appear personally and may, whether due to the aesthetic environment or perceptions of social stigma attached to such borrowing, rethink the need for a loan. By contrast, an on-line P2P loan applicant can submit a request for a loan entirely electronically. The lack of channeling of potential borrowers might mean that those who turn to on-line P2P have not adequately thought through their need for a loan or the likelihood they will be able to pay it back.

### C. The Emerging Importance of On-line Peer-to-Peer Lending

On-line P2P lending is “hot”: In 2011, Prosper was one of the top 50 “next big things,” according to the *Wall Street Journal*,<sup>77</sup> LendingClub was a 2011 “webby” award winner,<sup>78</sup> and P2P lending was a “breakthrough idea for 2009,” according to the *Harvard Business Review*.<sup>79</sup> Two reasons explain this development, one of a positive nature and one negative. The positive driving force of P2P’s popularity is the emergence of “Web 2.0” applications on the internet. The negative driving force was the near collapse—and certainly significant contraction—of the consumer and business credit markets in this country in 2008.

The first force driving on-line P2P, a positive one, is the development of Web 2.0 businesses. The term “Web 2.0” was popularized<sup>80</sup> by book publisher Tim O’Reilly to describe a second-generation of internet offering, “which relies on collective intelligence and action from the bottom up.”<sup>81</sup> First generation web activity, or “Web 1.0,” treated users as passive, presenting them with information but declining to involve them actively in the generation of web content.<sup>82</sup> For users of “Web 1.0,” the “characteristic

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<sup>77</sup> *The Next Big Thing 2011: The Top 50 Venture-Funded Companies*, THE WALL STREET JOURNAL, March 9, 2011, available at [http://online.wsj.com/article/SB10001424052748703300904576178673309577828.html#project%3DVC\\_Rank\\_20110307%26articleTabs%3Dinteractive](http://online.wsj.com/article/SB10001424052748703300904576178673309577828.html#project%3DVC_Rank_20110307%26articleTabs%3Dinteractive) (last visited 15 July 2011).

<sup>78</sup> *15<sup>th</sup> Annual Webby Award Winners*, available at [http://www.webbyawards.com/webbys/current.php#webby\\_entry\\_banking](http://www.webbyawards.com/webbys/current.php#webby_entry_banking) (last visited 15 July 2011).

<sup>79</sup> John Sviokla, *Forget Citibank—Borrow from Bob*, HARV. BUS. REV., Jan. 1, 2009 available at <http://hbr.org/web/tools/2009/01/list-toc> (last visited 15 July 2011).

<sup>80</sup> The question of who actually coined the term is more complicated, and, in expected Web 2.0 fashion, heavily debated among the Technorati. See Firoz Ansari, *Who coined the term Web 2.0?*, FIROZANSARI:BLOG, May 20, 2006, available at <http://www.firozansari.com/2006/05/20/who-coined-the-term-web-20/> (last visited 6 June 2011) (arguing that Dermot A. McCormack coined the term); *Who coined the term web 2.0?*, ANSWERS.COM, available at [http://wiki.answers.com/Q/Who\\_coined\\_the\\_term\\_web\\_2.0](http://wiki.answers.com/Q/Who_coined_the_term_web_2.0) (last visited 6 June 2011); Dylan Tweney, *Tim O’Reilly: Web 2.0 is about Controlling Data*, WIRED, April 13, 2007, available at [http://www.wired.com/techbiz/people/news/2007/04/timoreilly\\_0413](http://www.wired.com/techbiz/people/news/2007/04/timoreilly_0413) (last visited 6 June 2011).

<sup>81</sup> Jessica Guynn, *Tech Guru Challenges Next Generation to Get Serious*, LOS ANGELES TIMES, Oct. 10, 2008, at 1.

<sup>82</sup> Geoffrey Christopher Rapp, *Torts 2.0*, 37 WM. MITCHELL L. REV. 1587 (2011).

activity was surfing static Internet pages.”<sup>83</sup>

Web 2.0, by contrast, emphasizes the “architecture of participation.”<sup>84</sup> Web sites have become organic, developing as users (rather than site planners and developers) express their preferences. Authoritarian web-developers have given way to the “wisdom-of-the-crowds,”<sup>85</sup> in which the “harnessing of collective intelligence”<sup>86</sup> is accomplished through the use of new software tools.

Web 1.0 was EncyclopediaBritannica.com;<sup>87</sup> Web 2.0 is Wikipedia,<sup>88</sup> which relies on the inputs of users to create encyclopedia entries. Web 1.0 was askjeeves.com; Web 2.0 is Google,<sup>89</sup> which traces the behavior of search engine users to provide inputs to the site’s algorithms. Web 1.0 was ofoto, where individuals could print their photos, while Web 2.0 is the photo-sharing site Flickr.

On-line P2P lending offers the Web 2.0 alternative to Web 1.0 lending platforms such as e-loan, Lending Tree, and the like. On those sites, potential borrowers are passive. They provide information to a central web site, which in turn offers potential lenders the chance to finance customers’ loans. In Web 2.0 P2P lending, the collective intelligence of potential lenders is (at least in theory) harnessed to identify which borrowers will receive loans.

However, the sites as they exist now do not fully exploit the potential of Web 2.0 interfaces to harness collective intelligence. Investors are unable, for instance, to share information or perspectives on a particular borrower or their request – for instance, by wiki (is a Honda motorcycle the best choice for an investor with X credit score?).<sup>90</sup> Of course, one should remember that P2P lending is not a static industry that uses a single model, and along with the rest of Web 2.0, P2P lending will continue to morph and evolve.

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<sup>83</sup> Peter Lunenfeld, *Welcome to Web 2.0*, L.A. TIMES, June 24, 2007, at 11.

<sup>84</sup> Steven Levy, *Farewell, Web 1.0! We Hardly Knew Ye. Web 1.0 was making the Net for people. Web 2.0 is making the Internet better for computers*, NEWSWEEK, Oct. 18, 2004, at 20.

<sup>85</sup> Steven Levy, *The Future of Reading: Amazon’s Jeff Bezos already built a better bookstore. Now he believes he can improve upon one of humankind’s most divine creations: the book itself*, NEWSWEEK, Nov. 26, 2007 at 54.

<sup>86</sup> Dan Fost, *What Exactly does Web 2.0 mean? Well...*, SAN FRANCISCO CHRON., Nov. 5, 2006, at F5

<sup>87</sup> Daniel E. Harmon, *The “New” Web: Getting a grip on the slippery concept of Web 1.0*, LAWYER’S PC, Jan. 1, 2006, 1.

<sup>88</sup> *Id.*

<sup>89</sup> *Id.*

<sup>90</sup> See *supra* note 39.

The second driving force behind the growth in P2P lending has been the credit market contraction following the financial instability of 2008. In 2008, liquidity crises at several major financial institutions led to widespread fears that “credit markets, and in turn the global economy, would completely seize up, causing an economic catastrophe unparalleled in modern history.”<sup>91</sup> Most readers are no doubt familiar with the unparalleled federal bailout that followed.

In the wake of the crisis, even after the string of bailouts secured the health of most remaining affected institutions, consumer credit remained far more difficult to obtain than it had before. Although the financial crisis had its roots in the high default risk associated with the subprime mortgage lending industry, consumer credit constricted across the board. Total consumer lending fell by 6.10% between January 2009 and March 2010, “accelerating into a contraction the like of which has not been seen before.”<sup>92</sup>

Lenders tightened guidelines on access to mortgages and home equity loans. Particularly for high-risk individuals seeking unsecured debt-consolidation loans, the result has been difficulty obtaining access to credit via traditional sources. Even some students have had to turn to other sources after being turned away by traditional sources of student loans.<sup>93</sup> This has helped to drive borrowers toward emerging alternatives, including on-line P2P lending sites.<sup>94</sup>

The pressure from credit market challenges did not solely affect individual borrowers. Even small businesses have been forced to seek alternative means to obtain credit, and some have turned to P2P sites.<sup>95</sup> P2P has become one of the “fringe” banking options that has risen in importance as higher-risk borrowers have been turned away by increasingly risk-adverse traditional lending institutions.<sup>96</sup>

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<sup>91</sup> Edward J. Estrada, *The Immediate and Lasting Impacts of the 2008 Economic Collapse*, 45 U. RICH. L. REV. 1111, 1111 (2011).

<sup>92</sup> *Epic Consumer Credit Crunch Unfolding*, SEEKING ALPHA, March 2, 2010, available at <http://seekingalpha.com/article/191517-epic-consumer-credit-crunch-unfolding> (last visited 12 July 2011).

<sup>93</sup> Kelli B. Grant, *Loan Web Sites Tapped for College Cash*, THE WALL ST. J., April 29, 2008, D6.

<sup>94</sup> See Alex Brill, *Peer-to-Peer Lending: Innovative Access to Credit and the Consequences of Dodd-Frank*, WASHINGTON LEGAL FOUNDATION (Dec. 3, 2010), at 1, available at [http://www.wlf.org/publishing/publication\\_detail.asp?id=2215](http://www.wlf.org/publishing/publication_detail.asp?id=2215).

<sup>95</sup> See Sheryl Jean, *Also on the loan menu*, DALLAS MORNING NEWS, Feb. 14, 2010, at D01.

<sup>96</sup> While it may have been true that in the early days of on-line P2P lending, those turned away from traditional lenders were able to qualify for P2P loans, that appears to be less the case now that the sites have imposed stricter eligibility guidelines. These stricter guidelines mean that the sites are no longer “tak[ing] a chance on many of the people banks turned away.” Daniel Wolfe, *Prosper Model Changes, and So do Perceptions*, 175 AM. BANKER 1 (Oct. 28, 2010). The degree to which Prosper and Lending Club rejected high risk borrowers even led to the emergence of a new site – Loanio – aimed at those with “poor or no credit profile histories.” *Loanio.com Unveils its Peer to Peer Lending Platform Today and Offers Subprime, Thin and No Credit Borrowers the Opportunity to get Loans Without Exposing Higher Risks to its Lenders*, SCIENCE LETTER, Oct. 14, 2008, at 3701. Loanio was created after borrowers with

P2P lending has also allowed capital to flow to communities that were underserved by the credit markets even prior to the retraction of those markets in 2008. Individuals who previously were mired in debt and for whom payday lending may have seemed the only option have, thanks to on-line P2P, been able to consolidate their loans, pay off debts, and improve their credit scores.<sup>97</sup> P2P lending has allowed capital to flow into economically depressed communities and created new opportunities for community development and economic growth.<sup>98</sup> Moreover, P2P lending has not only fueled domestic economic development, it has also fueled economic development abroad.<sup>99</sup> Sites such as Kiva ([www.kiva.com](http://www.kiva.com)) specialize in lending internationally to support entrepreneurship and economic growth in developing countries.<sup>100</sup>

#### D. The Risks of Peer-to-Peer Lending

Despite the benefits of P2P lending, it also raises substantial concerns. P2P lending shares all of the risks associated with traditional “brick and mortar” lending. These risks include lending fraud, identity theft, money laundering concerns, consumer privacy and data protection violations, and terrorism financing concerns.<sup>101</sup> Those risks are then married to and amplified by the anonymity and ubiquity of the internet.

The model for P2P lending used by the major for-profit lending platforms also has a variety of problematic characteristics. First, the information supplied by borrowers is often not verified, and when the information is verified, it often proves inaccurate.<sup>102</sup> As a result, lenders using the sites face difficulty determining a borrower’s actual

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poor or no credit scores had “little luck” with the established for-profit P2P sites. The curious thing about Loanio, of course, is that it represented a *fringe* section of a *fringe* section of the lending market.

Not surprisingly, the Loanio business model was not a winner, and the site shut down in March 2011. It had made only seven loans, and all of the borrowers had defaulted. Peter Renton, *Loanio Closing Down in Next Two Weeks*, THE SOCIAL LENDING NETWORK, March 31, 2011, available at <http://www.socialending.net/news/loanio-closing-down-in-next-two-weeks/> (last visited 29 Sept. 2011).

<sup>97</sup> See Aleksandra Todorova, *Peer-to-Peer Lending Offers Solution for Strapped Consumers*, SMART MONEY, Oct. 15, 2007, <http://www.smartmoney.com/spending/deals/peer-to-peer-lending-offers-solution-for-strapped-consumers-21978>.

<sup>98</sup> See Chaffee, *supra* note 2, at 1439-41 (reporting on the role of peer-to-peer lending in domestic economic development).

<sup>99</sup> See generally Davis & Gelpert, *supra* note 7 (discussing the use of peer-to-peer lending to facilitate foreign economic development).

<sup>100</sup> See GAO REPORT, *supra* note 5, at 14-16 (reporting on Kiva’s peer-to-peer lending model and its role in foreign economic development).

<sup>101</sup> See Chaffee, *supra* note 2, at 1440.

<sup>102</sup> See Ron Lieber, *The Gamble of Lending Peer to Peer*, N.Y. TIMES, Feb. 5, 2011, at B1 (reporting that LendingClub does not verify the information submitted by borrowers a large portion of the time and when it does verify the information supplied, the information is often inaccurate).



creditworthiness.<sup>103</sup> Second, the credit ratings assigned by the platforms may not accurately predict how loans will perform because platforms have a limited amount of historical loan performance data.<sup>104</sup> Third, the returns on the notes that the platforms sell to individual lenders are based entirely on repayment by the individual borrowers and are not secured by any collateral or guaranteed by any third party.<sup>105</sup> Fourth, in the event of default by the borrowers, lenders are dependent on the P2P lending platforms and their designees for collecting on defaulted loan, which the platforms are notoriously bad at doing. For example, as of February 2009, Prosper Marketplace had recovered just over \$800,000 of the \$39.4 million it had charged off in default.<sup>106</sup> The lenders using such sites have no independent means of pursuing collection on unpaid loans. Fifth, investments made by individual lenders are significantly less liquid than many other forms of investment because many of the loans are for three to five year terms.<sup>107</sup> Moreover, some platforms restrict the sale and transfer of loans to other individuals, except to lenders on that particular platform.<sup>108</sup> Sixth, a high degree of uncertainty exists as to what would occur in the event that a platform became bankrupt.<sup>109</sup> Seventh, because models of P2P lending and the regulatory scheme associated with it continue to evolve, a high degree of uncertainty exists as to how P2P lending will evolve in the future.<sup>110</sup>

Because the commonly used model for P2P lending is riddled with these risks, P2P lending platforms have had a rocky start. Sites have experienced high default rates, which “rival or exceed those of credit card borrowers at big banks.”<sup>111</sup> During Prosper Marketplace’s first three years of operation, approximately one third of the loans that it helped originate ended in default, and investors lost on average 4.95 percent annually during that time.<sup>112</sup> In addition, as of this writing, neither Prosper Marketplace nor the LendingClub had yet turned a profit.<sup>113</sup>

As a result, on-line P2P, which at first appears to be a “golden goose,” may turn individual lenders into “pigeons.” In LendingClub’s

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<sup>103</sup> See GAO REPORT, *supra* note 5, at 22 (providing a list of risks for lenders that was identified by the major for-profit P2P lending platforms).

<sup>104</sup> *Id.*

<sup>105</sup> *Id.*

<sup>106</sup> See Hunsberger, *supra* note 11.

<sup>107</sup> See GAO REPORT, *supra* note 5, at 22.

<sup>108</sup> *Id.*

<sup>109</sup> *Id.*

<sup>110</sup> *Id.*

<sup>111</sup> See Hunsberger, *supra* note 11.

<sup>112</sup> See Lieber, *supra* note 96.

<sup>113</sup> See Prosper 2011 10K at 63, available at <http://secwatch.com/prosper-marketplace-inc/10k/annual-report/2011/3/30/7786716/filing#item6selectedfindata12310201>; *Prospectus dated June 10, 2011*, at 23, available at [https://www.lendingclub.com/extdata/Clean\\_As\\_Filed\\_20110610.pdf](https://www.lendingclub.com/extdata/Clean_As_Filed_20110610.pdf) (“We have not been profitable since our inception.”); Hunsberger, *supra* note 11.

defense, its prospectus, which exceeds 100 pages, does state, “The Notes[, i.e. loans made via its site,] are highly risky and speculative. Investing in the Notes should be considered only by persons who can afford the loss of their entire investment.”<sup>114</sup> And, in Prosper Marketplace’s defense, its prospectus, which exceeds 120 pages, includes the same language verbatim.<sup>115</sup> Still, the chance of misapprehension of the risk and improper investment portfolio diversification by lenders in P2P lending transactions remains exceedingly high.

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

### III. THE CURRENT REGULATORY REGIME FOR ON-LINE PEER-TO-PEER LENDING

The current regulatory structure for on-line P2P lending involves multiple overseeing agencies. Responsibility for regulating such lending potentially falls within the purview of a wide variety of federal and state regulators, including the new Consumer Financial Protection Bureau, the Federal Trade Commission, the United States Department of Justice, the United States Securities and Exchange Commission, various federal bank regulators, and the state counterparts of all these entities.<sup>116</sup> Two things inhibit the development of a coherent regulatory regime for on-line P2P lending. First, such lending is a relatively new phenomenon that has only recently attracted public attention, and therefore, regulators are still trying to puzzle through its implications. Second, a variety of different models exist for P2P lending, and models continue to be created and evolve, which means that developing a single coherent regulatory regime for P2P lending will be extraordinarily difficult.

Because banks are involved in the most prominent model of P2P lending, such lending is already the subject of significant regulation. As previously explained, the major P2P lending sites in the United States, Prosper Marketplace ([www.prosper.com](http://www.prosper.com)) and LendingClub ([www.lendingclub.com](http://www.lendingclub.com)), use a model in which a bank originates loans to

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<sup>114</sup> See *Prospectus dated June 10, 2011*, at 90, available at [https://www.lendingclub.com/extdata/Clean\\_As\\_Filed\\_20110610.pdf](https://www.lendingclub.com/extdata/Clean_As_Filed_20110610.pdf).

<sup>115</sup> See *Prospectus dated July 14, 2011*, at 47, available at [http://www.prosper.com/Downloads/Legal/Prosper\\_Prospectus\\_2011-07-14.pdf](http://www.prosper.com/Downloads/Legal/Prosper_Prospectus_2011-07-14.pdf).

<sup>116</sup> See GAO REPORT, *supra* note 5, at 3-7 (discussing the myriad of federal and state regulators that potentially share some responsibility for regulating P2P lending).

individual borrowers, and notes are then sold to individual lenders with payment on the notes being contingent upon repayment of the underlying loan. Because a bank is involved in the lending process, both companies admit that a myriad of federal statutes apply directly or indirectly to their lending activities.<sup>117</sup> These statutes include the Bank Secrecy Act,<sup>118</sup> the Electronic Fund Transfer Act,<sup>119</sup> the Electronic Signatures in Global and National Commerce Act,<sup>120</sup> the Equal Credit Opportunity Act,<sup>121</sup> the Fair Credit Reporting Act,<sup>122</sup> the Fair Debt Collection Practices Act,<sup>123</sup> the Federal Trade Commission Act,<sup>124</sup> the Gramm-Leach-Bliley Financial Modernization Act,<sup>125</sup> the Servicemembers Civil Relief Act,<sup>126</sup> and the Truth in Lending Act.<sup>127</sup>

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

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

The United States Securities and Exchange Commission has taken an aggressive role in regulating P2P lending because the most commonly used model of such lending involves the offer, sale, and purchase of securities. On the Prosper and LendingClub sites, banks issue loans to individual borrowers, and notes are then sold to individual lenders with payment on the notes being contingent upon repayment of the underlying loan.<sup>128</sup> The notes that are being offered, sold, and purchased in this model constitute securities under both the Securities Act of 1933 (Securities Act)<sup>129</sup>

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<sup>117</sup> See GAO REPORT, *supra* note 5, at 33 (proving a table of federal lending and consumer protection laws that officials from LendingClub and Prosper Marketplace admitted are applicable to P2P lending).

<sup>118</sup> Pub. L. No. 91-508, Titles I, II, 84 Stat. 1114-1124 (1970) (codified at 12 U.S.C. §§ 1951-1959 (2011)).

<sup>119</sup> Pub. L. No. 95-630, Title xx, § 2001, 92 Stat. 3728 (1978) (codified at 15 U.S.C. §§ 1693-1693r (2011)).

<sup>120</sup> Pub. L. No. 106-229, 114 Stat. 464 (2000) (codified at 15 U.S.C. §§ 7001-7006, 7021, 7031 (2011)).

<sup>121</sup> Pub. L. No. 93-495, Title V, 88 Stat. 1521 (1974) (codified at 15 U.S.C. §§ 1691-1691f (2011)).

<sup>122</sup> Pub. L. No. 91-508, Title VI, § 601, 84 Stat. 1128 (1970) (codified at 15 U.S.C. §§ 1681-1681x (2011)).

<sup>123</sup> Pub. L. No. 95-109, 91 Stat. 874 (1977) (codified at 15 U.S.C. §§ 1692-1692p (2011)).

<sup>124</sup> Pub. L. No. 203, 38 Stat. 719 (1914) (codified at 15 U.S.C. §§ 41-58 (2011)).

<sup>125</sup> Pub. L. No. 106-102, 113 Stat. 1338 (1999) (codified in scattered sections of 12 U.S.C. and 15 U.S.C.).

<sup>126</sup> Pub. L. No. 76-861, 54 Stat. 1178 (1940) (codified at 50 App. U.S.C. §§ 501-596 (2011)).

<sup>127</sup> Pub. L. No. 90-321, Title I, 82 Stat. 146 (1968) (codified at 15 U.S.C. §§ 1601-1667f (2011)).

<sup>128</sup> See *supra* notes 18-23 & accompanying text.

<sup>129</sup> 15 U.S.C. §§ 77a-77aa (2011).

and the Securities Exchange Act of 1934 (Exchange Act).<sup>130</sup> Section 2(a)(1) of the Securities Act<sup>131</sup> and section 3(a)(10) of the Exchange Act<sup>132</sup> provide definitions of a “security.” Because both sections include within the definition of a security the terms “investment contracts” and “notes,”<sup>133</sup> their applicability to on-line P2P lending is identical. Importantly, if the notes in online P2P transactions are either “investment contracts” or “notes” under federal securities law, then the notes in P2P transactions are securities, even if they qualify as only one of the two classes of securities.<sup>134</sup>

The notes used in the most common model of P2P lending constitute securities for purposes of federal securities law because they are investment contracts. In *SEC v. W.J. Howey Co.*, the Supreme Court established the test for identifying an investment contract under federal securities law.<sup>135</sup> In that case, W.J. Howey Company (Howey) sold tracts of land containing citrus groves to the public.<sup>136</sup> Potential customers were offered both a contract for the sale of the land and a contract for servicing the citrus groves.<sup>137</sup> The service contract was to be performed by Howey-in-the Hills Service, Inc. (Howey-in-the-Hills), a corporation with the same management and ownership as Howey.<sup>138</sup> Although the purchasers of the land contract could arrange for other service companies to tend their groves,

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<sup>130</sup> 15 U.S.C. §§ 78a-78nn (2011).

<sup>131</sup> 15 U.S.C. § 77b(a)(1) (2011) (“The term ‘security’ means any note, stock, treasury stock, security future, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or, in general, any interest or instrument commonly known as a ‘security’, or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.”).

<sup>132</sup> 15 U.S.C. § 78c(a)(10) (2011) (“The term ‘security’ means any note, stock, treasury stock, security future, bond, debenture, certificate of interest or participation in any profit-sharing agreement or in any oil, gas, or other mineral royalty or lease, any collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or in general, any instrument commonly known as a ‘security’; or any certificate of interest or participation in, temporary or interim certificate for, receipt for, or warrant or right to subscribe to or purchase, any of the foregoing; but shall not include currency or any note, draft, bill of exchange, or banker’s acceptance which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited.”).

<sup>133</sup> See *supra* notes 132-33 (providing the definition of a security under the Securities Act and the Exchange Act).

<sup>134</sup> See *Reves v. Ernst & Young*, 494 U.S. 56, 64 (1990).

<sup>135</sup> *SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946).

<sup>136</sup> *Id.* at 295.

<sup>137</sup> *Id.*

<sup>138</sup> *Id.*

Howey-in-the-Hills served approximately eighty-five percent of the land that was sold.<sup>139</sup> The service contracts had a ten year duration without option of cancellation and gave Howey-in-the-Hills “full and complete” possession of the land that was being serviced.<sup>140</sup> Howey-in-the Hills pooled fruit from all of the land that it serviced, and then made an allocation of the net profits to the land owners, most of whom were not residents of Florida, where the groves were located.<sup>141</sup>

The Supreme Court held that Howey and Howey-in-the-Hills were offering and selling securities under the federal securities laws because they were offering and selling investment contracts. The Court reached this holding by examining the definition of a security in section 2(1) (now 2(a)(1)) of the Securities Act.<sup>142</sup> After noting that the definition includes the term “investment contract,” the Court explained that the term “investment contract” is not defined in the federal securities laws, but that the term was commonly used in many state “blue sky” laws and broadly construed by state courts prior to the passage of the Securities Act and Exchange Act.<sup>143</sup> The Supreme Court adopted this broad approach and held that the test for an investment contract is “whether the scheme involves an investment of money in a common enterprise with profits to come solely from the efforts of others.”<sup>144</sup> The Court then held that the land and service contracts were investment contracts because Howey and Howey-in-the-Hills were offering and selling the opportunity to invest money in common enterprise to grow citrus fruit that they fully operated and managed.<sup>145</sup> The Court also held it irrelevant that the purchasers of the land could have found someone else to service the citrus groves and held that the test for a security was still met because Howey and Howey-in-the-Hills were “offer[ing] the essential ingredients of an investment contract.”<sup>146</sup>

The *Howey* test is usually broken down by courts into three distinct elements.<sup>147</sup> First, a common enterprise must exist that sufficiently intertwines investors’ interests with those of other investors and/or the promoters of the investment.<sup>148</sup> All courts have held that horizontal commonality, which exists when a pool of investors is created whose

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<sup>139</sup> *Id.*

<sup>140</sup> *Id.* at 296.

<sup>141</sup> *Id.*

<sup>142</sup> *Id.* at 297.

<sup>143</sup> *Id.* at 298.

<sup>144</sup> *Id.* at 301.

<sup>145</sup> *Id.* at 299.

<sup>146</sup> *Id.* at 301.

<sup>147</sup> MARC I. STEINBERG, *SECURITIES REGULATION* 28 (Rev. 5th ed. 2009).

<sup>148</sup> *Id.*

fortunes are tied to the overall success of the venture, satisfies the *Howey* test.<sup>149</sup> Some courts have held that vertical commonality, which focuses on the relationship between the investor and promoters alone, satisfies the *Howey* test.<sup>150</sup> Second, for an investment contract to exist, an investor must also have an expectation of profits based upon the investment.<sup>151</sup> Third, the expectation of profit must come solely from the efforts of others.<sup>152</sup>

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

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

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

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

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<sup>149</sup> *Id.* at 36.

<sup>150</sup> *Id.*

<sup>151</sup> *Id.* at 28.

<sup>152</sup> *Id.*

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

Although it seems clear that the *Howey* test for an investment contract is satisfied, investments in on-line P2P sites are also likely securities under federal law because they qualify as “notes”. In *Reves v. Ernst & Young*, the Supreme Court established the test for what constitutes a note within the definition of a security under federal securities law.<sup>153</sup> In that case, the Farmer’s Cooperative of Arkansas and Oklahoma (the Co-Op) sold promissory notes that were payable on demand by the holder in order to support its business operations.<sup>154</sup> The notes paid a variable rate of return that was adjusted monthly to keep it above the rate paid by other local financial institutions.<sup>155</sup> After the Co-Op declared bankruptcy, the plaintiffs in the case brought a class action against Arthur Young & Co. (Arthur Young), the predecessor to Ernst & Young, claiming that Arthur Young had intentionally ignored generally accepted accounting principles in its outside audit of the Co-Op to inflate the Co-Op’s assets and net worth.<sup>156</sup> As a result, the plaintiffs asserted that Arthur Young had violated various antifraud provisions of the Exchange Act and Arkansas state securities law.<sup>157</sup> Plaintiff’s won a \$6.1 million judgment in the district court, which was reversed by the United States Court of Appeals for the Eighth Circuit.

The Supreme Court reversed the Eighth Circuit and held that the notes in the case constituted securities under both the Securities Act and Exchange Act.<sup>158</sup> The Court began by examining Congress’s intent in defining the term “security” under federal securities law.<sup>159</sup> The Court noted that Congress “enacted a definition of ‘security’ sufficiently broad to encompass virtually any instrument that might be sold as an investment.”<sup>160</sup> The Court then adopted a “family resemblance” test for differentiating whether a particular note was an investment and covered by federal securities law or whether a note was commercial in nature and not covered.<sup>161</sup> Application of the “family resemblance” test begins with a

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<sup>153</sup> *Reves v. Ernst & Young*, 494 U.S. 56 (1990).

<sup>154</sup> *Id.* at 58.

<sup>155</sup> *Id.* at 59.

<sup>156</sup> *Id.*

<sup>157</sup> *Id.*

<sup>158</sup> *Id.* at 73.

<sup>159</sup> *Id.* at 60-61.

<sup>160</sup> *Id.* at 61.

<sup>161</sup> *Id.* at 64-65.



rebuttable presumption that every note is a security.<sup>162</sup> This presumption can be rebutted if the note at issue bears a resemblance to certain judicially created categories of instruments that are commonly referred to as “notes,” but nonetheless fall outside the definition of a security under federal securities laws.<sup>163</sup> These judicially created categories of notes that are exempt from federal securities law include notes that are delivered in consumer financing, notes that are secured by mortgages on homes, and notes that evidence loans by commercial banks for current operations of businesses.<sup>164</sup>

The Supreme Court also created a list of factors for determining whether courts should exclude additional categories of notes from the federal definition of security.<sup>165</sup> First, the motivations of the buyer and seller must be assessed.<sup>166</sup> If the buyer is primarily interested in profit and the seller seeks to raise capital for business purposes, then the note is likely a security under federal securities law.<sup>167</sup> Second, the plan of distribution of the instrument must be examined.<sup>168</sup> If the plan of distribution includes the creation of common trading for investment or speculation, then the note is likely a security.<sup>169</sup> Third, the expectation of the public must be analyzed.<sup>170</sup> If the public would view the note at issue as a security, then the note likely is a security, even if the realities of the transaction might suggest otherwise.<sup>171</sup> Fourth, the risks created by the note at issue must be assessed. For example, a court will be substantially less likely to hold that a note is a security if another regulatory regime significantly reduces the risk.<sup>172</sup>

The notes in the commonly used model of P2P lending are securities under the *Reves* test. The default presumption is that any note is a security, although this presumption can be rebutted if the notes fall within certain judicially defined categories of notes that are not securities. The notes in the most commonly used model of P2P lending are unlikely to fall within any of the currently existing categories of notes that are exempt from federal securities law for two reasons. First, on-line P2P lending has only gained the attention of the public within the past half decade, and courts have yet to

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<sup>162</sup> *Id.* at 65.

<sup>163</sup> *Id.*

<sup>164</sup> *Id.*

<sup>165</sup> *Id.* at 65-67.

<sup>166</sup> *Id.*

<sup>167</sup> *Id.* at 66.

<sup>168</sup> *Id.*

<sup>169</sup> *Id.*

<sup>170</sup> *Id.* at 66-67.

<sup>171</sup> *Id.*

<sup>172</sup> *Id.* at 67.

address whether the notes used in the most common model of such lending are securities. Second, the notes in the most common model of P2P lending are investments, while the notes in the judicially created categories of notes exempt from federal securities law are all consumer or commercial in nature. A major distinction between these notes and excluded consumer notes is that the person providing funds associated with the P2P note is not also seeking to facilitate the sale of real or personal property to the borrower.

In addition, courts are unlikely to hold that the notes in the most common model of P2P lending should be recognized as a new category of notes that do not constitute securities. All of the factors for creating new categories of notes that do not constitute securities implicitly ask the same question: Is this note an investment? Although the loans that are made by the bank to the individual borrowers in the most common model of P2P lending may not be investments, the securitized loans, i.e. the notes, that are sold to the individual lender definitely are investments. Arguing that the notes that are sold in P2P lending transactions to individual lenders are exempt from federal securities law would be similar to arguing the mortgage-backed securities that were at the heart of the most recent financial crisis are not securities. The concept behind both is the same, and a court is extraordinarily unlikely to rule that either is exempt from federal securities law.

Moreover, since the SEC and other regulatory agencies have deemed these notes securities, administrative deference would also apply to this issue. On November 24, 2008, the SEC issued a cease-and-desist order against Prosper Marketplace for selling unregistered securities.<sup>173</sup> The SEC alleged that Prosper Marketplace had violated section 5(a) and (c) of the Securities Act by offering and selling securities without either filing an effective registration statement or having an exemption from registration.<sup>174</sup> The SEC determined that the notes at issue in the action were securities by applying the *Howey* test for investment contracts and the *Reves* test for notes covered by the Securities Act and Exchange Act.<sup>175</sup> Put another way, the SEC employed an approach similar to the analysis discussed above.

An even stronger argument that the notes in the most common model of P2P lending are securities is based upon the fact that the major for-profit P2P lending platforms have begun registering the notes that they sell

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<sup>173</sup> Prosper Marketplace, Securities Act Release No. 8984, 2008 WL 4978684 (Nov. 24, 2008) (cease-and-desist order).

<sup>174</sup> *Id.* at 2.

<sup>175</sup> *Id.* at 4-6.

as securities. At the time that the SEC issued its cease-and-desist order, Prosper Marketplace had already submitted a settlement offer, which the SEC had accepted.<sup>176</sup> Although the Order states that Prosper Marketplace had entered the settlement agreement “without admitting or denying the findings [in the Order], except as to the Commission’s jurisdiction over it and the subject matter of [the] proceedings,”<sup>177</sup> one can hardly imagine any circumstance under which Prosper Marketplace would undergo the time and expense of registration, unless it believed the notes that it was offering and selling were securities subject to the Securities Act and the Exchange Act. Both Prosper Marketplace and LendingClub currently register the notes that they sell to individual lenders as securities. Because Prosper Marketplace and Lending Club have a strong financial incentive to avoid the costs of registration by finding any valid argument that the notes are not securities, questioning whether the notes are subject to federal securities law seems little more than an academic exercise.

One author, in a forthcoming article, has argued that the SEC could have decided that the notes sold in the note-based model of P2P lending should not be deemed securities. In *The Misregulation of Person-to-Person Lending*,<sup>178</sup> Andrew Verstein argues that policy favors exempting P2P from securities regulation, and that “[g]iven the tremendous benefits P2P promises, an ideal regulator would work constructively to grow and improve the industry.”<sup>179</sup> Verstein’s article is both thoroughly researched and well-written. All of the arguments he makes are plausible and have some grounding in existing law.

The authors of this piece, however, dispute several aspects of Verstein’s analysis. First, he begins with the conclusion that on-line P2P should be allowed to develop unfettered by securities regulation. Beginning with this policy conclusion weakens his case that existing law could have permitted the SEC to issue a finding that on-line P2P instruments are *not* securities. He chides the SEC for sticking to law in its cease-and-desist order against Prosper Marketplace for selling unregistered securities because the SEC “did not offer policy justifications for its positions”<sup>180</sup> The starting point in regulating a new financial product, however, is what the law says, not what one wishes policy would be. Although Verstein does make some

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<sup>176</sup> *Id.* at 1.

<sup>177</sup> *Id.*

<sup>178</sup> Verstein, *supra* note 8, at \*23 (“[T]he SEC’s hand was not forced.”)

<sup>179</sup> *Id.* at \*21.

<sup>180</sup> *Id.* at \*22.

valid points in his analysis of the *Howey* and *Reves* tests,<sup>181</sup> his analysis runs counter to the conclusions of regulators and the admissions of the industry that securities are being sold to individual lenders in P2P transactions.

Verstein does admit that his argument that P2P notes should be *legally* exempt from securities law, while “elegant,”<sup>182</sup> may not be convincing.<sup>183</sup> He ultimately advocates for the enactment of some sort of “provision to exempt existing P2P notes from the [federal] securities acts to whatever degree feasible.”<sup>184</sup>

As the GAO pointed out in its report, however, even if a new Congressional enactment excluded on-line P2P from the scope of *federal* securities regulation, state regulators could still decide the sites offered securities under *state* law.<sup>185</sup> The next section discusses the challenge on-line P2P has faced in the states, a regulatory concern Verstein does not engage.

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

State regulators have also been extremely active in the regulation of P2P lending. States have taken three basic approaches to regulating P2P sites. First, some states have prohibited on-line P2P sites from soliciting “investors” (lenders) in their states. Other states have allowed the sites to operate within their borders according to the business models provided by those sites. A third approach is to authorize such sites, but limit “investment” to sophisticated investors.

### i. Prohibiting States

Most of the states that have restricted on-line P2P lending have targeted only the “investor” or lender side of the P2P equation. Currently, twenty-two states ban Prosper.com from soliciting investors.<sup>186</sup> A few states have gone further, prohibiting both investing and borrowing via the sites.<sup>187</sup>

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<sup>181</sup> *Id.* at \*23-30.

<sup>182</sup> *Id.* at \*66.

<sup>183</sup> *Id.* at \*23 (“[T]he SEC’s determination was not entirely erroneous.”).

<sup>184</sup> *Id.* at \*66.

<sup>185</sup> GAO REPORT, *supra* note 5, at 44.

<sup>186</sup> Those states are Alabama, Arizona, Arkansas, Indiana, Iowa, Kansas, Kentucky, Maine, Maryland, Massachusetts, Michigan, Nebraska, North Carolina, North Dakota, Ohio, Oklahoma, Tennessee, Texas, Pennsylvania, Vermont, Virginia and West Virginia. *Legal Compliance*, PROSPER.COM, available at <http://www.prosper.com/legal/compliance.aspx> (last visited 12 July 2011).

<sup>187</sup> Borrowing is prohibited in Iowa, Maine, and North Dakota. *Legal Compliance*, PROSPER.COM, available at <http://www.prosper.com/legal/compliance.aspx> (last visited 12 July 2011).

LendingClub does not service borrowers in eight states.<sup>188</sup>

Rather than discussing each of the states' approaches, this section discusses one "representative" prohibiting state to illuminate the foundation of the prohibition approach. Ohio, through its Department of Commerce, Division of Securities, blocked Prosper.com from accepting "investors". The Chief Registration Counsel for the Division published a conference presentation discussing the state's reasoning.<sup>189</sup>

Ohio requires "merit review" for securities registrants, in which the Division of Securities must find that "the business of the issuer is not fraudulently conducted . . . that the plan of issuance and sale of the securities . . . would not defraud or deceive."<sup>190</sup> Prosper.com's registration statement included among identified "risk factors" the statement: "Information supplied by borrowers may be inaccurate or intentionally false. Information regarding income or employment is not verified in the majority of cases."<sup>191</sup> This led the Division to conclude that it was unable to find the business was not fraudulently conducted as required by Ohio law.

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<sup>188</sup> Those states are Idaho, Indiana, Iowa, Mississippi, Nebraska, North Carolina, North Dakota and Tennessee. See *Prospectus dated June 10, 2011*, at 90, available at [https://www.lendingclub.com/extdata/Clean\\_As\\_Filed\\_20110610.pdf](https://www.lendingclub.com/extdata/Clean_As_Filed_20110610.pdf) (last visited 12 July 2011).

<sup>189</sup> See Mark R. Heuerman, *Peer-to-Peer (P2P) Lending and Internet Platforms: Ohio Securities Act Implications*, available at <http://com.ohio.gov/secu/docs/Conference2010/MarkHeuermanP2P.pdf> (last visited 15 July 2011).

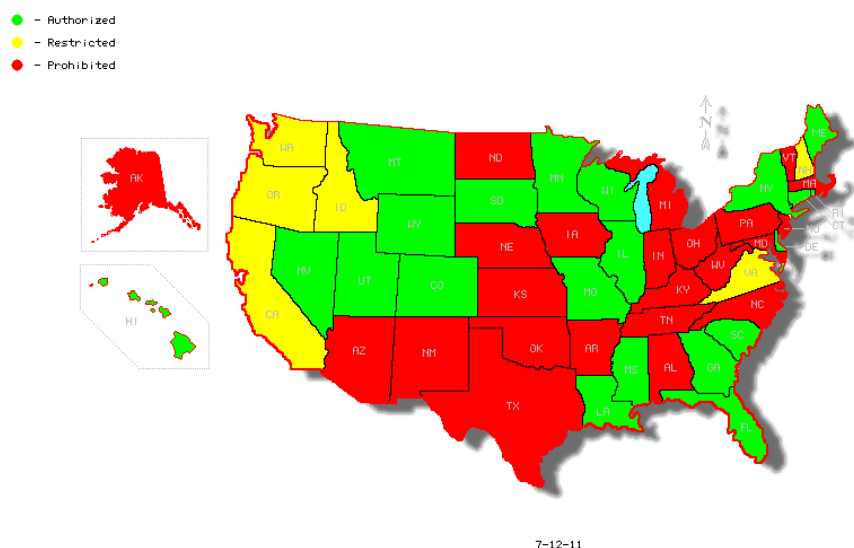
<sup>190</sup> O.R.C.A. §1707.09.

<sup>191</sup> Heuerman, *supra* note 189, at 5.

Other issues which led to the Ohio decision included the possibility that Prosper “itself may fall within the definition of a dealer by charging a fee for listing the notes on the platform,”<sup>192</sup> which would have required it to comply with broker-dealer regulations. The Division also worried that Prosper might be considered an “exchange,” in which case it would have to comply with the requirements for an exchange.<sup>193</sup>

Of course, prohibiting a site from operating within a state may not stop some enterprising would-be site users from finding a way on to the site. In the brick-and-mortar world of yesterday’s securities regulation, regulators knew where to go to stop a fraudster from bilking investors. Responding to

State Regulation of Prosper.com



their denial of access to Ohio residents, the sites could (and may indeed have) limited access to investing options based on an Ohio internet protocol address being associated with the would-be-user. But by crossing in to a neighboring state and setting up an account with a “fake” out of state address, a person might be able to evade well-meaning regulators’ reach.<sup>194</sup>

<sup>192</sup> *Id.* at 8.

<sup>193</sup> *Id.* at 9-10.

<sup>194</sup> See bulletin board posting by “Hornzup,” available at <http://www.shaggybevo.com/board/showthread.php/79967-Lending-Club-It-peer-to-peer-lending-gt?s=1fdc327778284852e50eebc3fa1f818&p=2378532&viewfull=1#post2378532> (last visited 21 July

ii. Authorizing States

Twenty-two states authorize both borrowing and lending via Prosper with no restrictions.<sup>195</sup> Twenty-eight states authorize investment and borrowing via LendingClub.<sup>196</sup> These states tend to be ones that mirror the SEC's approach to securities offerings, which does not involve merit review but simply requires disclosure.<sup>197</sup>

iii. States Authorizing with Conditions

A third group of six states authorize investing via on-line P2P sites but only for sophisticated investors meeting "suitability" requirements.<sup>198</sup> In most of these states, Prosper lending is limited to \$250,000-net-worth individuals (excluding home) or individuals with a \$70K income and \$70K net worth.<sup>199</sup> California imposes less stringent requirements, and only for Prosper investors who put in more than 10% of their net worth (to do so, investors must have a net worth of \$85,000 and an income of \$85,000 during the last tax year or a net worth of \$200,000).<sup>200</sup> LendingClub solicits loans in Kentucky only for individuals with \$200,000 income in the past two years or \$1 million in net worth.<sup>201</sup>

Among the reasons states impose such restrictions are the financial health of the platforms themselves. In its response to LendingClub's application, the Kentucky Department of Financial Institutions noted the firm's auditor's "going concern" letter, its negative earnings, and opined that investment in the site "constitute[s] a level of risk suitable only to

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2011) ("I created an account, with a fictional out of state address. No errors in account creation and I am getting emails asking me to go through the with set up and move money over from my checking account.").

<sup>195</sup> Those states are Colorado, Connecticut, Delaware, DC, Florida, Georgia, Hawaii, Illinois, Louisiana, Maine, Minnesota, Mississippi, Missouri, Montana, Nevada, New York, Rhode Island, South Carolina, South Dakota, Utah, Wisconsin and Wyoming. *Legal Compliance*, PROSPER.COM, available at <http://www.prosper.com/legal/compliance.aspx> (last visited 12 July 2011).

<sup>196</sup> Peter Renton, *Which States are Open to LendingClub and Proper Investors?*, SOCIAL LENDING NETWORK, available at <http://www.sociallending.net/investing-lending/which-states-are-open-to-lending-club-and-prosper-investors/> (last visited 18 July 2011).

<sup>197</sup> GAO REPORT, *supra* note 5, at 28.

<sup>198</sup> Investor "suitability" describes "the duty of licensed securities dealers to recommend investment products that are suitable to their clients, in light of the clients' investment objectives and financial means." Michael Bennett, *Complexity and its Discontents: Recurring Legal Concerns with Structured Products*, 7 N.Y.U. J. L. & BUS. 811, 817 (2011).

<sup>199</sup> Those states are Idaho, New Hampshire, Virginia, Oregon and Washington. *Legal Compliance*, PROSPER.COM, available at <http://www.prosper.com/legal/compliance.aspx> (last visited 12 July 2011); Hunsberger, *supra* note 11.

<sup>200</sup> *Legal Compliance*, PROSPER.COM, available at <http://www.prosper.com/legal/compliance.aspx> (last visited 12 July 2011).

<sup>201</sup> *LendingClub Supplement to Prospectus Dated July 30, 2009 for Distribution Solely in the State of Kentucky*, [https://www.lendingclub.com/extdata/ky\\_prospectus.pdf](https://www.lendingclub.com/extdata/ky_prospectus.pdf) (last visited 18 July 2011).



Accredited Investors.”<sup>202</sup> Similar financing issues have plagued Prosper, which has lost money since its inception and which, in SEC filings, that it might not “continue as a going concern.”<sup>203</sup>

#### IV. CREATING A COHERENT REGULATORY SCHEME FOR ON-LINE PEER-TO-PEER LENDING

The current regulatory regime for P2P lending is arguably a paper tiger. As explained in the previous section, under the most commonly used model for P2P lending, the borrower is protected by robust banking regulations that are designed to protect that individual from the bank that originates the loan.<sup>204</sup> Lenders are protected by robust federal and state securities regulation because notes, i.e. securities, are sold to individual lenders with payment on the notes being contingent upon repayment of the underlying loan issued by the bank.<sup>205</sup> If a P2P lending platform wanted to remove itself from this robust regulatory regime, the answer is simple: Remove the bank. For example, a platform could avoid having to comply with banking laws and securities regulation simply by providing a service that connects individual lenders to individual borrowers for a fee. Providing such connections between individuals interested in borrowing and individuals willing to lend is a valuable service, even if a platform, provides nothing else.<sup>206</sup>

If a P2P lending platform opted to provide a service that connected individual lenders to individual borrowers, although some additional laws might apply, such a model of P2P lending would be chiefly regulated by civil and criminal antifraud laws. On the federal level, for example, the United States Department of Justice would likely take a leading role in regulating P2P lending through the use of the federal mail fraud<sup>207</sup> and wire fraud<sup>208</sup> statutes and through the use of the Racketeer Influenced and Corrupt Organizations Act (RICO) under which mail fraud and wire fraud

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<sup>202</sup> File No. 70000487, available at <http://134.186.208.228/caleasi/PDFDocs/005277734.PDF> (last visited 18 July 2011).

<sup>203</sup> Prosper Form 10-Q, available at <http://www.sec.gov/Archives/edgar/data/1416265/000141626510000490/p10q9d30d2010.htm#notestofinancialstatementsq32010> (last visited 21 July 2011).

<sup>204</sup> See *supra* notes 115-124 and accompanying text (listing various statutes that are applicable to the most commonly used model of P2P lending because of the involvement of banks in the lending process).

<sup>205</sup> See *supra* Parts III.A-B (discussing the application of federal and state securities law to the most commonly used model of P2P lending).

<sup>206</sup> See *supra* notes 13-15 and accompanying text (discussing valuable service that P2P lending sites provide by connecting individual borrowers with individual lenders).

<sup>207</sup> 18 U.S.C. § 1341 (2011).

<sup>208</sup> 18 U.S.C. § 1343 (2011).

are predicate crimes.<sup>209</sup> Under this type of model, a robust and narrowly tailored system of regulation would be replaced by a thin and loosely tailored system of regulation. In addition, under such a model, most of the mandated *ex ante* disclosure of information that is required under the current commonly used model would be foregone in favor of *ex post* relief from wrongdoing under civil and criminal antifraud laws.

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

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

Section 989F of the Dodd-Frank Act mandated that the Comptroller General of the United States and the United States Government Accountability Office (GAO) conduct a study to “determine the optimal Federal regulatory structure” for P2P lending.<sup>210</sup> In conducting the study, section 989F required that the Comptroller General and GAO consult with a wide variety of entities including “Federal banking agencies, the [United States Securities and Exchange] Commission, consumer groups, outside experts, and the person to person lending industry.”<sup>211</sup> Congress specifically mandated that the content of the study include an analysis of:

- (A) the regulatory structure as it exists . . . , as determined by the [Securities and Exchange] Commission, with particular attention to—
  - (i) the application of the Securities Act of 1933 to person to person lending platforms;
  - (ii) the posting of consumer loan information on the EDGAR database of the Commission; and

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<sup>209</sup> 18 U.S.C. §§ 1961–1968 (2011).

<sup>210</sup> Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 989F, 124 Stat. 1376, 1947-48 (2010) (to be codified at 5 U.S.C. app. 11)

<sup>211</sup> *Id.* § 989F(a)(2).

- (iii) the treatment of privately held person to person lending platforms as public companies;
- (B) the State and other Federal regulators responsible for the oversight and regulation of person to person lending markets; . . .
- (D) consumer privacy and data protections, minimum credit standards, anti-money laundering and risk management in the regulatory structure . . . , and whether additional or alternative safeguards are needed; and
- (E) the uses of person to person lending.<sup>212</sup>

Congress also required that the report analyze “alternative regulatory options . . . [and] whether the alternative approaches [would be] effective.”<sup>213</sup>

Mandating a study represented a compromise between the United States House of Representatives and the Senate. Prosper Marketplace had lobbied both the House and the Senate hard to make the Consumer Financial Protection Bureau the primary regulatory of P2P lending and to exempt P2P lending from securities law.<sup>214</sup> Representative Jackie Speier, a Democrat from California, sponsored a provision in the House version of the financial regulatory reform bill that would have placed P2P lending under the supervision of the Consumer Financial Protection Bureau and removed it from SEC oversight.<sup>215</sup> The Senate refused to pass a similar provision.<sup>216</sup> By the time that the Dodd-Frank Act was signed into law on July 21, 2010, lawmakers had reached the compromise embodied in section 989F of the Act requiring a study.<sup>217</sup>

Dodd-Frank’s section 989F offers several lessons. First, Congress has a genuine interest in creating a coherent system of regulation for P2P lending. Second, Congress is in need of sophisticated information about P2P lending and how to regulate it. Third, Congress, or at least the Senate, is unwilling to take radical steps in regulating P2P lending, *e.g.* assigning the regulation of such lending to a new and untested Consumer Financial Protection Bureau, until more information is available.

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<sup>212</sup> *Id.* § 989F(a)(3).

<sup>213</sup> *Id.* § 989F(b)(2).

<sup>214</sup> See Silla Brush, *Online Lender Lobbies Congress for Industry Consumer Regulator*, THE HILL (June 9, 2010, 7:23 PM), <http://thehill.com/business-a-lobbying/102323-online-lender-lobbies-congress-for-industry-consumer-regulator>.

<sup>215</sup> *Id.*

<sup>216</sup> *Id.*

<sup>217</sup> See Brill, *supra* note 88, at 3.

## B. The GAO Report on On-line Peer-to-Peer Lending

On July 7, 2011, the GAO issued the mandated report.<sup>218</sup> The report is aptly titled *Person-to-Person Lending: New Regulatory Challenges Could Emerge as the Industry Grows*.<sup>219</sup> The title reflects both that P2P lending continues to grow and evolve and that any regulatory regime will need to continue to grow and evolve along with it.

The report is divided into three main sections. The first section details the lending models for the major for-profit (LendingClub and Prosper Marketplace) and non-profit (Kiva) P2P lending platforms operating in the United States.<sup>220</sup> The second section discusses the potential benefits and risks of P2P lending and the current regulatory regime governing such lending.<sup>221</sup> Finally, the third section of the report discusses options for regulating P2P lending going forward.<sup>222</sup>

The first and second sections of the report are thorough and well-written. This is little surprise considering the access, resources, and expertise of the Controller General and the Government Accountability Office. Notably, the drafters of the report had extensive access to a wide range of industry participants and regulators during the drafting process.<sup>223</sup>

The third main section of the report, however, is a disappointment. The report addresses only two possible models for regulating P2P lending, which can be boiled down to the following single, lengthy sentence:

We identified two primary options for regulating person-to-person lending that differ primarily in their approach to lender protection: (1) continuing with the current bifurcated federal system—that is, protecting lenders through securities regulators and borrowers primarily through financial services regulators, which will include the newly formed CFPB—or (2) consolidating borrower and lender protection under a single federal regulator, such as CFPB.<sup>224</sup>

The drafters of the report do provide some additional analysis of these

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<sup>218</sup> GAO REPORT, *supra* note 5,

<sup>219</sup> *Id.*

<sup>220</sup> *Id.* at 7-17.

<sup>221</sup> *Id.* at 18-42.

<sup>222</sup> *Id.* at 42-56.

<sup>223</sup> *Id.* at 60-63 (discussing the objectives, scope, and methodology in compiling the report).

<sup>224</sup> *Id.* at 42

models in the remainder of the section, but at an unfortunately high level of abstraction.

This level of abstraction is in a sense unsurprising given the current state of the P2P industry. As the drafters of the report note, “The continuing evolution and growth of person-to-person lending could give rise to new regulatory concerns or challenges, making it difficult to predict what the optimal regulatory structure will be.”<sup>225</sup> Although the drafters could have suggested a variety of radical approaches to regulating P2P lending, they discussed the two models that offer the most flexibility and likely the best use of existing expertise. However, one cannot help but be disappointed that the drafters did not discuss a wider range of regulatory options.

### C. Choosing Among a Myriad of Regulatory Options

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

- Allowing the On-line P2P Lending Industry to Self-Regulate
- Creating an Administrative Agency to Specifically Regulate P2P Lending
- Regulating P2P Lending Similar to On-line Gambling
- Developing a Harmonized International System of P2P Lending Regulation
- Creating an International Entity to Regulate P2P Lending<sup>226</sup>

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<sup>225</sup> *Id.* at 54.

<sup>226</sup> One of the authors of this Article has argued extensively for the international harmonization and centralization of securities regulation. See, e.g., Eric C. Chaffee, *Contemplating the Endgame: An Evolutionary Model for the Harmonization and Centralization of International Securities Regulation*, 79 U. CIN. L. REV. 587; Eric C. Chaffee, *Finishing the Race to the Bottom: An Argument for Harmonization and Centralization of International Securities Law*, 40 SETON HALL L. REV. 1581 (2010); Eric C. Chaffee, *The Internationalization of Securities Regulation: The United States Government's Role in Regulating the Global Capital Markets*, 5 J. BUS. & TECH. L. 187 (2010); Eric C. Chaffee, *Evolution, Not Revolution*, in *International Securities Regulation: A Modest Proposal for a Global Securities and Exchange Commission* (forthcoming); Eric C. Chaffee, *A Moment of Opportunity: Reimagining International Securities Regulation in the Shadow of Financial Crisis*, 15 NEXUS 29 (2010). Neither of the authors, however, would argue for the international harmonization and centralization of P2P lending regulation at this point. Both authors agree that both the industry and national regulation need to develop further before international coordination could possibly be attempted in any meaningful way.

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

Even among the two choices examined in the GAO report, however, placing P2P lending under the purview of a single regulatory entity, such as the Consumer Financial Protection Bureau, would also be a radical step because it limits the regulatory supervision of the industry, excludes various regulators from using their specific expertise, increases concerns about regulatory capture, and creates concerns about inhibiting the evolution of a growing and changing industry. Prosper Marketplace may have lobbied the House and Senate hard to place P2P lending under the auspices of the Consumer Financial Protection Bureau,<sup>227</sup> but one has to wonder about its motives. This is especially true because both Prosper Marketplace and LendingClub admit that they are selling “highly risky and speculative” securities.<sup>228</sup> Prosper Marketplace wants all the benefits of selling securities without the robust regulatory protections for investors that come along with it. Frankly, by involving banks and selling securities in its model of P2P lending, Prosper Marketplace opted into supervision by both banking and securities regulators, and it should not be allowed to cry foul because it does not like the model that it chose. Regulation solely by the CFPB is defensible if the only or primary concern with on-line P2P lending is the protection of would-be borrowers from excessive interest rates or the extension of credit that they would be unable to repay. But with on-line P2P lending, an equally important concern is the protection of investors, who purchase securities and sink funds in what are likely risky and dangerous investments. The new CFPB, unlike federal and state securities regulators, lacks a proven track record of protecting and educating individuals purchasing securities.

Verstein and others assert that the emerging on-line P2P industry is being stifled by over regulation, but the industry is continuing to grow. Perhaps, the industry is not growing as fast as it might be, but traditionally, under regulated financial services industries grow quickly until they suffer a

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<sup>227</sup> See *supra* note 207 and accompanying text.

<sup>228</sup> See *supra* notes 108-09 and accompanying text (containing language from Prosper Marketplace’s prospectus and LendingClub’s prospectus that state that the notes that they sell are “highly risky and speculative”).

dramatic crash.<sup>229</sup>

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

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

#### D. The Path Forward

In the short-term, Congress should adopt a wait-and-see approach to regulating P2P lending. The lending model used by both Prosper and LendingClub is adequately regulated by existing law. Individual borrowers are protected by a thick and robust system of lending regulation,<sup>230</sup> and individual lenders are protected by a thick and robust system of securities law.<sup>231</sup> Regulatory agencies should be given an opportunity to use their expertise to determine how existing statutes and regulations should be

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<sup>229</sup> See Eric C. Chaffee, *Standing Under Section 10(b) and Rule 10b-5: The Continued Validity of the Forced Seller Exception to the Purchaser-Seller Requirement*, 11 U. PA. J. BUS. L. 843, 851 (2009) (stating that Congress promulgated the Securities Act and Exchange Act in the wake of the stock market crash of 1929 because state securities statutes were “largely ineffective in preventing fraud”); see also Eric C. Chaffee, *Beyond Blue Chip: Issuer Standing to Seek Injunctive Relief Under Section 10(b) and Rule 10b-5 Without the Purchase or Sale of Security*, 36 SETON HALL L. REV. 1135, 1138-1140 (2006) (discussing the rise of federal securities law in the United States in the wake of the stock market crash of 1929).

<sup>230</sup> See *supra* notes 118-28 & accompanying text (discussing the some of the federal lending regulations that are applicable to the model of P2P lending used by Prosper and LendingClub because of their use of a bank in the P2P lending process).

<sup>231</sup> See *supra* Parts III.A-B (discussing the applicability of federal and state securities regulation to the model of P2P lending used by both Prosper and LendingClub).



applied to P2P lending and the opportunity to promulgate new regulations based on their existing statutory mandates.

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

## V. CONCLUSION

While section 989F of the Dodd-Frank Act evidences Congress's interest in regulating P2P lending, Congress may take a substantial amount of time to promulgate such regulation. The Dodd-Frank Act mandates a plethora of studies for purposes of potential future regulation, and the study required by section 989F is just one among dozens mandated to be conducted under the Act.<sup>232</sup> Although the Comptroller General and

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<sup>232</sup> See, e.g., Dodd-Frank Act § 123, 124 Stat. at 1412 (to be codified at 12 U.S.C. § 5333) (mandating a study of the effects of size and complexity of financial institutions on capital market efficiency and economic growth); id. § 202(f), at 1449 (to be codified at 12 U.S.C. § 5382) (mandating a study of international coordination relating to the bankruptcy process for financial companies); id. § 215, at 1518-19 (to be codified 12 U.S.C. § 5394) (mandating a study of secured creditor haircuts); id. § 216, at 1519 (to be codified at 12 U.S.C. § 5394) (mandating a study of the bankruptcy process for financial and nonbank financial institutions); id. § 217, at 1519-20 (mandating a study of international coordination relating to the bankruptcy process for nonbank financial institutions); id. § 415, at 1578 (to be codified at 15 U.S.C. § 80b-18c) (mandating a study of the criteria for accredited investor status and eligibility to invest in private funds); id. § 416, at 1579 (to be codified at 15 U.S.C. § 80b-18c) (mandating a study of a self-regulatory organization for private funds); id. § 417 (mandating a study of short selling); id. § 526, at 1591 (to be codified to 15 U.S.C. § 8205) (mandating a study of the nonadmitted insurance market); id. § 603(b)(1), at 1598-99 (to be codified 12 U.S.C. § 1815) (mandating a study of the treatment of credit card banks, industrial loan companies, and certain other companies under the Bank Holding Company Act of 1956); id. § 620, at 1631 (to be codified at 12 U.S.C. § 1851) (mandating a study of bank investment activities); id. § 750, at 1748-49 (to be codified at 7 U.S.C. § 25) (mandating a study on oversight of the carbon markets); id. § 913, at 1824-30 (to be codified at 15 U.S.C. § 78o) (mandating a study regarding the obligations of brokers, dealers, and investment advisers); id. § 914, at 1830 (to be codified at 15 U.S.C. § 80b-11) (mandating a study on enhancing investment adviser examinations); id. § 917, at 1836 (to be codified at 15 U.S.C. § 80b-11) (mandating a study regarding financial literacy among investors); id. § 918, at 1837 (to be codified at 15 U.S.C. § 80b-11) (mandating a study regarding mutual fund advertising); id. § 919A, at 1837-38 (to be codified at 15 U.S.C. § 80b-11) (mandating a study of conflicts of interest within the investment industry); id. § 919B, at 1838-39 (to be codified 15 U.S.C. § 80b-10) (mandating a study on improved investor access to information regarding investment advisers and broker-dealers); id. § 919C, at 1839-40 (to be codified 15 U.S.C. § 80b-10) (mandating a study on financial planners and the use of financial designations); id. § 929Y, at 1871 (to be codified at

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

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

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15 U.S.C. § 78d-5) (mandating a study on the extraterritorial application of private rights of action under the Securities Exchange Act of 1934); id. § 929Z (mandating a study on securities litigation); id. § 939C, at 1888 (to be codified at 15 U.S.C. § 78m) (mandating a study on strengthening credit rating agency independence); id. § 939D, at 1888 (to be codified at 15 U.S.C. § 78o-9) (mandating a study on alternative business models for compensating statistical rating organizations); id. § 939E, at 1888-89 (to be codified at 15 U.S.C. § 78o-9) (mandating a study regarding creating an independent professional organization for rating analysts employed by nationally recognized statistical rating organizations); id. § 939F, at 1889-90 (to be codified at 15 U.S.C. § 78o-9) (mandating a study of assigned credit ratings); id. § 946, at 1898 (to be codified at 15 U.S.C. § 78o-7) (mandating a study of the macroeconomic effects of risk retention requirements relating to asset-backed securities); id. § 967, at 1913-14 (to be codified at 15 U.S.C. § 78d-4) (mandating a study relating to organization reform within the SEC); id. § 968, at 1914 (to be codified at 15 U.S.C. § 78d-4) (mandating a study relating to the “revolving door” between the SEC and private sector financial institutions); id. § 976, at 1923-24 (to be codified at 15 U.S.C. § 78o) (mandating a study regarding increased disclosure to investors by issuers of municipal securities); id. § 977, at 1924 (to be codified at 15 U.S.C. § 78o) (mandating a study of the municipal securities markets); id. § 989, at 1939-41 (to be codified at 12 U.S.C. § 1831o) (mandating a study of proprietary trading by various financial institutions); id. § 989F, at 1947-48 (to be codified at 5 U.S.C. app. 11) (mandating a study of person-to-person lending); id. § 989I, at 1948-49 (to be codified at 5 U.S.C. app. 5) (mandating a study regarding the exemption for smaller issuers from section 404(b) of the Sarbanes-Oxley Act of 2002); id. § 1074, at 2067-68 (to be codified at 15 U.S.C. § 1693o-1) (mandating a study on ending the conservatorship of Fannie Mae, Freddie Mac, and reforming the housing finance system); id. § 1076, at 2075 (to be codified at 12 U.S.C. § 5602) (mandating a study on reverse mortgage transactions); id. § 1078, at 2076 (to be codified at 12 U.S.C. § 5602) (mandating a study on credit scores); id. § 1406, at 2142 (to be codified at 15 U.S.C. § 1601) (mandating a study of shared appreciation mortgages); id. § 1446, at 2172 (to be codified at 12 U.S.C. § 1701) (mandating a study on default and foreclosure of home loans); id. § 1476, at 2200-02 (to be codified at 12 U.S.C. § 2603) (mandating a study on the effectiveness and impact of various appraisal methods, valuation models and distributions channels, and on the Home Valuation Code of conduct and the Appraisal Subcommittee); id. § 1492, at 2206 (to be codified at 12 U.S.C. § 5219b) (mandating a study on government efforts to combat mortgage foreclosure rescue scams and loan modification fraud); id. § 1494, at 2207 (to be codified at 12 U.S.C. § 1715z-25) (mandating a study on the effect of the presence of drywall imported from China during the period beginning with 2004 and ending at the end of 2007 on foreclosures); id. § 1506, at 2222 (to be codified at 15 U.S.C. § 78m-2) (mandating a study of core deposits and brokered deposits).

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