‘Socially useful’ finance and the regulation of peer-to-peer lending in the United Kingdom

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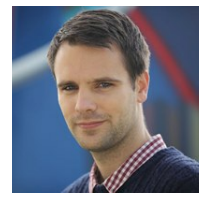
*Economic policy has been a central debate in British politics since the economic crash. Here, **Chris Rogers** and **Chris Clarke** assess how peer to peer lending has changed this landscape.*



The crisis of 2008 and its aftermath ignited a debate about the role of finance in society. Critics suggested that financial services had become too dominant in large economies, that financial institutions had become too powerful, and that as a result they had been able to capture regulation. Finance, it was argued, had ceased to serve the public interest and taken on the characteristic of a ‘club good’ in which elite collusion facilitated the extraction of rents by powerful interests, with catastrophic consequences for the economy more broadly.

In the aftermath of the crisis, several important regulators in the UK expressed significant concerns about these developments. Adair Turner, for instance, made a series of public interventions in which he questioned the value of some financial practices and went so far as to suggest that ‘some financial activities […] were socially useless’. Andrew Haldane similarly noted that banks need to ‘rediscover their social usefulness’, while Mark Carney stated that when finance ‘only talks to itself [it] becomes socially useless.’

Such public interventions raise a key question: what does or would socially useful finance look like? Is it even possible to realise? These are, of course, complex questions, not least because they require a settled notion of what is in the ‘public interest’—something that is difficult to pin down because it is subject to continual contest and debate.

However, the same regulatory figures that criticised the social usefulness of banking finance made some (undeniably limited) proposals about what ‘socially useful’ finance might look like. These were primarily linked to financial intermediation narrowly defined, and included, for Adair Turner, the ‘linking of savers to productive investments’ and facilitating the ‘flows of capital and trade’ and for Mark Carney, making a contribution to business investment and job creation.

These appeals to socially useful finance occurred at a time in which there was also a large-scale expansion of forms of financial activity that could lay claim to meeting some of these criteria. A sub-section of these emerging financial activities—peer-to-peer lending, in which various platforms focus on brokering direct lending agreements between counterparties—has seen particularly impressive growth, with statistics from Altfi showing lending volume across the sector totalling over £7.8bn by January 2017, rising from just £400m in January 2013.

One of the key problems that the sector faced in managing its growth related to developing an understanding among the general public of what the process involved, and fostering credibility for it. The regulation of the peer-to-peer lending marketplace is therefore of considerable significance, because regulation by the state represents an explicit endorsement that an activity is legitimate and credible as well as providing reassurance that adequate protections are in place.

Interestingly, the processes by which this regulation occurred bears some resemblance to the process of ‘capture’ it has been argued was typical of mainstream finance prior to the crisis. In the first stage of the process, the industry developed modes of self-regulation operating outside formal regulatory processes, beginning with the formation of the Peer-to-Peer Finance Association. This was accompanied by a process of lobbying for the incorporation of P2P lenders into the formal regulatory architecture by leading firms in the sector.

Ultimately, Financial Conduct Authority regulation aimed at developing a ‘proportionate framework’ allowing firms to ‘design systems and controls that are appropriate to the needs of their business model and consumers’. This effectively represents a light-touch regulatory regime that brings P2P lending under the state’s regulatory umbrella—thus legitimising it—without being particularly prescriptive, in a clear reflection of lobbying from the P2P lending platforms who wished to be regulated, but without overly burdensome prudential standards.

In sum, then, P2P lenders were successful in lobbying for regulation, providing the industry with reputational legitimacy without stifling industry practices. In contrast to mainstream finance were such appearances of capture have led to accusations of rent-seeking, the case of P2P lending appears to have facilitated financial activities that meet some regulators’ (admittedly modest) understandings of ‘socially useful’ finance.

In the context of on-going debates about the consequences of financialisation, the extent to which this expansion ultimately proves to be socially useful remains, of course, an open question. Nonetheless, the regulation of P2P lending in the UK suggests that interaction between regulators and regulated firms does not necessarily produce purely rent-seeking behaviour. Perhaps more significantly, by providing reputational legitimacy to a novel form of finance, the process illustrates, at the very least, the possibility of socially useful innovation in finance. As the FCA is currently undertaking a post-implementation review of the rules for the sector, questions around social usefulness and purpose are likely to be raised again as alternative finance is increasingly mainstreamed.

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Note: This blog is based on the authors’ recent article in the British Journal of Politics and International Relations.

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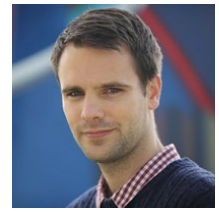

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