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The peer-to-peer lending model in Belgium: A disruptive outsider?

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Abstract

The growing penetration of modern internet technologies is changing our social and economic lives, including how we interact with one another and how we share resources. Digitalisation gives rise to new market entry opportunities, especially for technology providers in the financial services area. As a result, peer-to-peer lending, a recent type of alternative finance that puts borrowers and lenders in direct contact through an online platform, started to emerge in the 2000s. Peer-to-peer lending has rapidly expanded in several countries, to the point that one may start to believe that these platforms could one day destabilize financial institutions. This thesis reviews the current business and consumer peer-to-peer lending markets in Belgium, from what they offer today to their potential growth in the coming years in an environment filled with cultural, legislative, economic and social obstacles. We also discuss the legislation issues surrounding this new form of intermediation, and in particular the possible reasons of the prohibition of peer-to-peer consumer lending in Belgium. In this respect, we review and contrast the literature and the opinion of key players in the fields of finance and innovation. Our in-depth analysis argues that peer-to-peer business lending is currently more complementary than disruptive, while the implementation of an efficient legal framework and value-added services may lead to a different outcome. Regarding peer-to-peer consumer lending, there is significant interest today in Belgium for this concept, and this leads us to believe that the sector may have a glowing future. However, extend the exception of taking repayable funds from the public to natural persons should simultaneously include other measures to contain the risks involved, such as an access for platforms to the Central Individual Credit Register to avoid a potential shadow banking as well as enabling platforms to conduct proper creditworthiness analysis.

Keywords:peer-to-peer lending, business, consumer, investors, platforms, digital economy, Fintech, opportunities, obstacles, disruption, complementary, regulation, credit risk

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Introduction

In a world that is increasingly dependent on technology and connectivity, the economy of sharing is gaining momentum, and is reaching into a growing number of areas, naturally including the financial sector. This emerging industry of online financial services grew out of start-ups called Fintechs. Fintechs link finance and technology to provide channels and instruments that go well beyond those of our conventional financial system. They open the door wide to a disintermediated version of the core business of traditional institutions, and all their activities are true differentiators.

A new type of alternative finance emanates from this trend, and provides innovative opportunities to borrowers and lenders alike. This online method of debt financing enables people to access resources without the use of an intermediary. Born in the UK in the 2000s, peer-to-peer lending activities have rapidly grown in volume nearly from the ground up. Peer-to-peer lending business models and practices have expanded over time as platforms have matured innovative approaches and sought market opportunities, while continuing to build upon their core function of providing digital lending marketplaces.

One may support the idea that this new trend is one of those fads of which our hyper mediatized world is so customary, one of those "whooping-coughs" in which one loses interest as quickly as one has found oneself fascinated in the first place. We do not share this view, as peer-to-peer lending is based on concrete achievements that this thesis will endeavour to highlight. Fintechs have all the characteristics of a true fundamental tendency that may very well disrupt the exercise of the banking and financial professions as we know if today.

One may believe that these platforms may one day overturn the existing organisational and institutional structure of banking. There are however considerable divergences in the literature regarding the potential disruptive impact of these platforms and their role in the economy. In addition, even if this sector is currently growing, we cannot predict with any accuracy when the peak of growth will be reached.

In the meantime, many small revolutions have already taken place in different sectors such as telephony, distribution of recorded music or air and travel reservations. The industry is developing at the same pace as customer expectations are evolving. On the one hand, the experience of consumers in digital industries is intensifying their expectations for immediacy and convenience. On the other hand, consumers are also becoming progressively willing to experiment with new providers, this even in domains where the utmost trust is required. This environment, in addition to the significant loss of confidence in the traditional financial institutions brought by the crisis of 2008, seems to offer ideal conditions for the development of these innovative players.

Compared to that of its neighbours, the online alternative finance market in Belgium is still in its infancy, although it has shown a substantial annual growth since 2013. One cannot deny the fact that, even if the overall volume of transactions is currently insignificant, the catch-up movement is underway. To achieve success, the peer-to-peer lending sector must be supported by a relevant regulatory framework. Such a framework is already in place for business lending, which is regulated by the law of December 18, 2016 for the recognition and supervision of crowdfunding in Belgium. Nevertheless, as surprising as it may sound, peer-to-peer consumer lending is still prohibited in Belgium while the phenomenon is skyrocketing in several other countries.

First and foremost, we emphasize that alternative financing models, other than the business and consumer lending models, will only be mentioned for the sake of comparison. Only peer-to-peer consumer and business lending models are discussed in this thesis as they are the most widespread worldwide. Furthermore, we will always endeavour to point out the distinct interests of platforms, borrowers and lenders as the main actors in this play.

Part 1 of this thesis provides the reader with background information on online peer-to-peer lending, by describing the business model and its environment in more detail, from its emergence to today, and by comparing it with other online alternative financing models. We will show that documentation of the current legislation around peer-to-peer lending in the UK and Belgium highlights the need for a strong regulatory framework. We will conclude Part 1 with an analysis of the potentially disruptive effect that platforms could

have on the financial institutions. In this respect, we will focus on the Anglo-Saxon market, as the highest transaction volumes are recorded in this country. Our analysis of these two marketplaces will allow us to assess the potential evolution of this sector in Belgium, while at the same time considering the differences in their respective debt-driven cultures.

Part 2 of our thesis will focus on the case of Belgium through a review of the literature and interviews with key actors in the field, recognized for their relevant expertise. We address the prospects of peer-to-peer business and consumer lending in Belgium while also taking into consideration the current state of the market and the conditions in place for the potential development of the sector. In addition, we propose a challenging overview of the potential reasons of the prohibition of consumer lending in Belgium, by discussing what should be modified in the existing legislative framework. We will also examine the perspectives of both the platforms and the banks, to provide a better understanding of the state of the market. We will show that legislation is not the only factor responsible for the weak development of this new model.

Part 2 includes a critical analysis of the potential growth of this sector in Belgium, as well as the impact these innovative actors could have on our financial institutions in the coming years.

Part I

Literature Review

This first part provides the background information needed to understand how peer-to-peer lending is designed, as well as the environment in which it is evolving, in order to properly apprehend the second part of the thesis. Therefore, in the first chapter, we propose to define "Fintechs", from their emergence to today, as well as the functions and services they offer. In the second chapter, we consider the online alternative finance market, defining the different types of alternatives encountered, explaining their fields of application, mainly focusing on the peer-to-peer business model, as well as on the risks linked to this financial instrument. The following chapter provides the backdrop of global competition, with a focus on volumes and growth, between the different online alternative financing activities, paying particular attention to the Belgian market. In chapter four, we explain the reasons behind the development of peer-to-peer lending, through the motivations of the players and the ever-amplifying institutionalisation. In the fifth chapter, we review the regulations in place around peer-to-peer lending, and more specifically in the UK and in Belgium. Finally, in the last chapter, we propose an analysis of the role of peer-to-peer lending in financial intermediation, and discuss the positioning of financial institutions in relation to this new form of alternative financing.

Chapter 1

A world of Fintech

In this chapter, we propose to define the concept of fintech, by providing an explanation of how fintechs emerged and what their activities actually are.

1.1 Definition

As this thesis is about a new form of activity in the financial sector, it is important to understand its origin. From the publication of Bouyala (2016), peer-to-peer lending is referred to as "fintech", which is a merging of the terms finance and technology, and represents innovative solutions in financial services. Fintech can also be defined as an avatar in the field of banking and finance, enabling small agile entities to compete on their own ground (and/or supplement the offer) with actors installed in all areas of the economy (Airbnb for hotels and Uber for taxis are the most emblematic examples).

Fintech can be traced back to the creation of the printing press, which enabled countries to print paper currency as a more readily available and fluid source of currency. However, the most notable advancement came with the creation of the telegraph in 1866 and the laying of the first trans-Atlantic cable, which launched financial globalization. In 1918, the telegraph enabled the Federal Reserve Bank to set up a proprietary communication system in order to process fund transfers among the 12 Reserve Banks. This system has been used for bank transfers until the 1970s (Hess, 2016).

As Zimmerman (2016) from the New York Times noticed, a large part of our financial technology infrastructure was set up in the period from 1950 through 1970. In 1966, the global telex network was built, which sought to offer the framework for future financial technology development in the international field.

In the 1980s banks started to exploit the sophisticated data and record-keeping systems available through large mainframe computers. From that point on, most of the

fintech improvements were hidden behind the scenes, in the back offices of investment houses and banks. It was only in 1982 that E-Trade highlighted fintech to the public with its electronic trading system for individual investors. Thanks to the growth of the Internet in the 1990s, online stock brokerage websites based on the E-trade model started to appear. These websites were the first true fintech companies (Brooks & Gador, 2017).

Interestingly, since the 1980s, people started to use the word "fintech" to refer to a type of company, or even to the people managing those companies, rather than the field they worked in, which explains why the noun 'fintechs' exists in a plural form (Hochstein, 2015).

1.1.1 Fintech in the digital age

With the advent of Internet technology, fintech improved on much of the financial technology infrastructure with more sophisticated trade processing, risk management, cash management and data-analysis tools. In the 2000s improvements in Internet connectivity enabled new fintech companies to establish consumer-facing solutions. Paypal was, for instance, among the early fintech companies that transformed the way people handle their money through payments (Hess, 2016).

As more and more people are embracing the new wonders of fintech through online banking, online lending, online trading, smartphone payments or robo financial advisors, they will begin to look back on how things were carried out in the old days, just like some of us consider the manual typewriters today. The current development of fintech is accelerating at such a rate that our relationship with money will undeniably become unrecognizable within a decade (Zerucha, 2016). Fintech has entirely revolutionized our rapport with lines of credit, lending and obtaining business loans. However, fintech is not considered as a product of recent technologies. Ever since technology has been evolving, people have constantly devised new ways of applying it in order to improve the world of finance.

1.1.2 Market categorization

Like their cousins from others industries, Fintech companies support their development on three axes (Bouyala, 2016):

- The use of innovative technologies (often based on platforms with which the end-user interacts through a device - mainly mobile phone, computer or tablet - connected to the Internet or other communications networks) to provide products and services to the end customer that are better provisioned and/or cheaper than those of existing players.
- An economic model often disruptive, having no legacy model to preserve.
- The evolution of the customers' behaviour (mobile, connected, geolocalized, present on social networks), combined with the passive (and often archaic) actors in place, unable to respond to these evolutions of demand, at least not in a time lapse compatible with the haste that now characterizes it. A tendency aggravated in this field by the distrust vis-à-vis the banking and financial world generated by the crisis of 2008[1].

As a rule of thumb, start-up firms - peer-to-peer platforms but also 'challenger banks' - can design and implement operational systems that take advantage of the latest Web 2.0 technologies. Undoubtedly, 'challenger banks' are seeking to compete with established banks in a fuller range of banking services using new technologies without being slowed down by the need for ensuring continuity with older legacy systems (Milne & Parboteeah, 2016).

[1]The evolution of the American's confidence in Banks is provided in Appendix 1.

1.2 Description of services provided

Fintech companies can be categorized according to the types of financial services they provide as well as by the way the market itself is organized.

1.2.1 Activities encountered in the Fintechs

One of the main difficulties encountered when one tries to characterize Fintech more precisely and concretely, beyond the mere exercise of perimetric definition, is the exuberance of its fabric, the large variety of the range of financial services, especially since it is a world in constant expansion because new start-ups are created almost daily (Bouyala, 2016).

From now on, we will focus on simplifying, categorizing and synthesizing. Indeed, we will rely on a classification referring to the main banking sectors, with a framework very similar to that proposed in the study "The fight for the Customer - Global Banking", published by McKinsey in October 2015.

On this basis, the Fintechs can be divided into two main parts: payments and account management, and financing and saving. If we only briefly review the first point, we will obviously dwell on the second, since it is the very basis of the peer-to-peer lending model concept.

1.2.2 Payments and account management

Payments are undoubtedly one of the first traditional banking activities that opened up to competition from the Fintechs. In developed countries, the democratization of banking has led to an unprecedented development of scriptural money on dematerialized and user-friendly media (bank cards, transfers and direct debits). In order to facilitate their use and exchange, banks and central banks progressively developed and established efficient and secure payment systems during the second half of the twentieth century. This greatly facilitated the access to current accounts as well as the circulation of dematerialized money between economic agents (Houssa & Standaert, 2016).

This evolution led, at the turn of the new millennium, to the impassive landscape of a sea of oil, until, like a thunderclap in a serene sky, the rise in power of Fintech came to disrupt these payments and account management businesses.

The success of these new players is mainly due to the clever exploitation of inadequacies in the traditional banking service. They base their offerings on ease of access to the market, as well as on the potential for interaction and service provided by the widespread use of Web and mobile technologies. In this context, the most well-known sectors are retail, end-customer payment offers and account management offers (Brooks & Gador, 2017).

1.2.3 Financing and savings

Draining savings to finance the economy is a bank's primary purpose. In this field, Fintech develops its services according to three axes (Bouyala, 2016):

- The direct linking of savings and credit with online alternative financing activities.
- The development of innovative financing offers, based on existing techniques.
- The development of new tools for capturing and managing savings.

Fintech in this area is ideally positioned to offer better quality service both to lenders (e.g for tracking the current status of their investment and managing their lending) and to borrowers (e.g a simple loan application process with a quick decision and a flexible and transparent portal for reviewing outstanding commitments and monitoring their repayment) (Milne & Parboteeah, 2016).

Chapter 2

Concept and environment of peer-to-peer lending

What the very essence of banking had disconnected, savings and financing - the bank's purpose was to screen the two types of players by assuming the risk of borrowers defaulting - Fintech is joining again by directly connecting economic agents with savings to those who need funding.

In this chapter, we first define the environment in which peer-to-peer lending is evolving. Afterwards, we further discuss the business model, from its positioning in relation to other alternative forms of financing, to the market mechanisms used by the platforms to operate. As every opportunity brings risks, the last section in this chapter outlines the potential risks faced by the various economic players.

2.1 Funding by the crowd

Before we go any further, it is important to mention that the existing literature on the subject does not allow for an easy classification between the different forms of alternative financing activities. Experts do not seem to be able to reach a consensus on the positioning of peer-to-peer lending in the financial environment. On the one hand, there are those who prefer to make a clear distinction between crowdfunding and crowdlending, as these operate on completely different business models. On the other hand, there are those who consider crowdfunding as any type of funding made by the crowd for a specific project or purpose. In this scenario, peer-to-peer lending is thus a crowdfunding method that funds a project through a loan. We have decided to base our analysis on this second definition, as we see it as the most appropriate way to apprehend peer-to-peer lending in its environment.

The principle of crowdfunding is straightforward: directly bringing together agents in need of money with other agents who are willing to give it to them, to lend or entrust it. As a result, the term "Crowdfunding" encompasses several services completely different

from each other in their functioning or even in their philosophy. As we will observe, the literature classifies those services in many different ways[2].

2.1.1 The different types of crowdfunding

The different types of crowdfunding are classified depending on what investors will receive in exchange for the amount invested. For instance, on the one hand, crowdfunding platform types are divided into two categories: donation crowdfunding and investing crowdfunding (The World Bank, 2013). On the other hand, Röthler and Wenzlaff (2011) distinguished three main categories. These three categories are:

- crowdsupporting, where the crowd provides money without expecting any reward for the action
- crowdfunding, where the crowd expects some kind of benefit.
- peer-to-peer initiatives, where the crowd lends money to a project through platforms

A third classification was made by Kuti and Madarasz (2014), by dividing the concept into 4 categories; equity-based, credit-based, donation-based and reward-based crowdfunding.

We propose to analyse the different types of crowdfunding based on the report of the World Bank (2013). We see that the differentiation is made based on the different business models suggested by Kuti and Madarasz (2014) with Royalty-based as an additional.

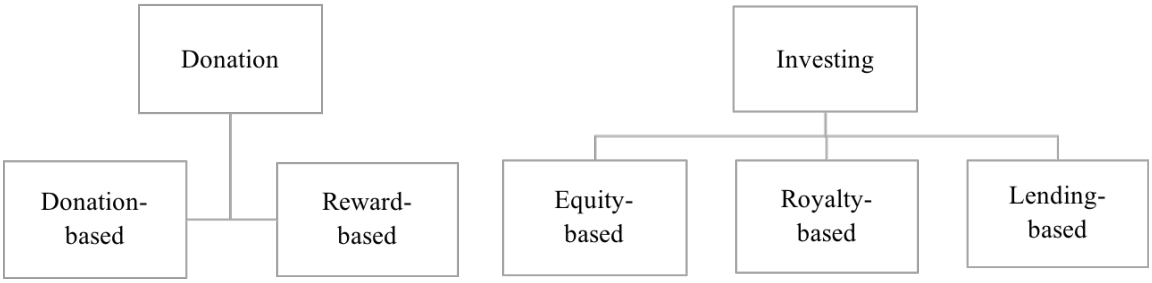


Fig. 2.1 Crowdfunding type of the World Bank

[2]We do not mention every classification found in the literature reviewed as there are plenty.

2.1.1.1 Donation crowdfunding-model

Donation-based In the context of a donation-based crowdfunding campaign, the contributors do not expect any financial or non-financial returns. According to Kuti and Madarasz (2014), the donation-based crowdfunding is aimed at supporting charitable, research, creative or personal projects. It is all about emotion: people are generally more inclined to support projects when these appeal to their beliefs and passions. Raising money for children or persons in need are projects that appeal to many investors. One of the most shining examples of this was the campaign for the Ocean Clean-up project that attracted more than 38 000 funders from 160 countries in 2014, and raised more than 2 million dollars in 100 days (The Ocean Cleanup, 2017). Even if contributors do not expect any financial or non-financial returns, it is common to give small rewards to show them how their gifts are appreciated. For instance, a thank-you email received after the donation or even the donor's name listed on the campaign website.

Reward-based The business model provides funding to a campaign by giving real products or services in exchange for the money received. The different categories of rewards will depend on the project and the amount offered. Generally, the higher the amount you offer, the higher the rewards you may receive. The World Bank (2013) mentioned the fact that this model involves low risk for both parties, especially if the reward is not a pre-ordered product but only a gift to show appreciation. As seems quite logical, if the financial goal of the campaign is not reached, every investor will be entirely refunded. For the company, the concept of offering a pre-ordered product can bring many advantages. Indeed, it offers entrepreneurs the opportunity to challenge their product without taking too much risk at the onset. By doing this, they have the opportunity to discover how the crowd will react to their innovation and if there are many people willing to pre-order the product. Furthermore, this initiative may give them the chance to adjust the product before its launch. Even if the financial goal is achieved, a worst-case scenario may occur where the product is not working or the production failed and therefore, investors will not receive the product and they will lose their money (Borner, 2016).

2.1.1.2 Investing crowdfunding-model

Equity-based Contrary to the donation crowdfunding-model, the equity-based model requires contributors to receive a financial return in exchange for their investment. Equity crowdfunding is the process whereby the investor acquires shares in the company in exchange for a small amount of money. This business model allows the investors to have ownership and to make a profit if the company does well (The World Bank, 2013). Like the other crowdfunding models, if the financial target of the campaign is not reached, investors will receive their money back. As with every risky investment, even if the project is fully funded, investors may lose some, or all, of their money during the project lifetime (Röthler & Wenzlaff, 2011).

It is important to emphasize that, although their motivations are essentially financial by nature, borrowers approach equity-based crowdfunding with a very different incentive than they do the lending-based model presented below (cfr infra p.36). Equity-based crowdfunding directly allows small companies to access credit but indirectly allows for market research also. Investors can indeed give their opinion on the project. If the "fundraising" campaign fails, it will be necessary to determine why and to draw lessons from it. If successful, participants will become true ambassadors. From then on, an equity-based crowdfunding campaign can offer market visibility to companies and to their lead users, and also enables an evaluation of the potential of their project (Kuti & Madarasz, 2014).

Royalty-based Less common than the other business models, the royalty-based crowdfunding model recently appeared on the market. The principle is simple: an investor has the opportunity to lend a certain amount to a company and in exchange he will receive a profit proportional to the success of the project. Indeed, instead of having ownership as it is the case in the equity-based model, the investor will earn a percentage of the profit generated (Borner, 2016).

Lending-based This business model is also known as peer-to-peer lending. Peer-to-peer lending is defined by Kirby and Worner (2014) as an online platform that matches lenders/investors with borrowers/issuers in order to provide unsecured[3] loans. Indeed,

[3]As we can notice in an article written by Renton in 2011, platforms begin to offer “secured” loans.

this business model is a method of debt financing that enables people to find resources without the use of an intermediary, such as the bank (Borner, 2016). This model will be more detailed in the following section.

2.1.2 A shift in vocabulary

Finally, even if we have just proposed the expression “Crowdfunding”, we observe that this term has recently been somewhat neglected to be replaced by "Online Alternative Finance"[4]. This vocabulary shift can be explained by several factors. Indeed, even if the principle remains almost identical, “Online Alternative Finance” is an expression that induces a reference to several different types of alternative financing activities that are difficult to encompass in the term “Crowdfunding”.

Furthermore, the origin of the concept was “funding” by the “crowd”, as a large number of individuals invested directly in projects. However, nowadays, a significant portion of this funding is carried out by financial institutions (cfr infra p.38), and therefore the term “crowdfunding” has become somewhat irrelevant. As a result, we mainly consider the term ‘online alternative finance’ to describe the market in which peer-to-peer lending is evolving.

2.2 The peer-to-peer business model

Now that the framework in which peer-to-peer lending operates has been established, we intend to go into further details regarding its business model. Basically, the concept of peer-to peer lending (also known as P2P lending) allows an interaction between two distinct parties without the presence of an intermediary.

The origin of this system comes from the area of computer networking. The P2P structure is an alternative to the client-server model, where the client requests services from a service provider, called a server. Indeed, the P2P network refers to a system where any computer can act either as a client or as a server to other computers without the need

[4]Online alternative finance refers to financial instruments and channels that have emerged outside of the traditional finance system such as capital markets and regulated banks. In this case, we only consider the channels and not the instruments such as cryptocurrencies, community shares, or others ‘shadow banking’ mechanisms (Segal, 2016).

for a special server device (Milne & Parboteeah, 2016). The growth of Internet makes the disintermediation between users easier and has led to the development of several P2P services. One of the first examples of this type of activity to become popular was the peer-to-peer file sharing, where files such as photos, movies, games or music can be shared between computers present in the same network without having to connect to a centralised server (Kung, Picard, and Towse, 2008). This technology appeared in the early 2000's and was made possible through services such as Kazaa, BearShare, Limewire, Napster or BitTorrent. The first one to emerge, Napster, created in 1999, revolutionized the music industry by enabling people to share and swap files (Lamont, 2013).

2.2.1 The birth of peer-to-peer finance

The story of peer-to-peer finance began with the launching of two companies, a UK-based company named Zopa in 2005 and Prosper in 2006, a US-based company. Zopa was the first P2P lender and the story began in 2004, when the three founders of Zopa – Richard Duvall, David Nicholson and James Alexander - who used to work for Egg, the first internet bank founded by Prudential in 1998, decided to create a marketplace for lending and borrowing, called Zopa (Atz & Bholat, 2016). Egg was the first company to launch credit cards and the first online funds supermarket. The first Internet bank achieved commercial success while it was acting purely as an online intermediary by interacting with the customers exclusively online. This model gave Zopa's creators confidence in the concept of online intermediaries and they finally came to the P2P concept for unsecured personal loans, as they were all three working in the same assets sector at Egg. According to an interview of the founders with the Bank of England, they spotted opportunities in both borrowers and lenders markets while they were working at Egg (Evans, 2015). On the borrower's' market side, they projected that over time, less and less people would have a full-time job and therefore would have more trouble accessing credit from banks. Regarding the lenders' market, two groups would be interested, those who would see a "social angle" because they will know who will end up with their money, and those who would see peer-to-peer loans as a way to reduce risk by adding this asset class in their portfolios[5]. Finally, in 2005, Zopa went public and issued its first loan. After that, many competitors decided to enter the market because of Zopa's success, especially after the

[5]The motivations of both lenders and borrowers are further detailed in Chapter 5.

financial crisis of 2008 that altered the credit market. Indeed, in the wake of the global crisis, where liquidity was compromised and credit was difficult to access, online social lending naturally developed and expanded (Atz & Bholat, 2016).

2.2.2 The basic peer-to-peer lending model

To provide a good understanding of the business model, we describe the simplest peer-to-peer lending model, in which the investor decides to lend money to an individual borrower or to a company (depending on the form of the alternative financing activity). In return, the borrower will reimburse the principal with interest. Borrowers and investors are both facing risks that will be more detailed in the following section.

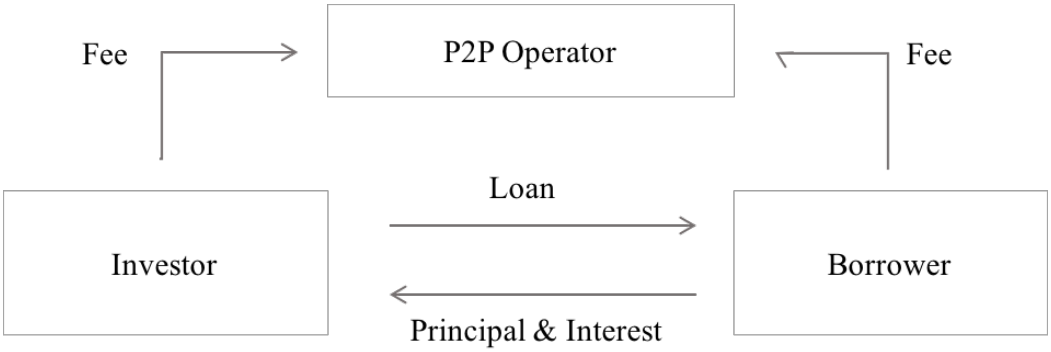


Fig. 2.2 Basic peer-to-peer lending model[6]

As can be seen in figure 2.2, the business model is completely different from the one that traditional financial intermediaries may propose. Indeed, peer-to-peer lending operators are only responsible for matching borrowers and investors through an online platform[7]. The main source of revenue comes from the transaction fees. On the borrower's side, platforms usually charge a transaction fee, called closing fee, which is deducted directly from the total amount of the loan before it is transferred to the borrower's account. Moreover, it is not unusual that platforms require additional fees in case of payment delay on the borrower's side. On the investor's side, platforms also charge fees for matching them with borrowers (David & Murphy, 2016).

[6]Figure 2.2 comes from the essay of David & Murphy (2016).

[7]As we have mentioned, platforms are offering services that are increasingly complex.

2.2.3 Platform market mechanisms

Platform markets had to overcome the critical problem of efficiently allocating several resources among a set of self-interested agents (Feldman, Gravin, and Lucier, 2013). Indeed, the choice of market mechanism is a fundamental question for platforms. The two best-known market mechanisms are detailed below.

2.2.3.1 The auction mechanism

In the early years, Zopa and Prosper used to apply the auction mechanism to set the interest rate of the loan. On the one hand, borrowers had to create their loan listing with a specified expiration date, by indicating the amount of money with a reserve interest rate, representing the maximum rate they were prepared to pay. On the other hand, lenders had the opportunity to bid on individual listings, by stating the amount they were willing to lend and at which minimum interest rate or even by choosing the borrower based on his personal story, friends, etc. Then the bidding started. It started at the reserve price chosen by the borrower and lenders could bid down the interest rate in an auction. The principle is simple, many lenders fund a loan and they will be selected based on the amount they are willing to lend and at which interest rate (Lin & Wei, 2013).

The auctions are semi-open because the platform releases information relating to the bid during the auction. Indeed, the platform allocates the loans to the lenders who specified the first-lowest interest rates among all those who bid. If the amount bid does not entirely fund the loan, the platform will allocate the loan to the lenders with the second-lowest interest rate and will repeat this operation until the loan is fully funded. At the end, if the loan is fully funded, the final interest rate, called the contract interest rate, will be the same for every lender. The amount bid and every lender's identity will be revealed while the interest rate specified remains undisclosed. It is still possible for the outbid lenders to place a new bid if their bid is at least 5 basis points (0.05%) below the current loan rate (Andrews, Dholakia and Herzenstein, 2010). It is of paramount importance to highlight the fact that every bid is irrevocable and cannot be withdrawn. Therefore, it is the auction mechanism itself that sets the contract interest rate instead of letting the borrower know immediately what the rate will be.

2.2.3.2 The posted price mechanism

On December 20, 2010, Prosper puts in place a new market mechanism, known as posted price. The interest rate will no longer be chosen by an auction but pre-set by the platform based on the evaluation of the borrower's creditworthiness. Contrary to the auction, the contract interest rate in this mechanism is the rate pre-set at the beginning (Lin & Wei, 2013). Ever since Prosper replaced its auction mechanism, other platforms have decided to give up their previous model and adopt the posted price mechanism.

According to a study carried out by Lin & Wei in 2013, the change of regime seemed to improve the conditions of borrowers and lenders, especially in the short term. Indeed, loans are funded more rapidly under posted price, allowing borrowers to access funds faster. However, as a rule of thumb, we observe that interest rates seem to be higher with the posted price mechanism. Lenders benefit from a higher return and this will thus generate a higher cost for the borrowers. As the interest rate is the factor the most correlated with loan default, Lin & Wei (2013) suggest that this new regime ultimately creates a net loss in total social welfare.

From then onwards, online platforms worked hard to make the credit assessment model as efficient as possible in order to propose competitive interest rates for both borrowers and lenders.

2.3 Risks related to the peer-to-peer lending model

Investing on a peer-to-peer lending platform is risky. Regulators are more and more concerned about these risks, especially for poorly informed participants. The literature highlights four main types of risks related to the peer-to-peer lending model.

2.3.1 Default risk and poorly informed investors

As peer-to-peer platforms have created a new asset class, investors may not understand their true nature and therefore the risk of making wrong lending decisions increases. As it is a loan, the main risk for lenders is that the borrower may not be able to repay his loan. To make investors aware of the risks, peer-to-peer platforms release many details and the

risks characteristics for all of theirs loans. Releasing details will increase the transparency, and the level of informational asymmetry between investors and the peer-to-peer operators will consequently decrease (Emekter, Tu, Jirasakuldech, and Lu, 2015).

Furthermore, investors should also consider the credit spreads of the loan. The credit spread is the difference in interest rates between a ten-years government bond, considered as almost no risk, and the loan itself. Thanks to information made public by platforms, investors have an opportunity to assess the relation between the spread and the risk (Rainer, 2016). The return of the loan should correctly reflect the risk attached to it. Finally, every investor should be aware that his capital is at risk. Indeed, the borrower's payment is not guaranteed if he goes into default.

2.3.2 Financial advice

Most platforms use a mechanism based on the posted price, and therefore, post the interest rate for a loan according to an evaluation of the borrower's creditworthiness. Platforms act as credit rating agencies by providing borrowers' risk grades. Some platforms perform the credit rating themselves while others receive it from external credit rating agencies. Many questions related to the risk can be raised. On the one hand, the mechanism used by platforms to determine the borrower's creditworthiness may not be effective, which will lead to incorrect risk-reflective interest rates. On the other hand, advice-related risk can occur if the marketing of investments proposed by the platforms involves some kind of relationships with the financial advisers (David & Murphy, 2016).

2.3.3 Investment illiquidity

In a lending contract, the lender holds the loan until its maturity. Due to this maturity matching between the two parties, peer-to-peer investments are largely illiquid (Kirby & Worner, 2014). Nevertheless, there is a possibility that a secondary market is established. As we mentioned in the previous sub-point, platforms generally release all the information available about the borrower. As a result, the seller of the loan does not have more information than the potential purchasers of this same loan. All in all, it could avoid the

issue of adverse selection[8], and therefore support the effective functioning of this secondary market. (Emekter & al., 2016).

2.3.4 Agency risk

Platform insolvency is a major risk for the investors. Indeed, according to a survey conducted by Oxera (2016, p. 35), 59% of potential investors consider bankruptcy as the main risk of investing in a peer-to-peer lending account. A platform may close down due to several factors, such as unprofitability of business model or operational events while the borrowers did not default. Investors could lose their investments without borrowers going into default (Rainer, 2016).

To summarize, investors face different risks when they choose to lend their money through peer-to-peer lending. Even if we outline the main risks, there are plenty of others that can arise. For instance, as the services are provided by an online platform, there could be a risk of cyber-attack on the information. Therefore, investors should have a good level of technical expertise to prevent such issues (Kirby & Worner, 2014). Furthermore, some risks are more general, such as the adverse selection problem or moral hazard, while others may depend on a specific situation. Another important risk that investors can face is the concentration risk, which is the probability of loss when a significant proportion of the portfolio is exposed to a particular risk, for instance an individual loan. As a matter of fact, this risk can easily be mitigated by diversification (cfr infra p.58).

We mentioned the risks investors faced because, by nature, borrowers are exposed to less risk than investors. However, borrowers can be exposed to certain risks too, such as default management policies (Rainer, 2016).

[8]The Economic Times (n.d.) defines adverse selection as “a situation where sellers have information that buyers do not, or vice versa, about some aspect of product quality”.

Chapter 3

The size, growth and geographic distribution of online alternative finance

This chapter provides a detailed review of the European alternative finance market and some comparisons with the Americas and Asia Pacific regions. We also highlight the somewhat limited share of total lending that the markets have attained to date, as well as the wide range of business models and the significant differences in economic and regulatory institutions that have emerged along different development paths in different jurisdictions[9].

3.1 The European market

The study carried out by Zhang & al (2016)[10] supports us in showing the growth and development of the European online alternative market. By 2015, Europe reached €5,531 million in terms of market volume for the online alternative finance market, representing an annual growth of 92% when compared to €2,833 million in 2014 (cfr. figure 3.1).

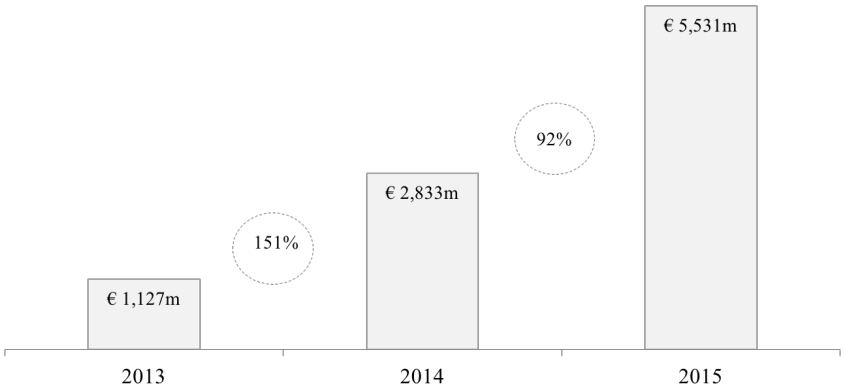


Fig. 3.1 European online alternative finance market volume in € EUR[11]

[9] A description of the alternative finance models is provided in Appendix 2.
[10] At the time of drafting this thesis it has not yet been possible to evaluate the vol. for the year 2016.
[11] Figure 3.1 comes from the research conducted by Zhang & al. (2016, p. 24).

Although the alternative finance market has grown in terms of volume, the actual rate of increase has diminished during the period 2014-2015 (92%) compared to the period 2013-2014 (151%). This decline in the rate of increase is mainly due to the fact that the UK has experienced a slowdown in its annual growth, from 161% in 2014 to 84% in 2015.

Indeed, the UK is clearly the largest market for alternative finance in Europe with €4,412 million for 2015 and therefore only €1,019 million was generated outside the UK[12]. Apart from the UK, France, Germany and the Netherlands have a well-established and rapidly growing online alternative finance market, ranking them respectively as Europe's top three contributors in terms of volume on the alternative finance market. Belgium ranks 7th with a market volume of €37 million (cfr. figure 3.2).

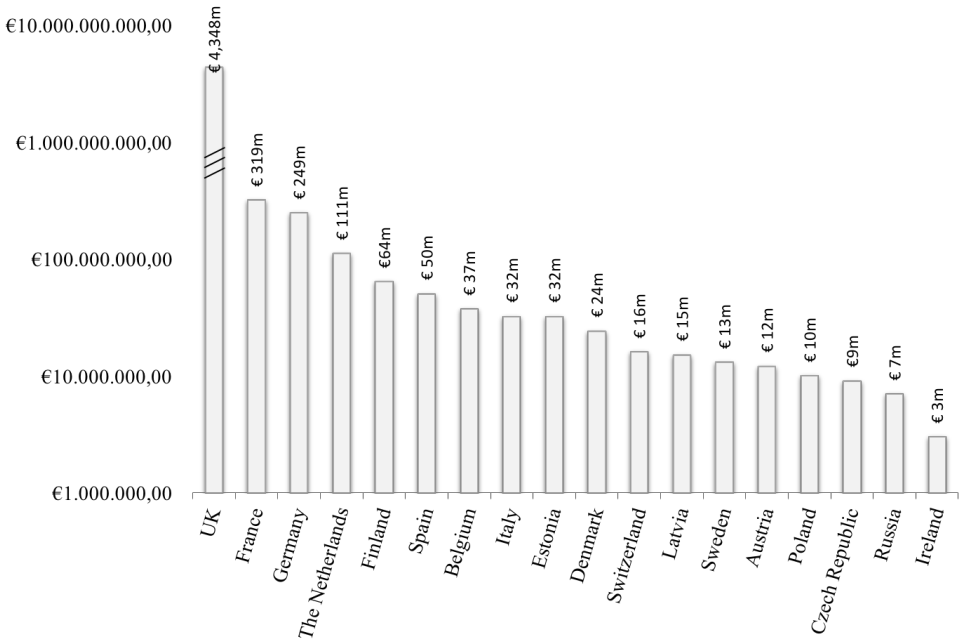


Fig. 3.2 Online alternative finance volume by country 2015 (€ EUR)[13]

[12]The European Online Alternative Market Volume 2013-2015 (excl. the UK) is provided in appendix 3.
[13]Figure 3.2 comes from the research conducted by Zhang & al. (2016, p. 28).

3.2 Online Alternative Finance by global region

In their, survey conducted by Zhang & al. (2016) put into perspective the size and growth of the alternative finance market in Europe compared with the global areas of the Americas and the Asia-Pacific regions. We see in figure 3.3 that in 2015, in terms of market volume the Asia-Pacific region is 17 times larger than that of Europe with €94.61billion and that the Americas are about 6 times larger than Europe with a volume of €33.58 billion (cfr. figure 3.3).

However, one should keep in mind that, when looking at the alternative finance market landscape, each of the three regions has a market leader that distorts the results somewhat as this leader contributes significantly to the total volume and the activity in its region. In Europe there is the UK, in the Americas it is the US and for the Asia-Pacific region, China is the world's largest market for online alternative finance. Furthermore, despite the UK's strong contribution, the European market remains relatively small compared to the other two regions[14]

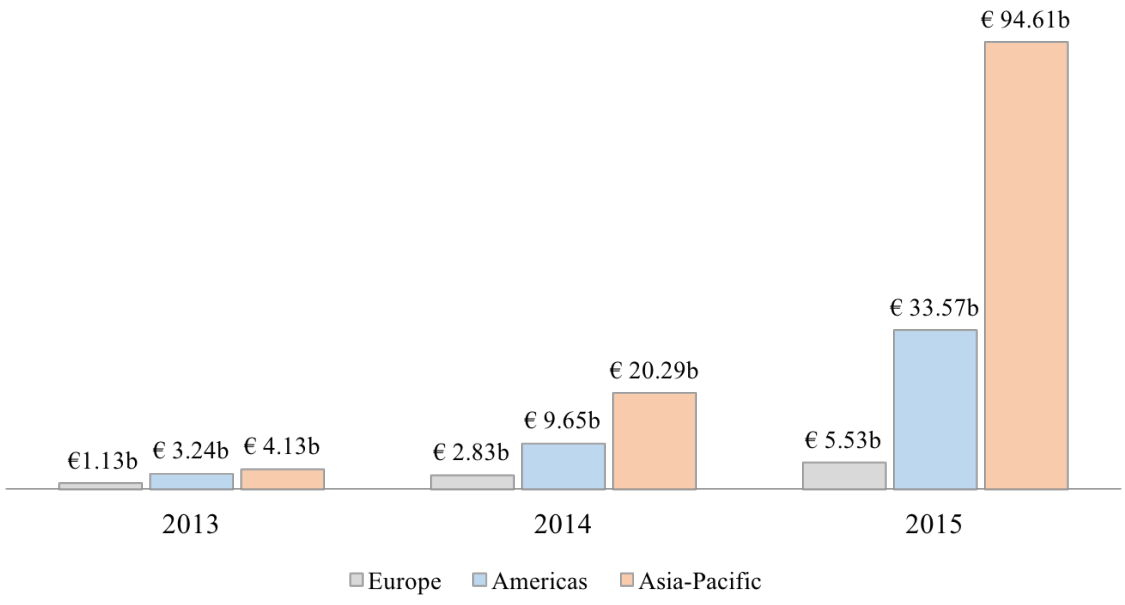


Fig. 3.3 Regional Online Alternative Finance volumes (€ EUR)[15]

[14]The regional Online Alternative Finance Volumes (excl. UK, US and China) is provided in app. 4.
[15]Figure 3.3 comes from the research conducted by Zhang & al. (2016,p.26)

Not all consulting firms agree on the exact number of alternative finance platforms in the world. According to Crowdsurfer (2015), there were more than 1,700 platforms at the end of 2015, distributed across 80 countries (excluding China). In their 2014 annual report on crowdfunding, Massolution (2015, p. 24) counts 1,250, against 813 in 2012. Not surprisingly, the United States has the majority (36%), followed by the United Kingdom (11%), France (6%), Germany (5%) and the Netherlands (5%)[16]. Given the significant increase in the number of platforms, the five largest players in Europe share 64% of the market, compared to 95
% in 2011. In this respect, we can certainly expect a wave of consolidations by 2020 (Bouyala, 2016).

3.3 Market share by Alternative Finance model

We decided to extend our analysis to all the business models of online alternative finance in order to perform some comparisons and establish a ranking according to their size and growth. Our first observation was that the peer-to-peer lending model in its entirety is by far the most developed compared to the other business models.

According to the survey (cfr. Figure 3.4), peer-to-peer consumer lending is by far the model with the largest market share in terms of volume for alternative finance with €366 million recorded for the year 2015 (cfr. Figure 3.5). The model coming in second position is peer-to-peer business lending with €212 million, followed by equity-based crowdfunding in third position with €159 million.

With regards to growth by alternative finance model, we must underline the enormous increase in invoice trading, which only had a volume of €7 million in 2014 and reached €81 million in 2015, which obviously represented the largest growth of all models (cfr. figure 3.5).

[16] A map of the Belgian alternative finance market is provided in appendix 5.

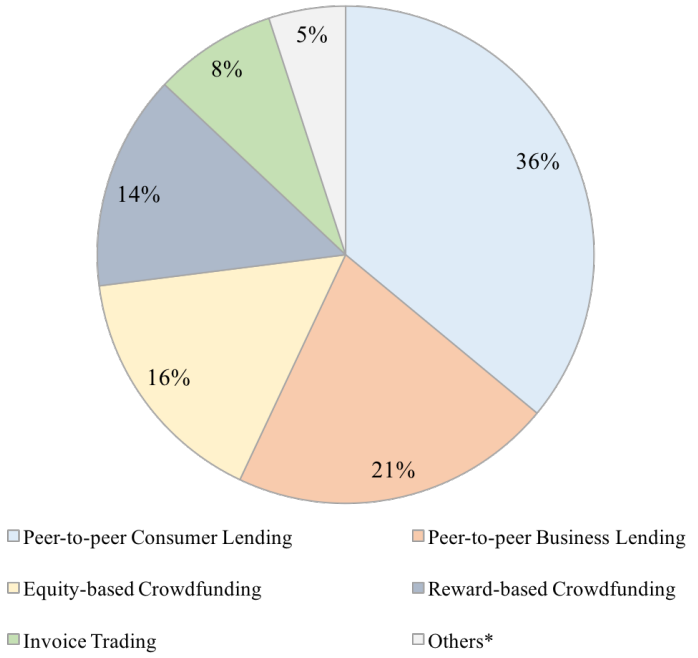


Fig. 3.4 Market share (%) by model (excl. UK) in 2015[17]

Finally, peer-to-peer lending business models and practices have expanded over time as platforms have matured innovative approaches (see section on risk management) and sought market opportunities, still building upon the core function of P2P platforms in providing digital lending marketplaces. In recent years, we have seen an increasing diversity of business models emerge, as different platforms pursue different types of loans (business, consumer, invoice financing, property...) and different types of investors (in terms of their preferences and the size of their investment).

The type of borrower is also a key distinguishing feature of the different business models, as business lending carries different risk characteristics, and is subject to different regulations compared with consumer lending or property-related lending. That is why the share of European P2P lending in smaller businesses is more difficult to pin down than that of unsecured consumer loans. Undeniably, P2P business lending is a mix of a wide variety of different business borrowers, making an accurate census more difficult to achieve (Milne & Parboteeah, 2016).

[17]Figure 3.4 comes from the research conducted by Zhang & al. (2016, pp. 31-32).

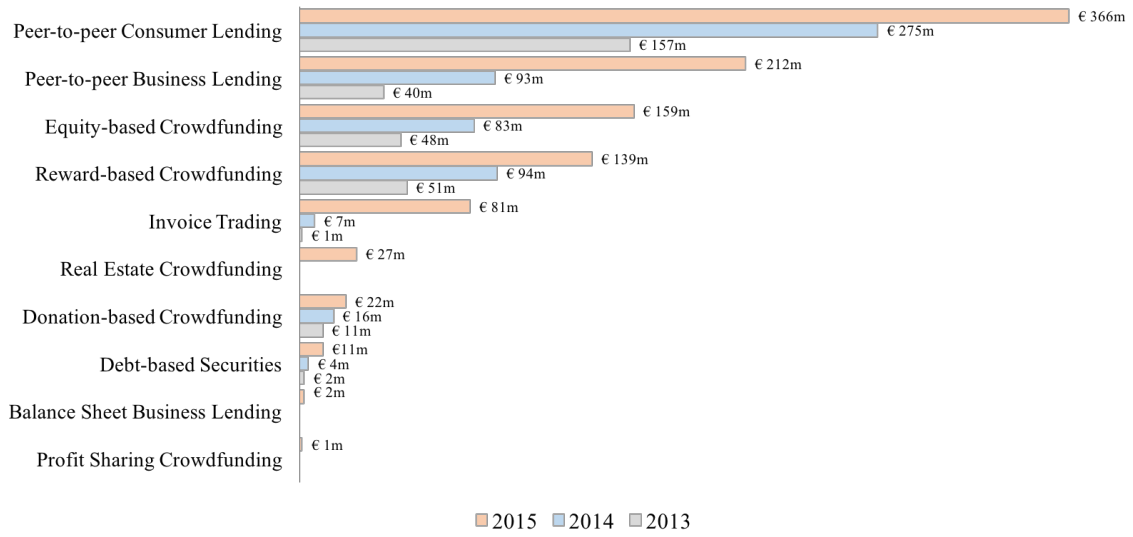


Fig. 3.5 Alternative finance volume by model in Europe (excl. UK) 2013-2015 (€ EUR)[18]

3.3.1 Peer-to-peer lending in global regions

The UK and the United States have been pioneers in the development of P2P lending (in the US it is described as 'marketplace lending'). There are several regulatory and institutional differences between P2P lending in the UK and in the US. The biggest difference between the two is the fact that the US is much more focused on consumer credit compared to the UK (U.S. Treasury, 2016). In addition, the US P2P lending model has developed further away from the initial concept of directly linking individual lenders and borrowers, converting largely into a mechanism for the sales of loans to institutional investors. Regardless of this rather different orientation and approach, US P2P still represents, as is the case in the UK, a somewhat limited share of total unsecured consumer lending (Milne & Parboteteeah, 2016).

We mention the status of P2P lending in China for information only. P2P lending in this country is stated to have almost quadrupled to a staggering $93 billion in 2015. Moreover, there are supposedly more than 2000 online P2P platforms in China. At the same time, however, there is ample concern about possible fraud, in particular since the failure of platform Ezubo in 2016, which resulted in the loss of approximately $11 billion of investors' money (Wu, 2016).

[18]Figure 3.5 comes from the research conducted by the Univ. of Cambridge and KPMG (2016, p. 33).

3.3.2 Debt vs. Equity Online Alternative Business finance

From the point of view of online alternative business funding, the number of SMEs across Europe funded through a platform increased to over 9,400 in 2015, with a corresponding €536 million raised. Secondly, of the amount raised for SMEs, a large part was made by debt-based funding with €349 million in 2015 (cfr. figure 3.6), representing 69% of the total online alternative SMEs funding (unsurprisingly, P2P business lending generated the most significant portion). Moreover, lending models (which encompass peer-to-peer business lending, balance sheet business lending, invoice trading and debt-based securities) recorded the highest growth of 156% year-on-year compared to the equity-based crowdfunding which for its part increased by 93% year-on-year to reach €159m, still in 2015.

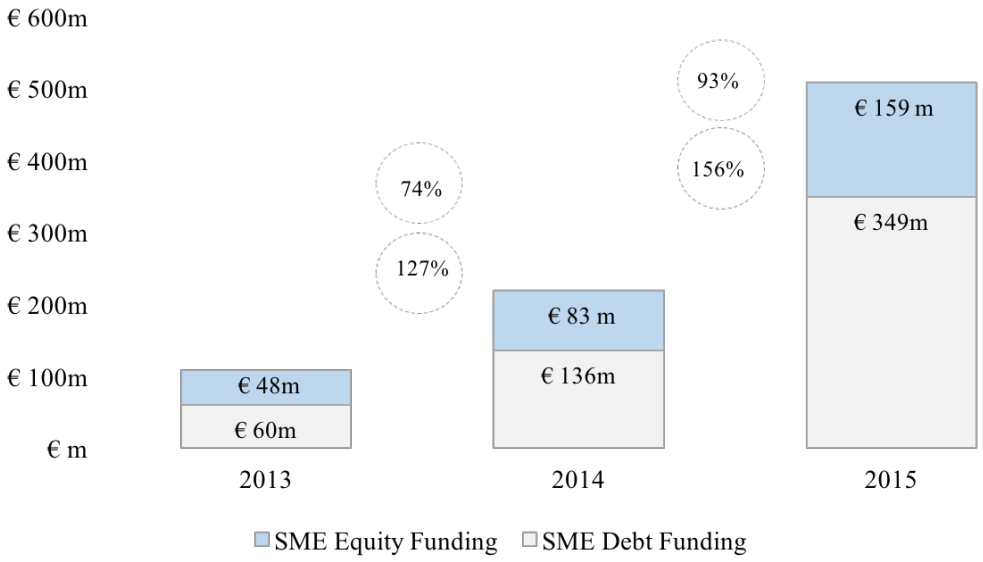


Fig. 3.6 Debt vs. equity online alternative business finance 2013-2015 € EUR)[19]

3.3.2.1 Broader SME finance context in Europe

It is interesting to look at the broader SME financial context as online alternative business funding continues to grow. In today's environment, the external funding options the most sought-after by European businesses are undoubtedly bank-based products such as bank

[19]Figure 3.6 comes from the research conducted by Zhang & al. (2016, p. 36).

loans and overdrafts. This is even more pertinent for SMEs as "SMEs have few (debt based) alternatives to bank loans, since they cannot easily access capital markets directly" (European Commission, 2016a).

Based on the report of the European Commission (2016a), enterprises across Europe have seen their access to financing made moderately easier in 2016. In addition, according to the quarterly bank lending survey of the European Central Bank (2017), bank financing improved in 2016, driven by net easing of credit standards.

However, despite a commitment to fund more SMEs, "increasing non-interest rate costs of financing and collateral requirements" (ECB, 2017) have deterred SMEs, by making it more difficult for them to access traditional debt-financing such as bank loans. Among these non-interest rate costs are an increased reliance on personal guarantees or assets by a bank, as well as onerous obligations and terms, which result in the business receiving less funding than required. Therefore, although credit conditions for enterprises have somewhat improved in Europe, online business funding alternatives such as P2P business lending and invoice trading will still continue to play a meaningful role in providing a viable substitute to traditional sources of finance.

3.4 An overview of the Belgian market

CrowdfundingHub, the European expertise centre for Alternative and Community Finance released a report in 2016 that highlights the state of the various alternative financing activities across Europe.

The survey has analysed more than 25 countries and has created a list split in 15 research areas[20] in order to represent the situation of the online alternative finance industry. As we can see (cfr. figure 3.7), 8 of them are related to regulation issues and the others are more general. The colour indicates the differences (positive or negative) in each area. If a country differentiates itself in a positive manner, the area is highlighted in dark blue. For instance, the area "tax reliefs" is in dark blue for the UK because of its very progressive

[20]The research areas are represented by columns in the table.

position compared to the other European countries. The opposite applies, when the area is highlighted in a lighter blue, it means that the regulation has a negative impact, because of some additional conditions that have to be fulfilled or because of the prohibition of certain online alternative finance instruments.

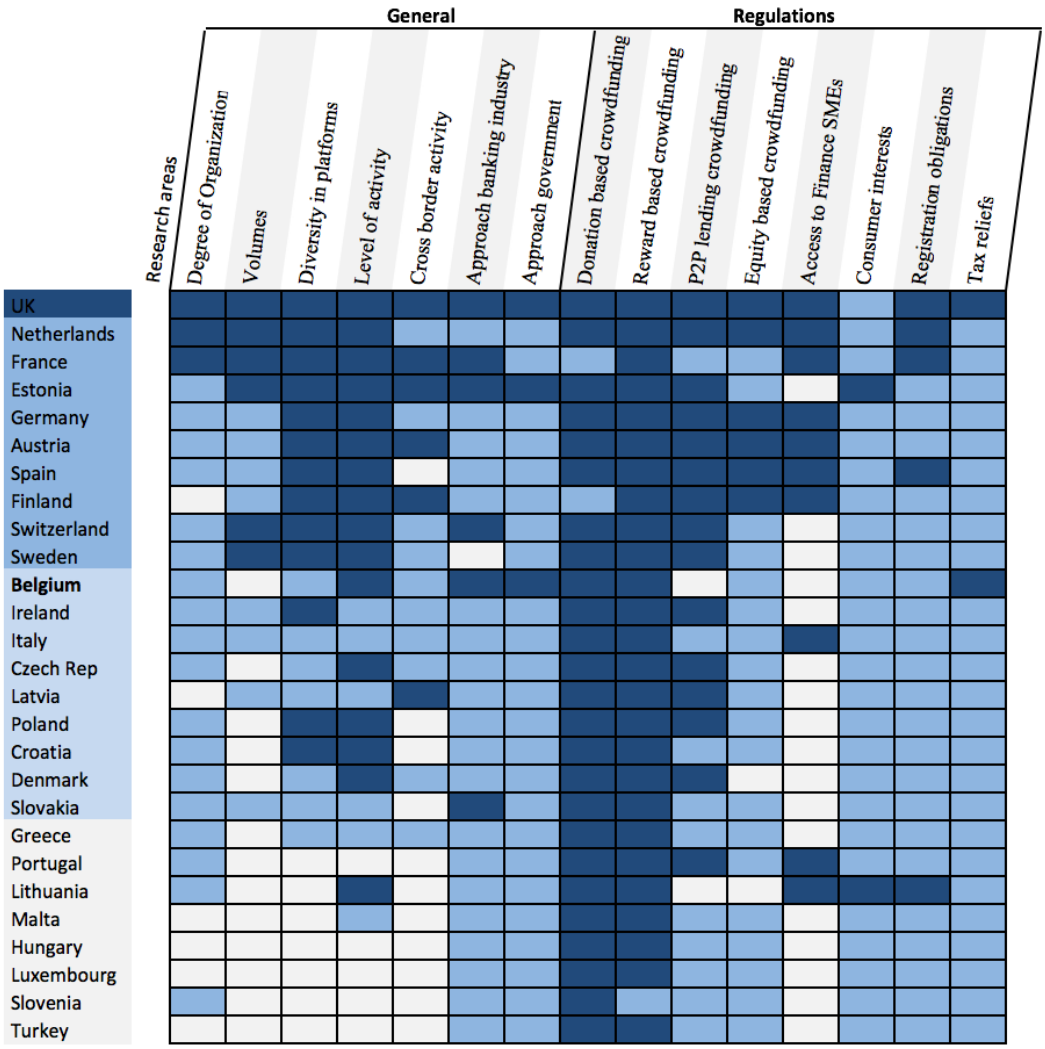


Fig. 3.7 The alternative finance maturity index[21]

As to the Belgian situation, several areas draw our attention. We observe dark blue in the areas of the approach of the banking industry and the approach of the government. Indeed, the banking industry seems to slowly enter the industry through platforms created by themselves or through partnerships. Indeed, several partnerships between platforms

[21]Figure 3.7 comes from a report of the European expertise centre for Alternative and Community Finance (2016).

and banks have developed in Belgium, such as BNP Paribas Fortis with MyMicroInvest in 2015 in the field of equity-based crowdfunding[22].

Furthermore, some regulations promote the development of the alternative finance industry, such as the UK government that requires banks to offer alternative finance options when the client is rejected. In Belgium, the government has played a very active role in launching, operating and financing crowdfunding for start-ups by means of the introduction of some specific fiscal incentives and other supporting rules. Nevertheless, in the area of the access to finance for SME's the survey highlights that Belgium seems to be lagging behind. Indeed, the authorised amount for debt and equity crowdfunding remains rather low[23]. Furthermore, the dark blue in the area related to tax reliefs brings to light the Tax Shelter[24], voted in 2015 but that only came into effect in February 2017.

Regarding the P2P lending sector, we notice a great variance between Belgium and the other countries. Indeed, we even observe no blue of any kind in this sector. Only Lithuania is noted at the same level as Belgium in the P2P lending crowdfunding category. Due to an unfavourable regulatory regime, P2P lending does not develop in Lithuania, with the exception of a few consumer lending platforms launched in 2015. In this respect, the regulation in place in Belgium seems to have a negative impact on the development of peer-to-peer lending as will be explained in the chapter related to the regulatory regime.

[22]BNP Paribas Fortis, a Belgian bank and MyMicroInvest, an investment platform very active since its foundation in 2011 launched a partnership in the field of crowdfunding in 2015. Thanks to this, BNP Paribas Fortis allow entrepreneurs to have access to more diverse sources of funding. (BNP Paribas Fortis, 2014)

[23]The investor can invest for an amount of maximum 5.000€ and the total amount of the offer has to be below 300.000€ (Law of 18 December 2016, Moniteur belge, p. 87668). When those limits are exceeded, the Prospectus Act applies that requires companies to publish a prospectus with all the necessary information to allow investors to understand clearly the nature of the investment. All the conditions and details of this Prospectus Act can be found on the Belgian's monitor website (Law of 16 June 2006, Moniteur belge, p. 31352).

[24]In place since the 1th February 2017, this regulation offers a fiscal advantage to those who lend to start-ups through crowdfunding platforms in order to promote investments in those fresh companies. Therefore, an individual who decides to invest can fiscally deduct until 45% (depending of the size of the companies) of its investment from the income tax. You will find all the details of this regulation on the Belgian's monitor website (Law of 10 August 2015, Moniteur belge, Art. 48-57)

Chapter 4

The reasons behind the development of peer-to-peer lending

Given the substantial growth observed in the recent years, it seems most relevant to examine the reasons that led to the development of peer-to-peer lending. The peer-to-peer lending sector effectively came into the spotlight after the 2008 crisis. After this unprecedented disaster, financial authorities required that institutions such as banks be more cautious than ever with credit. As a result, the access to funding by consumers and businesses was somewhat frozen, to avoid repeating the horrors of this crisis.

Individuals and small businesses who were having difficulties satisfying the stringent criteria established by the financial institutions started looking for alternative sources of funding. From that point onward, P2P lending started to emerge thanks to lenders who were willing to accept the risk of providing such loans or to submit them at lower rates of interest (Milne & Parboteteeah, 2016).

Indeed, as the interest rates began to fall, investors might as well put their savings under their mattresses, the little difference it would make. As for the stock market, it was in a downward trend in 2008. Not to mention its high volatility and the associated risk and uncertainty which did not encourage the confidence of investors (Kirby & Worner, 2014).

At first glance, one could easily think that it was the financial crisis of 2008 that led to the huge growth of P2P lending, with the increasing requirements to provide access to credit, as well as the fall in interest rates. In a nutshell, all the necessary conditions seemed to be gathered for this model to emerge, not only from the borrower's perspective but also from the investor's point of view. Nevertheless, we will see throughout this chapter that the reasons for this growth are much more complex than that.

4.1 Motivations of the players

From 2008 on, the meteoric growth of peer-to-peer lending was only made possible by supply and demand factors. On the supply side, when it comes to lending, some sector enthusiasts claim that the main drivers were based on ideological ideas (Aldohni, 2017). "Who gets funded? You decide"[25]. No doubt that in some post-financial crisis circles, the promise to give individuals control over how their monies are invested has some resonance.

Furthermore, it is perceived that P2P lending offers a more socially favourable form of finance by directly linking individual/business borrowers and lenders, without the concern of banks and other conventional financial intermediates abusing their market position and pursuing profit without adequate consideration of the interests of their own customers. (Amara, Ben Cheikh, and Abdellatif, 2017)

In order to highlight the motivations of both players, lenders and borrowers, we deliberately restrict our analysis to P2P business and consumer lending for two main reasons. On the one hand because those alternative finance models are the most widespread worldwide. On the other hand, for the sake of clarity and consistency, as only these two models are discussed in our qualitative analysis.

4.1.1 Motivations of lenders

Contrary to expectations, a study conducted by Nesta (Baeck, Collins, and Zhang, 2014) in the UK shows that the main motivation of lenders seems to be pecuniary. Indeed, when respondents were asked about their motivations to participate in the peer-to-peer market, 82% of the lenders surveyed on peer-to-peer business lending platforms checked 'To make a financial return" as very important, while only 35% checked 'To have control over where my money goes" of similar significance[26] (Baeck & al., 2014, p. 34). The fact that P2P lending is no longer considered a more socially beneficial form of finance could be explained by the increasing presence of institutional investors as lenders on P2P platforms(Milne & Parboteeah, 2016).

[25]The title comes from the website "BankToTheFuture.com".
[26]The detailed figure is provided in appendix 6.

The motivations behind the various forms of online alternative finance are different each time. Unlike the reward-based or donation-based crowdfunding, the opportunity to support a specific industry or sector, supporting family or friends or a social cause through the P2P business lending model was of moderate importance for most of the lenders. It is also interesting to note that almost none of the lenders on the P2P platforms had personal connections to the enterprise or individual they lent to (Amara & al., 2014).

Furthermore, while 78% of lenders supplying funds through peer-to-peer consumer lending platforms indicated the interest rate available as very important, only 35% of those surveyed mentioned “Supporting an alternative to a big bank” as very important too (Baeck & al., 2014, p. 44).

As far as Belgium’s motivations are concerned, no study so far has focused on analysing its P2P business[27] lending market. However, a survey carried out in Belgium in 2015 by Ivox, on behalf of KBC BoleroCrowdfunding, reveals similar results when considering both lending and equity as a whole. Indeed, the financial aspect is decisive in the choice of the project. If the Belgian is asked to classify five reasons in order of importance, surprising results emerge: the financial aspect prevails with 38%, followed by the functional (22%), emotional (14%), social (13%) and innovative (12%). Ivox concludes that the functional aspect should be seen as a basic condition for entering or not into a project while the financial aspect weighs more on the choice of the "best" opportunity (BoleroCrowdfunding, 2015, p. 32).

4.1.2 Motivations of borrowers

On the individual borrower’s side, Amara & al. (2014) found that main motivations were very similar to lenders’ in that they were more concerned about the bottom-line than by the pursuit of lofty ideals. Indeed, surveyed borrowers using peer-to-peer consumer lending platforms rated the interest rate available as their dominant motivation for participating in the market[28] (Baeck & al., 2014, p. 45).

[27] As detailed in Chapter 4, consumer lending is still prohibited in Belgium.
[28] The detailed figure is provided in appendix 7.

n terms of the service offering, P2P business borrowers have been found to emphasise supplementary choices with regards to speed, simplicity and product features. Still based on the survey conducted by Baeck & al (2014, p. 38), business borrowers marked the combination of ease and the speed of the lending process as important or very important with results of 93% and 90% respectively.

All in all, if the individual borrowers are very cautious about the rates as a reflection of their primary concern, it seems to be different for SME's. They are more seduced by innovative approaches offered by platforms as well as the rapid and flexible access to the loan market.

4.2 Institutionalisation

Besides the individual investors, another actor seems to appreciate the investment vehicle proposed by the peer-to-peer lending model. Indeed, according to the study conducted by Zhang & al, (2016), institutionalisation took off in mainland Europe with 24% of peer-to-peer business lending and 26% of peer-to-peer consumer lending funded in 2015 by institutions such as banks, pension funds, asset management firms and mutual funds (cfr. figure 4.1). Regarding the investment in equity-based crowdfunding, 8% is funded by institutional investors such as business angels, venture capital firms, family offices or funds. We cannot ignore either the impressive amount of institutional investment across invoice trading platforms which accounted for 37% of the model's total volume for 2015.

What is even more surprising is the fact that 44% of the European platforms surveyed (excluding the UK) reported some level of institutional funding in 2015 and just under 30% of P2P consumer lending platforms announced having a majority of institutional shareholders (e.g. a bank, a VC, corporate) (Zhang & al, 2016, p. 42). Consequently, institutional investors began to play an increasingly significant role not only in funding provision, but also by investing directly in alternative finance platforms themselves[29].

[29] As institutions began investing in bundles of loans, leading the P2P lending sector to be named more accurately as 'marketplace lending'.

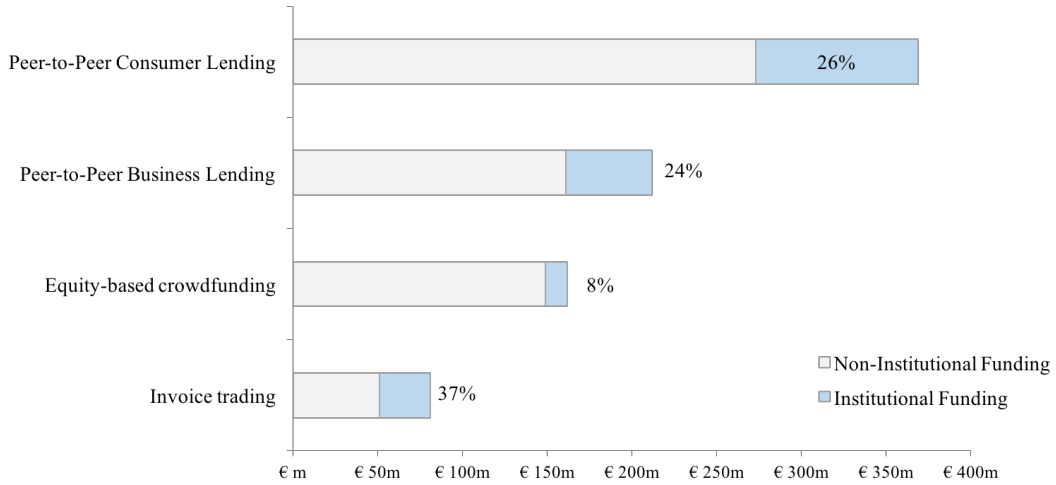


Fig. 4.1 Percentage of institutional funding across models in 2015[30]

4.2.1 Consequences of institutionalisation

As mentioned in our description of the market mechanisms operated by platforms (cfr supra p.20), in the beginning, borrowers had to justify their funding request by indicating the amount they wanted to borrow and their personal stories. However, in a world where online alternative finance models are continually evolving, we found that the peer-to-peer lending market is slowly evolving into a model very different from the simple one originally provided by Zopa. Indeed, the fact that mainly this new class of institutional lenders now invests in this sector could completely eradicate the very essence of peer-to-peer lending. On the one hand, the P2P platforms that were supposed to destabilize these institutions now seem to slowly become dominating figures among them in their own right. This could become a real worry, as the competition that P2P was expected to bring could be drastically reduced (Dellot, 2016). On the other hand, supporters of this evolution argue that this will be beneficial to the industry, as more capital will be available to borrowers as a consequence (Athwal, 2014).

As a result, P2P could progressively evolve into I2P as banks, pension funds or hedge funds increase the role they play on those platforms. This could turn into an issue, as institutions could end up receiving preferential treatment and consequently be able to choose the best borrowers to invest in, leaving the other individual borrowers with the

[30]Figure 4.1 comes from the research conducted by Zhang & al. (2016, p. 42).

plans with the lowest return[31] (Dellot, 2016). This explains the worry of the financial conduct authority in the UK, as we will explain in the chapter related to the regulatory regime.

Furthermore, a striking fact has been observed with the emergence of peer-to-peer lending derivatives. Platforms are increasingly gathering loans together and selling them off to institutional investors. They have thus transformed their activities into merely playing the role of intermediary for the use of their own balance sheet, their own managed investment, and their own securitization funds. This concept of "asset-backed securities" reminds us of what happened in 2008 as this practice was at the centre of the financial crisis (Cox, 2017). In a nutshell, institutional investors buy the loans and slice them into different pieces ("tranches") to attract a wider range of investors (Alloway, 2013).

However, we need to state that this last point was mentioned only for information purposes. To consider this in more detail, more information should be available in the relevant literature than we have today. Moreover, we assume that this mechanism is currently confined to the Anglo-Saxon countries, since a country like Belgium is light years away from this kind of drift: peer-to-peer business lending is in its start-up and structuring phase, while peer-to-peer consumer lending is still prohibited, as we will discuss in the next chapter.

[31] Called institutional "cherry-picking".

Chapter 5

The regulatory regime

In this section, we propose an overview of the regulatory regime of both Belgium and the UK on peer-to-peer lending. As the UK is the European market leader in this innovative sector, it is interesting to present it in more detail. Afterwards, we present the legislation in Belgium and more particularly as it relates to peer-to-peer consumer lending. It is important to note that we address only the relevant rules of each law in the second part of this thesis.

5.1 The case of UK

It was not until the 1st of April 2014 that new rules were passed by the Financial Conduct Authority (FCA)[32] for the regulation of crowdfunding platforms. The investment-based crowdfunding had already been regulated by the FCA before 1 April 2014, contrary to the loan-based crowdfunding, which is a consumer credit activity. Previously, the activity was controlled by the Office of Fair Trading (OFT) and the FCA took over the regulation. The OFT, who was responsible for protecting consumer interests throughout the UK closed in 2014 and its responsibilities were transferred to several different organisations. Firms operating in the peer-to-peer lending sector, who had the authorisation of the Office of Fair Trading to operate loan-based crowdfunding platforms, received an authorisation from the FCA to carry on with their activities until October 2015, deadline for them to apply for full FCA authorisation. However, new firms entering the peer-to-peer lending market after the first of April 2014 had to apply for an FCA authorisation right away.

5.1.1 Article 36H

Article 36H *the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 - "Operating an electronic system in relation to lending"*

[32]Every information related to the UK comes from the Financial Conduct Authority (FCA, 2016).

Article 36H established under an article 36H agreement that "operating an electronic system which enables the operator ("A") to facilitate persons ("B" and "C") becoming the lender and borrower" is a specific kind of activity. The article set the conditions and specified several tasks that the operator had to respect, such as providing relevant information and guaranteeing the quality of this information. The Financial Services and Markets Act 2000 specified that an "article 36H agreement" is *"an agreement between one person ("the borrower") and another person ("the lender") by which the lender provides the borrower with credit."* This agreement applies only if several conditions are met.

This requires the lender and the borrower to be individuals or relevant persons[33]. Moreover, the lender will have to lend an amount lower than or equal to £25,000 failing which the agreement is deemed not to be wholly or predominantly for the purpose of supporting a business. In other words, when the borrower is an individual or relevant person, particularly a consumer or a sole trader, or even a small partnership that decides to borrow less than £25,000 for the purposes of supporting his business, the credit agreement is defined as a "regulated credit agreement" unless a specific exemption of the law applies.

First of all, it is necessary to consider the difference made by the regulation in the UK between a commercial and a non-commercial credit agreement. Where the lender is concerned, the regulation is different depending on the lending purpose. On the one hand, if the lender decides to grant a credit in the course of a business (it is usually the case for institutional investors), the agreement will need to fully respect the requirements of the Consumer Credit Act 1974 (CCA), have the authorisation of the FCA and also to comply with the rules of the FCA Consumer credit sourcebook (CONC). The consumer credit sourcebook contains the detailed obligations that are specific to all credit-related activities. Moreover, the platforms will need to have the authorisation from the FCA to engage into these types of activities. This means, for instance, that the lender has to release an accurate report on the borrower's creditworthiness. This regulation applies in a parallel requirement to peer-to-peer lending platforms. On the other hand, if the credit is not in the course of a business purpose, although it may still be a regulated credit agreement, it will be characterised as a "non-commercial agreement' in regards to the

[33]As is legally described in Article 36h, 9° of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001- "Operating and electronic system in relation to lending".

CCA. For instance, if an agreement is considered "non-commercial", an FCA authorisation for the lender is not mandatory and therefore, the lender does not have to respect some of the requirements regarding the form or the content of the information released, in particular the pre-contract credit information and the execution of the credit agreement. For example, sections 77, 77A and 78 regarding the obligation to give information to the debtor do not apply to non-commercial agreements.

As a result, the FCA decided to establish new rules in CONC in order to protect the borrower engaging in a non-commercial agreement. Henceforth, the platform will have to release appropriate pre-contract information, including key risks to the borrower and give the opportunity to borrowers to withdraw within 14 days, and to apply CONC rules on arrears, recovery and default. Furthermore, the rules were introduced in CONC in order to protect the investor, and to guarantee that an appropriate assessment of the borrower's creditworthiness is presented. If the agreement is not regulated by the CCA and CONC, firms have the opportunity to conduct their own assessment of the borrower's creditworthiness. In this case, the FCA allows a certain flexibility but requires that companies present their assessment approach and key risks to the investor fairly and clearly.

5.1.2 The FCA authorisation

Platforms have to respect several conditions, such as having a regulatory business plan, an operational website and adequate financial resources in order to obtain the FCA authorisations. Indeed, peer-to-peer lending may have benefits to investors as it is considered as a substitute for other business models, such as asset management. The Financial Conduct Authority is aware of the development of maturity mismatch products on several platforms that authorised investors to take out their money after a 30-day notice period while the borrowers borrow for a much longer period of time. If investors have the opportunity to withdraw their monies, these investment products become very similar to a savings account. This means that platforms face similar risks as the banks, more precisely a liquidity risk if all savers decide to withdraw at the same time. Contrary to banks, platforms have less possibilities to repay investors, depending on the money they have available or the willingness of other investors to buy the loan on the secondary

market. Because of this significant risk, banks are subject to much higher prudential standards than platforms where capital requirements are concerned. For this reason and to ensure the continuity of operations assuming a financial crunch, platforms need to respect a minimum capital requirement of £50,000 or a percentage of loaned funds. Furthermore, as explained in more detail in the section regarding the possibility for platforms to address risks, they need to have resolution plans in place in case of bankruptcy, that will ensure loan repayments are collected and managed until maturity. More precisely, if the platforms fail, the loan will continue to be handled and administered by another firm and investors will not lose their money.

5.1.3 FCA investigations

The Financial Conduct Authority closely tracks new developments in this sector. They publish documents entitled "Call for input to the post-implementation review of the FCA's crowdfunding rules" on an annual basis, where they discuss the existing regulation and request peer-to-peer lending actors to participate in the review of the regulation. The FCA monitors the situation to ensure that the rules are appropriate and sufficient.

Furthermore, the authority requires firms to have systems and controls in place to mitigate the risks. One of the recent offers on peer-to-peer lending platforms consisted of the pooling of credit risk. The platforms create pools of investors in order to fund a single borrower. Platforms provide several services to mitigate risk, that will be further detailed in the subsection "Platform risk management" (cfr infra p.56). Again, the FCA is aware of these new services and makes sure the information is correctly released and that both parties, lenders and borrowers understand clearly the nature of the agreement.

Many new types of platforms have been founded, which offer a wider range of credit agreements, such as hire-purchase (e.g Zopa Car Refinancing) or even guarantor lending (e.g Guarantormyloan) (FCA, 2016). These new developments bring the FCA into question regarding the possible regulatory arbitrage between the banking business and the peer-to-peer lending platforms that are subject to a less restrictive regulation. The FCA also keeps an eye on the emergence of asset-backed securities based on P2P loans.

Another important fact is related to investments made by institutions in the business and consumer loans. As we explain in the subsection related to institutionalisation, we noticed an increase of institutional investment in peer-to-peer lending platforms (cfr supra p.38). This causes the FCA to worry about a potential favourable treatment for institutional investors compared to retail investors.

Finally, where investment-based crowdfunding is concerned, a regulatory framework exists, that requires an assessment of the awareness of potential investors of the credit agreement and the risks involved. The FCA is considering the option of having the same approach in the future for investors who participate in loan-based crowdfunding platforms.

5.1.4 Client money protection and Financial Services Compensation scheme

Investors need to be aware that potential loss is not covered by the Financial Services Compensation Scheme (FSCS). As its name suggests, it is a compensation system that allows investors to be refunded when a firm is unable to fulfil their commitment. For instance, in the UK, investors are protected for deposits in banks up to a maximum of £85,000 per person per firm[34]. At present, lenders are not covered by the FSCS because measures such as minimum capital requirements needed for platforms and the resolution plans in place in case of financial distress are considered as sufficient by the Financial Conduct Authority to protect investors. Therefore, investors are not protected in case of a borrower's failure or even if the platform fails. Nevertheless, customers might already be protected in some specific situations. For example, one specific situation is when a platform fails before the amount is invested, when the money was transferred to the platform, but not yet lent to the borrower. This case falls under the FSCS jurisdiction and investors should be protected.

Besides that, platforms are subject to the client money rules stated in the Client Assets sourcebook. Indeed, the CASS 7[35] includes a specific regulatory framework for loan-based crowdfunding. The FCA has the right to take action against platforms that do not comply with all the rules included in this framework.

[34]Figures come from the website of the Financial Services Compensation Scheme.
[35]CASS 7.13 Segregation of client money (FCA, 2016).

5.2 The case of Belgium

The Financial Services and Markets Authority (FSMA) is the financial regulatory agency in Belgium. There are a number of constraints which prevent peer-to-peer lending to grow as fast as the in other countries. The law of 18 December 2016 organizes the recognition and supervision of crowdfunding in Belgium and provides a legal framework around crowdfunding. As is explained in this section, this law does not apply to peer-to-peer consumer lending. In order to outline the complex regulatory framework in Belgium, we will follow the document written by Houssa in 2016 and published by Simont Braun, a law firm located in Brussels.

5.2.1 The definition of a repayable fund

The term "repayable fund" is not specifically defined by Belgian law. Nevertheless, the doctrine of case law outlines two essential features of what should be a repayable fund. On the one hand, the borrower who receives the funds has to have access to those funds and be able to use them for his own benefit. On the other hand, the borrower is legally obliged to reimburse at least the nominal amount of the funds he received (De Cordt, Lambrecht, and Malherbe, 2015).

Because of this reimbursement obligation, corporate securities are excluded from this definition because of the risks involved. The bonds, for their part, are considered as repayable funds according to the doctrine. The civil code defines a lending contract as a debt instrument, which is different from an investment instrument, and therefore can be considered as a repayable fund.

5.2.2 The Belgian Royal Decree of October 9, 2009

The Belgian Royal Decree of 9 October 2009 concerns the public nature of the solicitation of reimbursable funds. The first article of the Decree describes the situation in which the solicitation of reimbursable funds is of a public nature. One of the applicable conditions relates to advertising. Indeed, if the advertising for announcing or recommending the solicitation of reimbursable funds reaches more than 50 people, the solicitation is considered public. Furthermore, if the solicitation is made by an intermediary, the same rule applies.

An intermediary is defined as *"Any natural or legal person who, even as a subsidiary or temporary activity, and in any capacity whatsoever, solicits or receives directly or indirectly, for any remuneration or benefit whatsoever, deposits or other repayable funds on behalf of the beneficiary, with the exception of the credit institutions that operated in the context of payment transactions"* [Our translation] (Houssa, 2016). Therefore, as peer-to-peer lending platforms will be compensated for the service, they should be considered as intermediaries.

5.2.3 The law of June 16, 2006 (The Prospectus Act)

Article 68 bis[36] *of the law of the 16th of June 2006 related to public offers of investment instruments and admission of investment instruments to trading on regulated markets*

Article 68 bis lists all the people and institutions who are authorised to make public offers in order to receive deposits or other repayable funds. This monopoly mainly benefits credit institutions that collect the funds of their clients through deposits, and who have the legal obligation to reimburse the deposits.

Furthermore, the law requires the publication of a prospectus providing all the information necessary to enable investors to make an informed financial decision[37]. Article 3 lists the categories offered, which are not public in nature. More particularly, offers for less than €300.000 are not considered public. The maximal amount allowed per investor has to be lower than €5000 and every document relevant to the transaction has to indicate those thresholds[38].

[36] Article 68bis of the Prospectus Act replaces article 4 of the law of the 22nd of March 1993 on the control and status of credit institutions that were repealed.

[37] "The prospectus shall contain all information in which, taking into account the particular nature of the issuer and the securities offered to the public or permitted to be traded on a regulated market, are information necessary to enable investors to make informed decisions on the patrimony, the financial condition, results and prospects of the issuer and the prospective guarantor, as well as the rights attached to such securities." [Our translation] (Art. 24 § 1 of the law of 18 December 2016).

[38] Figures come from the Art. 18 § 1 of the Prospectus Act.

5.2.4 The legal incapacity of peer-to-peer consumer lending

It is indisputable that the borrower who wants to apply for a loan through a peer-to-peer lending platform falls within the first article of the Belgian Royal Decree of the 9th of October. Therefore, as the nature of the loan is public, the borrower will have to reimburse it according to the law of June 16, 2006. Because they don't have banking status, peer-to-peer lending platforms are not authorised, according to the law on public offers, to collect repayable funds.

Nevertheless, this banking monopoly has a few exceptions, including one that allows companies to finance by debt. Hence, those who can solicit and receive repayable funds are *"persons, enterprises and institutions who provide offers for sale or by underwriting investment instruments through which reimbursable funds are raised in accordance within the limits of the provisions of this Act"* [Our translation] (Article 68 bis, 6° of the Prospectus Act). Indeed, companies are allowed to make public offers if they issue debt securities in return for the collected repayable funds per the Prospectus Act.

From this point of view, it is thanks to this exception that the FSMA supports the peer-to-peer lending model in which companies receive investments to fund their projects in return for a loan contract with interest[39]. This on the sole condition that every investor should benefit from the same modalities on their contract (interest rate, reimbursement terms, etc.), regardless of the amount invested. If they issue debt securities in return for the collected repayable funds, companies are authorised to collect those funds for their projects (Houssa, 2016). However, according to the Prospectus Act, only legal persons are allowed to issue debt securities[40]. In the peer-to-peer lending consumer business model, the loan contract with interests should be, through assumptions, issued by a natural person. However, as is defined in Article 9, 2°, the Belgian legislation does not allow a natural person to issue debt securities in return for collected repayable funds.

[39]The FSMA have decided that those loan contracts should be considered as an investment instrument as written in article 4th, §1, 10° of the Prospectus law, a status for "All other instruments that provide the opportunity to have an investment of the financial asset type, regardless of underlying assets" [Our translation].

[40]The FSMA defines the supplier and the issuer in Article 9, 1° and 2° of the Prospectus Act. The supplier can be a natural or legal person but the supplier can only be a legal person.

5.2.5 The law of December 18, 2016 (Legal framework for crowdfunding)

The development of platforms based on the exception discussed above required the FSMA to better regulate the crowdfunding sector. Hence, the law of December 18, 2016 organizes the recognition and supervision of crowdfunding in Belgium and provides a legal framework for crowdfunding. Platforms have to send an application to the FSMA to obtain the authorisation to actively commercialise financial instruments in Belgium.

A regulatory agreement is required for financial investments made on platforms. Therefore, platforms that offer donation-based or reward-based crowdfunding are not subject to this law[41]. This legal framework provides an accreditation system, rules related to the company's activities, operating rules and supervisory and sanctioning mechanisms. In addition, the law provides for a larger exemption to the prospectus for crowdfunding. In particular, the amount of the offer has to be lower than €300.000 with a maximum of €5.000 per investor (Article 41, Law of 18 December 2016).

5.2.6 Indirect peer-to-peer lending as an alternative

The only exception that allows companies to issue debt securities does not apply to natural persons. Therefore, as we have already mentioned, peer-to-peer lending that directly invites individual borrowers and lenders to meet is not permitted. This structuring of the peer-to-peer lending model requires the presence of a legal entity that will issue debt securities as loan contracts.

The individual will not lend directly to another individual through an online platform. Instead, the borrower will request a loan to the lending platform. And the investors will invest in notes issued by the platform. There is no contractual relationship between the borrower and the investor, only with the platform. This model, developed by the Mozzeno platform in Belgium, will be discussed in more detail in the second part of this thesis.

[41] As a result, peer-to-peer business lending platforms are regulated by the law of the 18th of December 2016.

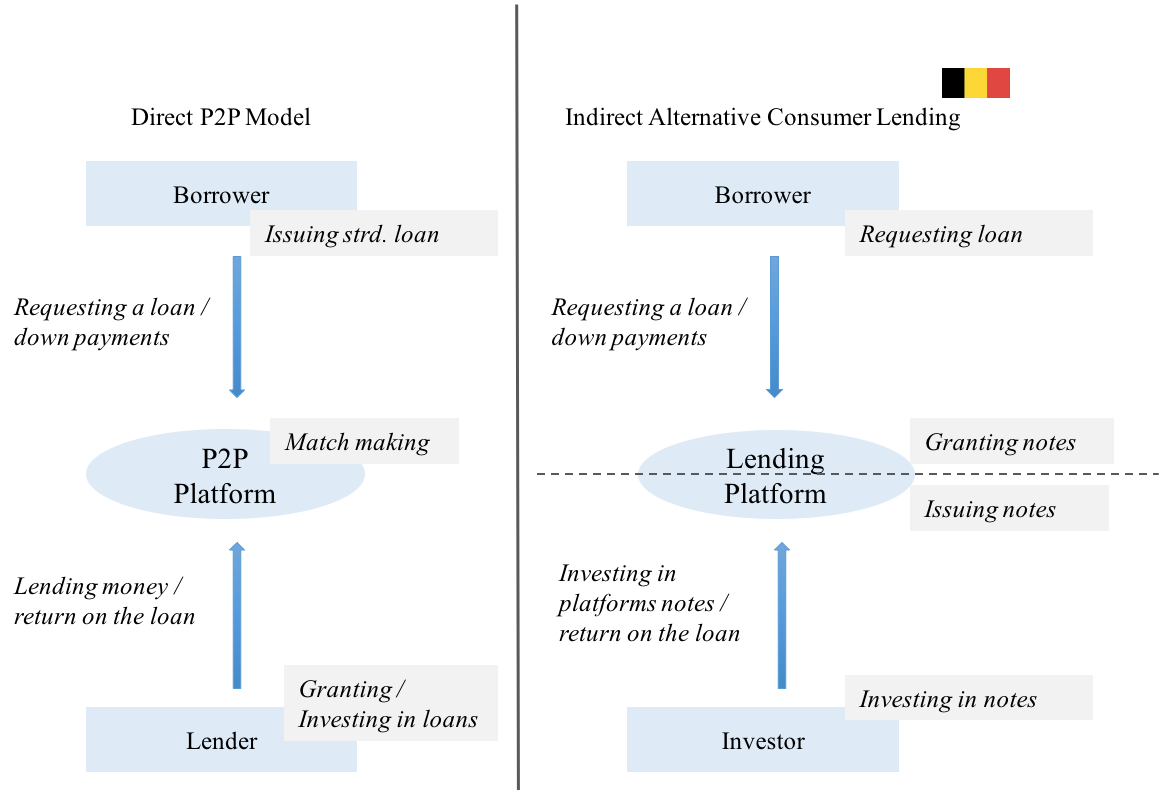


Fig. 5.1 Comparison between the direct P2P model & Indirect alternative consumer lending[42]

5.2.7 The impact of regulation on peer-to-peer lending activities

A lack of consistent regulatory frameworks for peer-to-peer lending at both the European level and in individual national contexts remains an important obstacle to growth and to cross-border flow of peer-to-peer lending in some jurisdictions. Despite the fact that a certain number of member states regulate peer-to-peer lending activities, many suffer from complex rules or lack of bespoke regulations, which may negatively impact investment activities. Moreover, regulations remain non-existent in a handful of countries, thus restraining further development of peer-to-peer lending in those jurisdictions. Because regulations vary substantially from jurisdiction to jurisdiction, and because there is no cohesive supra-national regulatory approach, it seems clear to us that cross-border investment is restricted and less developed than it could be (Zhang and al., 2016).

[42]Figure 5.1 comes from a law firm in Brussels, Simont Braun, from a presentation made to FintechBelgium (2017).

Chapter 6

The role of peer-to-peer lending in financial intermediation

Peer-to-peer lending platforms convey funds from investors to borrowers. They belong to a wider spectrum of financial institutions carrying funds such as banks, non-bank lenders, asset managers, venture capitalists and hedge funds that are referred to as financial intermediaries. It is important to compare the different services provided by those intermediaries, as well as the market positioning for investors in terms of liquidity and risk-return trade-off. After that, we propose to point out the risk management put forward by platforms to increase their attractiveness. Finally, as the bank is the market leader in the lending industry, we propose an interesting point of view by contrasting the business models of both banks and platforms.

6.1 The different forms of financial intermediation

6.1.1 Value chain

The study conducted by Oxera (2016) described the four main types of financial institutions peer-to-peer lending platforms are competing with.

As financial intermediaries, peer-to-peer lending platforms are two-sided markets[43] that meet the needs of both investors and borrowers (cfr. figure 6.1). As we have already mentioned, the role and nature of peer-to-peer lending towards investors and borrowers are very different.

From the perspective of borrowers, peer-to-peer lending platforms offer sources of funding that compete essentially with those proposed by banks. However, we observed in recent years the growing presence of non-bank lenders. Therefore, some variation can appear in

[43] In economics, 'two-sided markets' refer to economic platforms with two distinct user groups that provide each other with network benefits.

the rates offered by the different types of lenders because of their own assessment of credit risk and risk appetite combined with the relative supply of funds (Emekter & al., 2015).

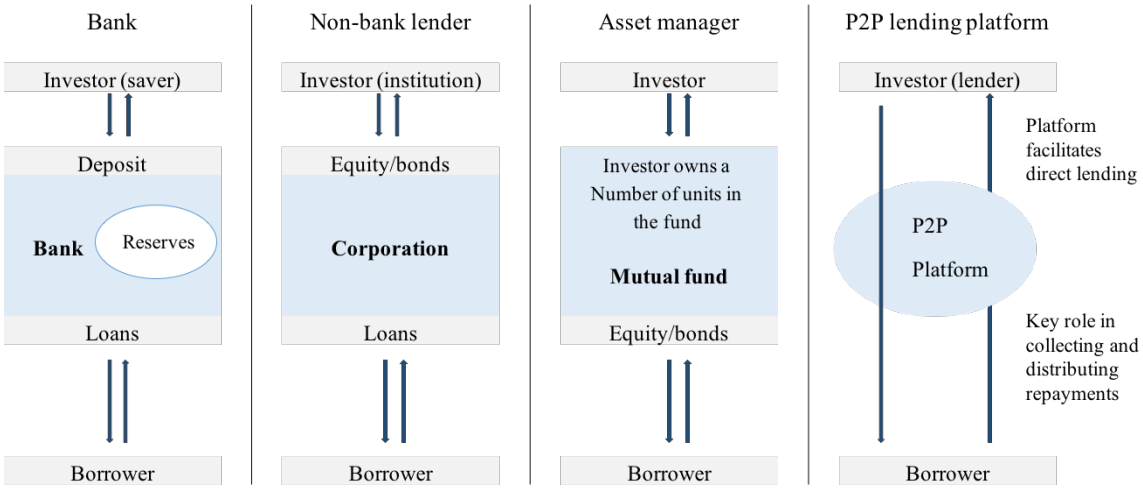


Fig. 6.1 Value chain for four main forms of investor exposure to lending[44]

Due to this increasing competition, institutions offer value-added services to borrowers. Regarding the peer-to-peer lending platforms, they provide several services such as options to repay the amount borrowed before term at no extra charge, or guidance to SMEs on how to set-up their proposition in a loan request.

On the other hand, the investor's situation is more innovative. Indeed, peer-to-peer lending platforms provide the opportunity to fund loans directly to both retail and institutional investors. The closest comparison would be the ownership of a portfolio of corporate bonds, except that peer-to-peer lending platforms facilitate loans primarily to SMEs and individuals, rather than large capitalization companies (Emekter & al., 2015).

Additionally, investors benefit from a new distribution channel with peer-to-peer lending platforms, that is different from existing financial institutions such as asset managers and banks (Meyer, 2007). For sure the extent of investor engagement differs by platform, some grant access for investors to examine characteristics of the borrower in detail while others give less information about borrowers. As can be seen in figure 6.1, this is totally different

[44]Figure 6.1 comes from the study conducted by Oxera (2016, p. 9).

from the models of banks, where there is no relationship between investors and borrowers at all.

Also, a similitude between peer-to-peer lending and asset management can be observed in that that they both convey funds from investors to borrowers without being directly exposed to capital loss from the performance of the loans. However, peer-to-peer platforms are exposed in some measure to the performance of loans since they record a loss of loan servicing fees if loans default. A corresponding loss of annual servicing fees affects asset management if the investments managed perform poorly. In addition, the reputations and revenues of both peer-to-peer lending platforms and asset managers much depend on the returns made by investors on their investments; in other words, they both have the appropriate incentives to operate cautiously and conduct decent credit risk assessments as detailed in the next section of this thesis.

However, a difference between these two types of financial intermediaries resides in the fact that the bonds and shares of companies which are held by asset managers are usually issued by an investment bank, while peer-to-peer lending platforms essentially 'issue' by themselves the P2P agreement by preparing the contracts that manage the direct relationship between investors and borrowers (Emekter & al., 2015). The function of facilitating direct lending from investors to SMEs or individuals therefore makes the platform more responsible for servicing loans than is generally the case with the financial securities held by asset managers. Finally, peer-to-peer lending focuses on somewhat smaller loans compared to asset managers that mainly focus on corporate bonds for larger capitalization companies.

Finally, investors need to have a good understanding of the nature of the risk on the peer-to-peer platforms, as an incorrect assessment could lead to potential misunderstanding and disappointment (Berger & Gleisner, 2009). Indeed, it is in the platform's own interest to guarantee that investors clearly understand that the platform offers direct lending through P2P agreement, as is not the case for a bank deposit.

6.1.2 Difference in the credit profile of business and individual borrowers

To adequately present the role of the different financial intermediaries, it is interesting to understand whether a distinction of positioning is made between the P2P consumer lending platforms and the P2P business lending platforms, and therefore if both models compete equally against banks on the borrower side.

From the survey conducted by Baeck & al. (2014, p. 46), there appears to be a striking difference between the credit profiles of business and individual borrowers on peer-to-peer platforms. In the P2P market for personal loans, 59% of the borrowers surveyed[45] sought funding from banks at the same time as they applied for an online loan on a P2P platform. 54% of them were granted funding (by a bank) but chose to fund their project via the lending platforms instead. On the contrary, in the market for P2P business loans, 79% sought funding from banks but only 22% of the respondents were granted a loan. Peer-to-peer business lending therefore funds many borrowers who would otherwise struggle to obtain a loan, as they have in many cases unsuccessfully sought funding from more conventional funders such as banks.

6.1.3 Investment characteristics

Since investors directly finance loans via the platforms, they receive essentially the cash flow of a lending business, linked to specific loans through the P2P agreement. That is why this type of investment, which is so unique compared to other standard investment opportunities, is not easily comparable in terms of risk-return trade-off and liquidity. Therefore, the Oxera study (2016) tried to classify the various forms of investment opportunities previously considered (asset management, bank, non-bank and P2P lenders) in relation to these two factors (cfr. figure 6.2). In order to perform this comparison, they made the assumption that a diversified portfolio of each asset class is being held, as diversification reduces the risk.

[45]This means that these borrowers were already funded by the platform. In other words, 41% (100-59) sought funding directly on the platform without asking a bank at the same time.

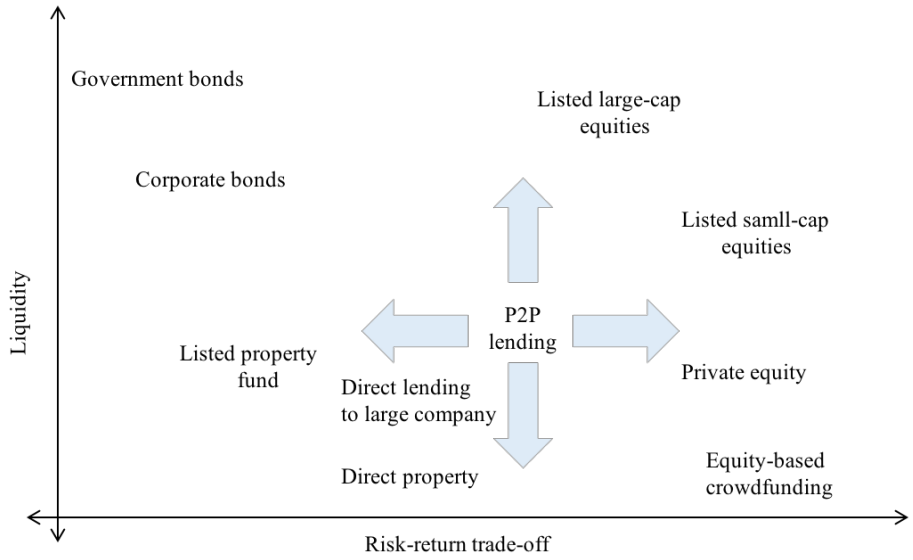


Fig. 6.2 Illustration of relative liquidity, and risk-return trade-offs for selected investments (diversified portfolios only)[46]

The classification laid out in this graph is obviously imprecise as there are variations between the different types of loans and services rendered on peer-to-peer platforms. Similarly, certain variations could appear between the different securities within the other types of investments. This leaves the door wide open to a debate on the exact place investments should have within this two-dimensional graph.

As we can see (cfr. figure 6.2), government bonds are typically the kind of financial products with a low risk-return trade-off, while being at the same time very liquid, as the likelihood of investors having difficulties selling government bonds is almost non-existent. We could also place savings accounts at the lowest-risk end of this graph, since this financial product provides immediate liquidity combined with a virtually risk-free return profile (a deposit guarantee). At the highest-risk end, we could place liquid investments like publicly listed equities of large companies, the sale of which can be made at any time but is subject to fluctuations in value and thus as a consequence could benefit from a higher return. The last example relates to private equity and equity-based crowdfunding, which could be located in the range of assets with low-liquidity and high-risk investments. As a rule of thumb, we can conclude that peer-to-peer lending offers an additional and innovative form of investing in lending operations and thus new opportunities for investors.

[46]Figure 6.2 comes from the Oxera study (2016, p.13).

6.2 Platform risk management

As peer-to-peer lending platforms belong to a wider spectrum of financial institutions, they have to offer competitive advantage to attract investors. As a result, it is critical for peer-to-peer platforms to manage risk effectively because of both direct revenue and reputational impacts. On the one hand, peer-to-peer platforms earn revenue by applying fees on loans; therefore, platforms are subject to losing these fees every time a borrower defaults. Often at a rate around 0.7% and 1% (Oxera, 2016, p18), this represents a significant proportion of their income. On the other hand, as we have already mentioned before, most platforms have changed their business model, from an auction mechanism where investors determine interest rates for projects, to a mechanism where platforms choose the interest rate after a thorough credit risk assessment. Platforms have to pay risk-reflective interest rates in order to attract investors. An increase in default losses could directly affect the reputation of the platforms and even of the P2P platform sector as a whole. Because the lending market is very competitive, platforms without effective credit score assessments will not survive (Mathews, 2016).

Many value-added services are offered to investors by platforms to help them manage risk. As a rule of thumb, platforms have to continually enhance risk management to increase their attractiveness. The literature outlines 5 different ways for investors to reduce the risk.

6.2.1 The interest rate

The credit risk models developed by P2P platforms are mostly similar to those used by traditional lenders. They use data from credit reference agencies and others sources, such as TransUnion, that informs Prosper of their borrower's credit score (Prosper, 2016). The interest rate is determined based on the borrower's credit rating, in other words, platforms highly value risk management to determine a risk-reflective interest rate. This is why many businesses and consumers are rejected from platforms, as they do not pass the credit assessment.

Oxera (2016) analysed the loan book of Funding circle, a UK platform that emerged after Zopa and has raised more than £2.5 billion so far[47], in order to compare the difference between the average borrower interest rate and the actual default rate of several ranges of credit scores for all the loans the platform has granted (mainly peer-to-peer business loans). As we can see in figure 6.3, the risk assessment process seems to perform relatively well, with a higher interest rate when there are more defaults. (The credit score "E" was recent at the time the study was conducted, and is therefore not risk-reflective as other defaults can have occurred since then). This analysis does not allow us to reach a definite conclusion on the risk assessment process of every peer-to-peer lending platforms, but points out the significance of having a performing risk rating system. As we have previously mentioned, investments have to be risk-reflective.

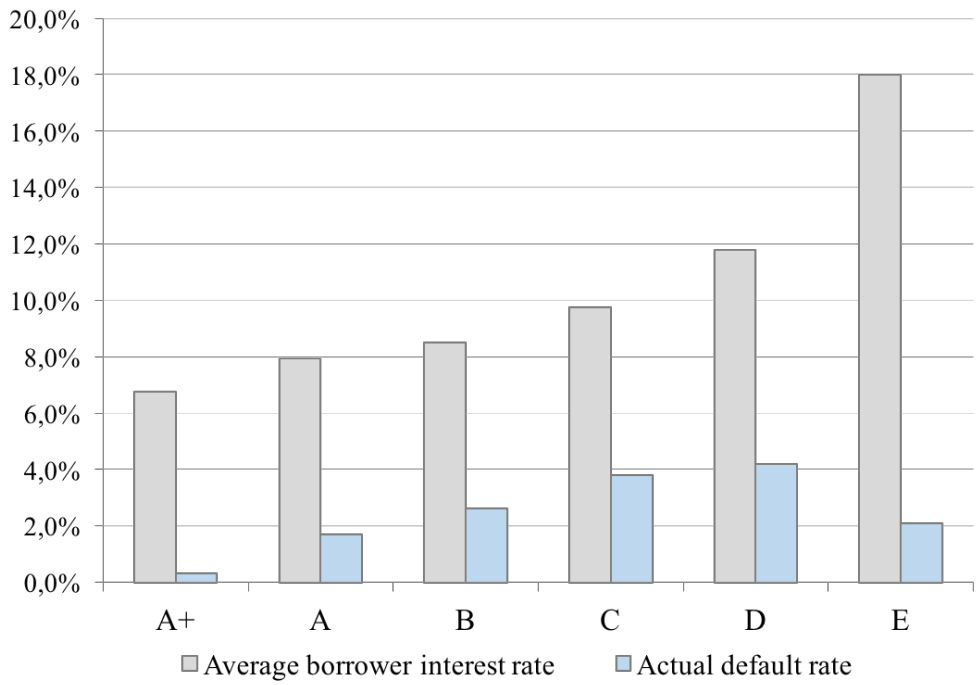


Fig. 6.3 Average borrower interest rate and actual losses due to default per credit band for all Funding Circle loans[48]

Furthermore, an effective credit risk assessment system, that enables platforms to compute estimated loan losses accurately, is of fundamental importance. If platforms are looking to attract investors, an efficient risk credit risk assessment is essential. As peer-to-peer

[47]Figures come from the Funding Circle's website.
[48]Figure 6.3 comes from the Funding Circle's website.

platforms are newcomers in the lending industry compared to other financial institutions, they are far more susceptible to reputational risk, and therefore have to prove their efficiency by providing risk-reflective loans.

6.2.2 Diversification

Peer-to-peer lending platforms offer investors the opportunity to benefit from risk diversification through different services. First of all, the emergence of peer-to-peer lending has given investors the possibility to invest in a new asset class in order to diversify their portfolios. Furthermore, platforms enable them to spread their investments across several different loans to mitigate the risk. Platforms try to encourage investors to spread their invested amounts by offering auto-diversification tools, that can be optional or sometimes mandatory (Kirby & Worner, 2014).

Each platform has its own allocation strategy in order to offer the best service to their investors. Indeed, it is very challenging for an investor or even for an institutional investor to make good lending decisions. Platforms have well understood this issue and have therefore developed allocation strategies against predetermined criteria such as credit risk, interest rate, security cover and industry sector. For all platforms[49], loans are allocated randomly to investors' portfolios to ensure that the distribution is completely fair (Oxera, 2016). Therefore, it is possible for investors to get the best loans available purely by chance.

6.2.3 Buffer funds

In order to manage risk, many platforms have developed buffer funds to protect investors from default losses. This service can considerably reduce the risk profile faced by investor in normal times, but it is more difficult to predict this risk in severe economic scenarios. For each loan, a small amount of money will be set aside within the fund and it is usually taken from the borrower's fees. Therefore, the buffer funds will protect the investor if the borrower goes into default by covering payments, such as interest and principal. Unless the fund runs out, investors should not be worried by default losses because the fund will pay instead of the borrowers themselves. In other words, the risk faced by investors,

[49]Platforms that provide the auto-allocation algorithm.

namely the loan default risk is in a way transformed into the risk that the fund may run out. The buffer fund is seen as a guaranteed fixed return for investors. However, the depth of coverage offered by buffer funds differs from one platform to another (Weeks, 2015).

6.2.4 Providing liquidity

Liquidity is defined as the ability to quickly sell or buy assets on a market without affecting the asset price (Gopalan, Kadan, and Pevzener, 2012). A number of platforms have set up the possibility for investors to sell their loans to other investors before loan maturity. Thanks to this system, investors will have ready access to their funds when another investor is ready to buy the remaining loans. By doing this, platforms create a secondary market, where investors can sell and buy loans. The investor who wants to resell his loan on the secondary market will have to pay charges to most platforms, and moreover, the interest rate could be different, depending on the market conditions. The fees he will have to pay are comparable to what a bond investor pays when he decides to sell his bond before redemption (Oxera, 2016).

6.2.5 Platform risks

Investors may wonder what would happen to their investments if the platform goes bankrupt. The UK, very proactive in the online alternative finance sector introduced a new regulation requirement in February 2016 after key issues arose from platform closure (FCA, 2016a). This rule[50] requires from firms that, even if the platform goes bankrupt, loan contracts must continue to be administrated and managed in accordance with the contract agreement.

[50]SYSC 4.1.8 - Operators of electronic systems in relation to lending: arrangements to administer loans in the event of platform failure

6.3 The potential for peer-to-peer disintermediation of Banking

As explored in Deloitte's report on disrupted payments (Ley & al., 2015), as well as in the World Economic Forum report (Bruno & al., 2015), the combination between regulation and new technology is eroding many of the core competitive advantages that banks hold over new market entrants.

Furthermore, these structural threats take place at a time when interest rates are at a historical low and with the tightening of regulatory capital. Both these changes are definitely making the goal of generating returns above the cost of capital a continuing challenge for banks (Doyle, Foottit, Tura, Ross, and Sonnad, 2016).

Peer-to-peer lending platforms are thus leveraging all of these trends to hurt one of the core profit-generating activities of commercial banks: lending. Throughout this section, we will aim at answering two main questions: do peer-to-peer lending platforms constitute a disruptive threat to the bank's core lending and deposit-gathering businesses in Europe? And what should banks do to react to the emergence of these peer-to-peer lending platforms?

6.3.1 The initiatives of peer-to-peer lending affect intermediation, the core nature of banks

In order to show that the bank's core lending and deposit-gathering business can be threatened by P2P lending platforms, we propose to consider the situation in the US and in the UK, as they are two market leaders in this innovative area. Furthermore, this analysis could be interesting in making some assumptions on the possible disruptive impact of peer-to-peer lending on the banks in Belgium.

6.3.1.1 The case of the US

A study conducted by Goldman Sachs (2015) shows that in the United States, the development of online alternative finance begins to weigh on the results of major banking

groups in their credit activities. The newly emerged operators (Lending Club, Funding Circle) who allow investors to make loans – and more broadly non-bank players in credit – represent a $11 billion threat on the annual profits of large US banks within the coming five years. This represents 7% of all profits in 2014 ($150 billion).

In total, Goldman Sachs estimates that, for the types of loans concerned (personal loans, SMEs, student, real estate, etc.), overall, the share of banks could be reduced by 20% against these new players. The largest part of the shortfall - $4.6 billion in profits - is related to personal loans ("unsecured personal lending"). Ultimately, new competitors such as Prosper or Lending club may be able to seize a third of the share of the old giants of finance.
In addition, another report conducted by PWC (2015) projects that peer-to-peer lending would grow by 2025 to capture 10% of the $800 billion US market for revolving consumer debt and 4% of the 1.4 trillion of non-revolving consumer debt held by financial institutions such as banks.

Finally, Moldow (2015) forecasts global peer-to-peer lending to rise to $1 trillion by 2025, on the assumption that it secures 10% of consumer and other lending markets.

6.3.1.2 The case of the UK

According to a survey conducted by Milne and Parboteeah in 2016, the volume of peer-to-peer lending remains very small relative to conventional bank lending. Indeed, they found that peer-to-peer consumer accounts for 0.53% of total unsecured consumer lending in the UK, while peer-to-peer business lending is 0.45% of total business (SMEs) lending in the UK[51] (Milne & Parboteteeah, 2016, p. 8).

The fact that the United States is more affected than Europe is logical: the role of bank lending in the economy is traditionally lower and the market for financing by "non-banks" is therefore more widespread (Bruno & al., 2015). So far, this trend has been concentrated on large SMEs and, of course, large corporate clients via the bond market. The new platforms simply extend this same logic to individual loans.

[51]The figure on the P2P lending volumes by platform compared with other credit markets in the UK' is provided in appendix 9.

6.4 The relative economics of peer-to-peer platforms vs banks

As we are showing with our analysis, it is challenging to measure the real impact that the peer-to-peer sector could have on the bank's core business. Indeed, there is no consensus among experts as to the part of shortfall in profits that may arise in the future due to the development of platforms. As a result, we propose to take a look at the different structure of the cost incurred in originating and servicing loans for both banks and platforms. As they are both part of the lending industry, it is interesting to establish if one of them has a potential pricing advantage when issuing loans.

6.4.1 Cost economics of banks and platforms

As banking holds the reputation of being an expensive form of financial intermediation, we wonder if peer-to-peer lending platforms have found ways to overcome these cost barriers and offer a lower potential price-point.

Thanks to the study conducted by Deloitte (Doyle & al., 2016) that compares the relative costs of unsecured loans offered by banks and platforms in the UK, we can form an opinion on whether or not P2P lending platforms truly possess a pricing advantage over traditional banks. To this end, they developed their analysis on three factors: the cost of funds, operating expenses and how they price risk.

6.4.2 Funding cost

First of all, the survey detailed the funding costs of banks and platforms as those costs represent an important component in the loan's total cost profile. In order to have an accurate comparison between the expenses incurred by banks and P2P platforms, Doyle & al. (2016) examined the different types of costs that are required in the loan-making process attract funds.

6.4.2.1 Bank's funding cost

Regarding the banks' funding costs as a whole, banks must first attract deposits, ensure equity on their balance sheet, obtain wholesale funding and maintain liquidity reserves in order to meet the need of their customers. The true cost of attracting funds has to take into account both the interest-based and the non-interest-based costs of gathering deposits. Indeed, on the one hand, banks must handle the direct cost of funding and liquidity such as the interest rates, returns and yields payable on these funding sources. On the other hand, they need to attract and retain deposits, which requires more than just paying interest. Indeed, banks also provide processing and payment services, and most of them also run a branch network. But beyond this, banks will also incur marketing and regulatory costs (cfr. figure 6.4).

6.4.2.2 Peer-to-peer platforms funding cost

When platforms need to attract lenders, the process involves offering returns that outweigh the risks that the lenders are prepared to accept. Then, they will also incur marketing costs, servicing and lender-processing costs as well as some other non-interest-related expenses. Furthermore, the platform itself has to be funded, and it must also ensure a return to its own investors (cfr. figure 6.4).

6.4.2.3 The comparison between "fully-loaded" costs

Two main observations can be made from the figure below. First, the total funding costs seem to be lower for banks than for P2P platforms. Then, the ratio of interest costs/non-interest costs for banks is completely different than for platforms. We observe a ratio of 0.74 for banks whereas we have a ratio of 3.7 for platforms. This means that an increase in the interest rate would have a completely different impact on the two funding cost structures. That is why Doyle & al. (2016) decide to stress the two cost functions as the interest rates increase and the credit environment normalises. Overall, we notice an increase of 13% for banks and of 25% for platforms in Deloitte's scenario[52].

[52]Deloitte used a scenario where base rates increased to 200 bps, and credit spreads have returned to pre-crisis levels, to show the estimated increase in these funding costs.

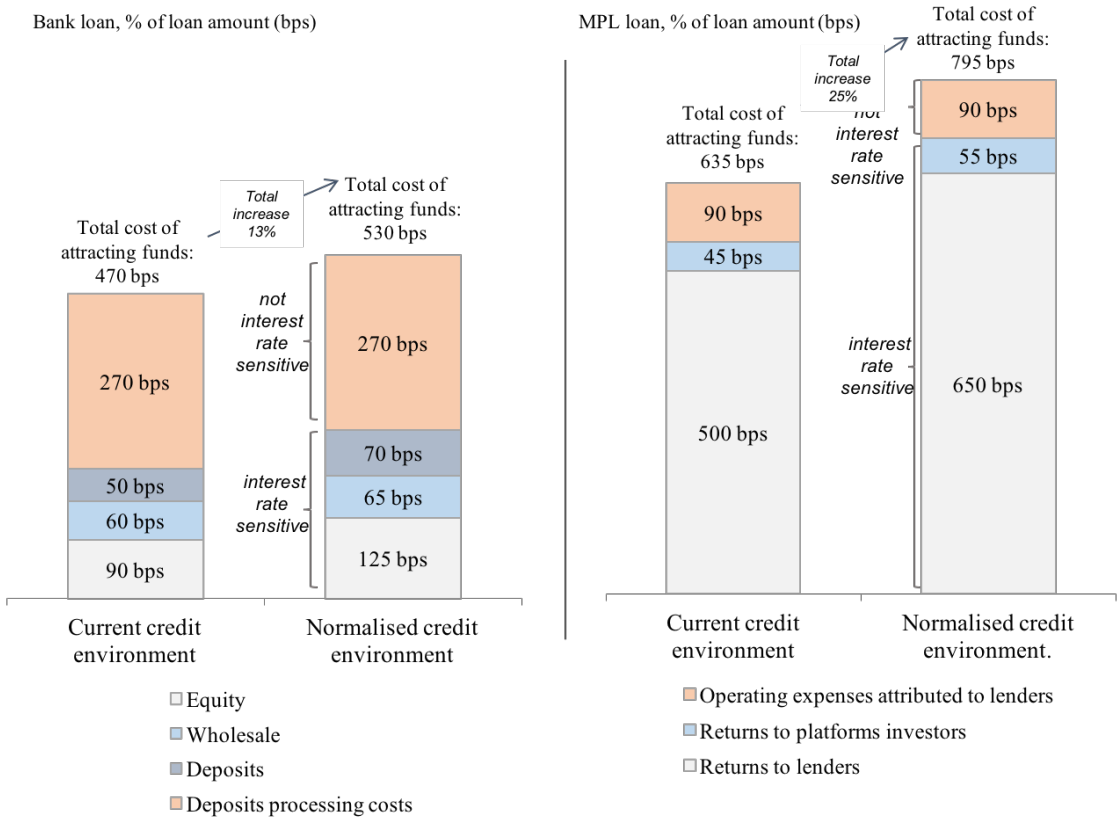


Fig. 6.4 Costs of funding unsecured personal banks and MPLs[53]

The authors justify this smaller increase for banks by the fact that they are able to borrow very cheaply, since taking deposits grants them inexpensive access to funding[54]. Banks benefit from this structural advantage both because of their exclusive regulatory position (with deposits underwritten by the government/protection scheme) and because of their ownership of the payments infrastructure.

A notable proportion of banks' balance sheets is funded by taking current accounts, which are less sensitive to fluctuations in base rates than other sources of funding, such as instant access deposit or term deposits. For this reason, Doyle & al. (2016) believes that banks will have a fundamental cost advantage over P2P platforms if and when the credit environment normalises.

[53]Figure 6.4 comes from the study conducted by Doyle & al. (2016, p. 12).
[54]A figure of bank deposit rates in a normal credit environment is provided in appendix 10.

6.4.3 Operating expenses

Regarding the operating expenses, the survey examines and compares the structural advantages for both banks and platforms in granting and servicing loans[55]. P2P platforms possess a potential advantage thanks to their ability to create exclusively online channels to manage the loans on-boarding and servicing processes from scratch. Furthermore, a fully automated procedure (for most platforms) for processing and underwriting loans allows P2P platforms to avoid the material costs that banks must deal with as a result of their multiple channels and legacy systems. To conclude, as banks are highly regulated entities, they also incur significant costs, both in redressing any breaches and in ensuring compliance.

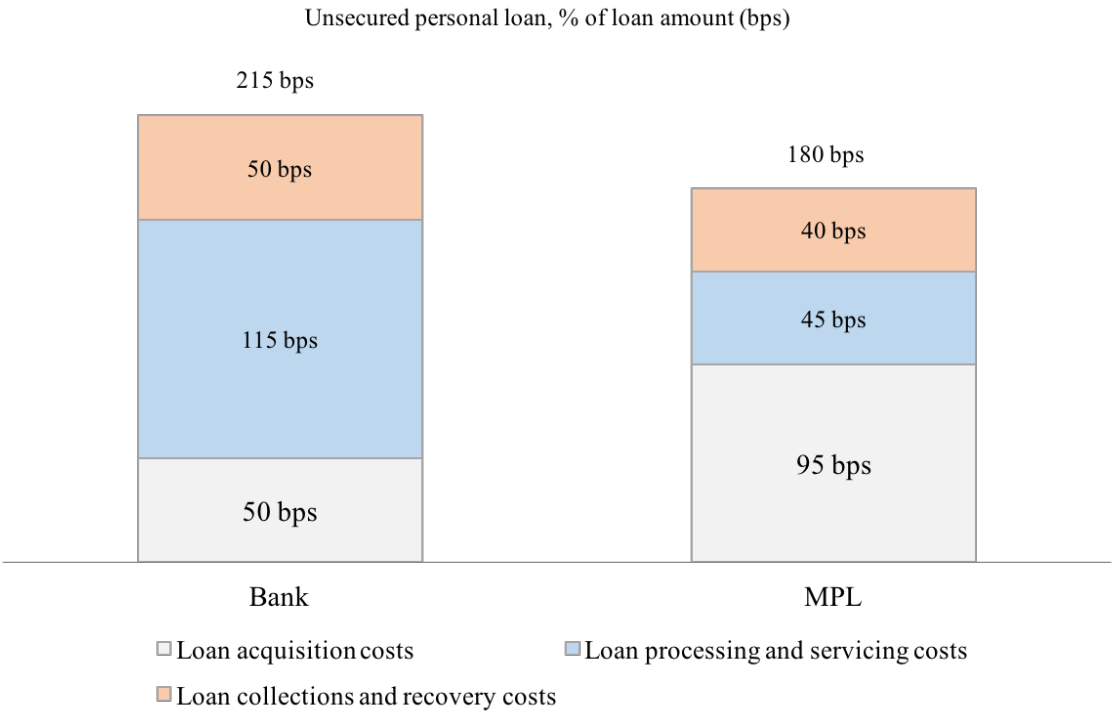


Fig. 6.5 Operating expenses of an unsecured personal loan, banks and MPLs[56]

[55]Only the operating costs associated with lending activities.
[56]Figure 6.5 comes from the study conducted by Doyle & al. (2016, p. 13).

6.4.4 Structural cost advantage for banks

Deloitte's analysis demonstrates that banks have a structural cost advantage over P2P platforms. Indeed, even if P2P platforms benefit from lower operating costs, a bank's broad cost description is less sensitive to growing interest rates than that of an equivalent P2P platform. As rates are at historically low levels, this advantage is not obvious in the current credit environment. However, if and when interest rates and spreads return to pre-crisis levels (credit environment normalises), it is expected that the cost incurred in P2P platforms credit transmission would increase more compared to that of banks.

For these reasons, Doyle & al. (2016) do not believe that P2P platforms represent a disruptive threat to banks in terms of relative economics. Banks currently enjoy a pricing parity with P2P platforms and this will become a pricing advantage in a normalised credit environment. Finally, Deloitte's market-sizing assessment does not foresee a shift in lending from banks to platforms owing to a fundamental pricing advantage.

6.5 Operational partnership

In this competitive sector, we should consider the question of whether banks should completely distinguish themselves from platforms or should on the contrary be looking for partnerships.

6.5.1 The emergence of operational partnerships between platforms and banks

In this field, while competition is hardly engaged, initiatives are starting to multiply, but the time for consolidation will no doubt come. It is likely that some asset classes will grow faster than others. Already, loans to businesses and individuals are growing exponentially, while capital flows appear to be stagnating. In each asset class, it is likely that only two or three operators will remain, at most, after the selection and consolidation processes (Bouyala, 2016).

Which asset classes, which operators will be the winners of the competition race? Are these winners destined to be redeemed, as has happened for online brokers, by traditional banking players? Or will the agreements with the banking world multiply? Banks may be forced to refuse credit for reasons independent of the risk of the company in question: the file is too small to be profitable, or the choice of commercial or financial strategy (optimization of the use of their own funds) is inadequate.

In such cases, the banker may have an interest in offering the company an alternative, directing it to a P2P platform (with which it has formed a partnership), whose economic and prudential models are different from his. Indeed, the boundaries between these two businesses are porous and the two players may mutually benefit from working together tomorrow. For banks, transformed by the financial crisis, the historical job of converting deposits into credit evolves towards establishing more and simpler connections between companies and investors, which is precisely the business of « crowdfunding ».

The platforms would bring their know-how in digital marketing and an unprecedented level of traceability in the nature of the assets to be financed. For its part, online alternative finance could find in banks a risk-maker culture and investor-saving cohorts (Aranoff, 2016).

It is therefore clear that the bank or broker may propose many additional benefits. There is however a "but". Few are the financial crowdfunding platforms that make a profit. An investment must therefore still take place. There is also the problem of reputational risk. If a project or a start-up fails, it can affect the image of the financial actor. However, this reasoning can also be reversed. A financial actor who engages in the field of crowdfunding can expect a positive effect in terms of image. Indeed, it makes a constructive contribution to the economy. Moreover, for such a financial player, it is interesting and instructive to be independently active in this area, which could potentially constitute a break from the banking sector. This brings new innovative technologies and a fresh entrepreneurial approach to start-ups (Bolero Crowdfunding, 2016; Massolution, 2015).

6.5.1.1 Example of cooperation initiative

Several examples of cooperation between banks and fintechs can already be observed. For instance, in 2015, ING launched a strategic partnership with fintech Kabbage that lends to SME's. The pilot started in Spain, by providing loans up to 100,000€. The companies that are already ING customers can benefit from an automated loan application and an approval process that are both simpler and faster. As for ING, they have more flexibility in their risk management due to the credit scoring and the monitoring of the risk provided by Kabbage. For those enterprises who are already ING clients, they will have the possibility of being granted a loan in less than 10 minutes (ING, 2015).

Part II

Qualitative analysis of different players with acknowledged expertise in peer-to-peer lending

The first part of this thesis was dedicated to the consideration of existing literature on peer-to-peer lending with the purpose of promoting a better understanding of this qualitative analysis. As we can observe, this market shows a significant growth around the world, more specifically in the UK, in the United States and in China. In Belgium too, but with much lower volumes per capita. Therefore, we were wondering if one day this business could hope to see further development and if it could potentially disrupt the banking sector.

In this perspective, the second part of this essay proposes to address questions and concerns regarding the peer-to-peer lending market in Belgium. Through interviews, we investigate in more depth the case of peer-to-peer business and consumer lending, and the potentially disruptive impact of this sector on the financial institutions in Belgium. We highlight the most relevant elements from the interviews we conducted in order to further analyze the situation, while always bearing in mind the main question of our research: *"What are the prospects for peer-to-peer business and consumer lending in Belgium?"*.

This qualitative analysis is divided into four chapters. Ultimately, we will outline the limits of our essay and we will formulate a conclusion to our research. The first chapter is devoted to the presentation of the methodology used, as well as to an overview of the actors interviewed. The substance of our qualitative analysis is contained in the following three chapters.

First, we propose an overview of the current market in Belgium, by providing a more in-depth description of the business model of the platform Look&Fin as well as the one offered by Mozzeno. Indeed, Look&Fin suggests a model of peer-to-peer business lending similar to those operating in other countries. On the contrary, since peer-to-peer consumer lending is prohibited in Belgium, as we explained in the first part of our essay, Mozzeno chose to apply an online indirect lending model, that is close in concept, but that cannot be defined as peer-to-peer consumer lending.

After seeing that Belgium distinguished itself where peer-to-peer consumer lending legislation is concerned, we explored the potential reasons behind the current prohibition. We now propose an in-depth analysis of the current legislation and its consequences on the development of peer-to-peer consumer lending platforms in Belgium. Furthermore, we discuss what we believe should be modified in the current regulation in order to authorise this model and enable this sector to grow in Belgium.

Finally, after collecting the view of the platforms, we illustrate in the last chapter the opinion of banks. We were interested in understanding if the banking sector was preparing itself to the likely arrival of new platforms and if these could potentially one day create competition with banks. Moreover, as volumes traded in Belgium are relatively low, we thoroughly investigate the environment provided by the country in order to identify possible obstacles that could explain this under-development and prevent a growth in the future.

Chapter 1

Guide to qualitative analysis

In this first chapter, we describe the methodology used, as well as the reasons that drove our sample selection.

1.1 Methodology

By analyzing the literature and data available on peer-to-peer lending in Belgium, we quickly observed that it was impossible for us to achieve a quantitative analysis on this type of online alternative finance model. Indeed, since peer-to-peer lending is a relatively recent innovative phenomenon, the number of platforms and the data available are insufficient to allow a meaningful quantitative analysis.

It is for this main reason that we have opted to do a qualitative analysis on the basis of semi-structured interviews. Interviews were conducted either face-to-face or over the telephone[57]. For some of them, we provided a number of questions beforehand in order to obtain more substantial and structured responses. For others, we did not provide questions upfront, as we wanted to collect more spontaneous information, to bring another dimension to our analysis.

Each interview was specific, depending on the information required and the positioning of the actor in the market. However, they all followed the common thread of attempting to answer our main research question.

Our decision to hold interviews instead of using a questionnaire was based on the fact that face to face interaction allows for more nuance and detail. It also allowed us to ask spontaneous follow on questions to the interviewees during the course of the conversation.

[57] We have interviewed Mr. Xavier Laoureux from Mozzeno through a phone call.

Finally, all the interviews were recorded[58], with the express agreement of the party involved, and were then transcribed to facilitate the analysis[59]. In addition, we sometimes used the websites of the organizations interviewed to supplement the information received.

1.2 Sample selection

The objective of our sample selection was to encompass all the players with a direct or indirect interest in the peer-to-peer sector, and to collect all the relevant elements they could provide with a view to answering our research question[60].

As we mentioned in the first part of this work, two types of online lending-based models can be found in Belgium. On the one hand, the Look&Fin[61] platform is the market leader in Belgium in the area of peer-to-peer business lending. Moreover, it is by far the leader in the overall online alternative finance market in Belgium. We had the opportunity to meet *Mr. Nicolas-Alexandre Verdbois*, senior Business Analyst at Look&Fin. In the consumer lending area, as the direct peer-to-peer consumer lending model is prohibited in Belgium, the company Mozzeno[62] has launched an alternative model by offering an online indirect lending approach (cfr supra p.49). We interviewed *Mr. Xavier Laoureux*, co-founder of Mozzeno. In order to get a complete overview of the current peer-to-peer lending industry in Belgium, it appeared wise to us to collect the opinions of these two platforms.

Furthermore, in order to gather even more information on the fintech environment in Belgium, *Mr. José Zurstrassen* agreed to share some of his time with us to express his opinion on peer-to-peer lending. Actively involved in the fintech world, he is the co-founder of Skynet and Keytrade Bank and in addition, he is also the co-founder and former Chairman of MymicroInvest, a belgian equity-based crowdfunding platform.

[58]Mrs. Catherine Houssa did not wish to be recorded.
[59]The complete transcript of the interviews can be found in appendix.
[60]The comments of the interviewees do not in any way engage the organizations for which they work.
[61]A Belgian peer-to-peer business lending platform created in 2012.
[62]A Belgian indirect peer-to-peer consumer lending platform established in 2015.

In order to address the potential disruptive impact of these platforms in Belgium, we contacted two major Belgian banks, BNP Paribas Fortis and ING Group. Our objective was to determine whether they were closely monitoring the situation, and if they were prepared for the potential arrival of new peer-to-peer lending platforms in Belgium. Specifically, we met with *Mr. Hans Jacobs*, innovation Hub Business manager at BNP Paribas Fortis and with *Mr. Philippe Hugon*, Head of Professional Banking ING Group in Belgium.

In the first part of this essay, we analysed the regulatory framework in place by examining a document[63] published by Simont Braun, a law firm located in Brussels. This document was authored by *Mrs. Catherine Houssa*, president of the European Association of Banking and Financial law (Belgian section) and a member of the board of Fintech Belgium. As she is actively involved in "Digital Finance", we decided to meet with her in order to expand our knowledge on the relevant legislation.

We also believe it is of interest to mention the opinion of two well-known Belgian economists, *Mr. Bruno Colmant* and *Mr. Etienne de Callatay*. Our main subject of discussion was around the issues related to the evolution of the credit environment, and the potential role of the new alternative financing platforms in the more traditional environment of our financial institutions.

In addition, *Mr. Tom Van den Berghe*, CSR manager of the Belgian Financial Sector Federation received us in his office. As Febelfin[64] defends the interests of all its members, including banks, we were interested in their opinion on this innovative sector, that can potentially be perceived as competition. And finally, we also met from the Financial Services and Markets authority (FSMA). The FSMA being the authority that regulates the crowdfunding market in Belgium, including peer-to-peer business lending and also most probably the future consumer lending if a change occurs in the legislation, we considered his opinion very pertinent to our research.

[63] "Le peer-to-peer lending: un disrupteur innovant à l'avenir encore incertain" (Houssa, 2016).

[64] Febelfin represents the Belgian banking and financial associations at national and European level, with the various economic and monetary authorities in order to defend their/our interests.

Chapter 2

The state of the peer-to-peer lending market in Belgium

In this chapter, we propose an overview of the peer-to-peer lending market in Belgium. First, we discuss the peer-to-peer business lending model offered by Look&Fin. Then, we highlight online indirect lending as it is proposed by Mozzeno, as the model that comes closest to the actual peer-to-peer consumer lending model. Furthermore, in the analysis section, we provide our view as to which model is potentially the best suited to compete with banks on their deposits and borrowings activities.

2.1 Peer-to-peer business lending

To come to a comprehensive overview of the peer-to-peer business lending model as it is offered by Look&fin, we decided to meet with Mr. Nicolas-Alexandre Verdbois. In this section, we explain the features of the model and the measure in which it distinguishes itself from the banks.

2.1.1 An appropriate way to finance companies

One of the first questions that comes to mind is why Look&Fin chose to limit itself to the peer-to-peer business lending model. According to Mr. Nicolas-Alexandre Verdbois, this model is by far the most attractive for both borrowers and investors. Since the main motivation of Look&Fin members is financial return on their investment, donation-based crowdfunding and reward-based crowdfunding didn't appear to be the models with the greatest potential. The choice that had to be made was only between equity-based and lending-based financing.

The equity-based model has many disadvantages according to Mr. Verdbois. On the one hand, as the purpose of this model is to allow investors to acquire shares in the company, entrepreneurs must open their capital to many small investors. However, entrepreneurs

do not always want to be diluted, especially when their business is still in the startup phase. On the other hand, the second major problem lies in the difficulty of evaluating startups. Mr. Verdbois estimates that the model is even less suited to investors as it is to entrepreneurs. The main drawbacks for them are the illiquid nature of their holdings and a potential that is very uncertain. All things considered, these disadvantages lead Look&Fin to believe that the online lending-based model is the most appropriate way to finance companies.

2.1.2 A loan considered as a guarantee for banks

Mr. Verdbois compared the positioning of Look&Fin in relation to the financial institutions in place in Belgium. He first reminded us that the banking environment has changed significantly after the crisis. Indeed, the economy is evolving towards a policy of "quantitative easing"[65] with historically low rates, in order to revive the economy. However, it should be noted that this stimulus policy is not very efficient, as the lending policy of banks has become much more stringent at the same time, especially due to Bale III, by raising the risk levels of all banking activities.

Mr. Verdbois observed that when a bank grants a loan, it has to allocate almost the same amount in its balance sheet as its own funds. In order to counter that, banks ask for guarantees that are placed on the asset side of the balance sheet and which avoid capitalization of their own funds. Nowadays, according to Mr. Verdbois, the perverse effect of this practice is that banks increasingly seek guarantees in the entrepreneur's private wealth (personal home, etc.).

As a result, many entrepreneurs at the head of healthy SMEs, which still have funding needs, face overly restrictive banking policies that impose too many guarantees. He explained that this is precisely when Look&Fin's model makes the most sense. Indeed, Look&Fin never requests a guarantee as it only issues subordinated loans.

[65]The unconventional monetary policy in which government securities and other securities from the market are purchased by the Central Bank in order to increase the money supply and reduce the interest rate (The Bank of England, n.d.).

Interestingly, he mentioned that when an SME raises funds via the Look&Fin platform, it allows it to leverage the banks. Indeed, banks consider this kind of subordinated loan as equivalent to the company's equity contribution. Mr. Verdbois illustrated these remarks with a very simple example. If an SME needs to raise €1 million, it will collect € 300,000 (considered as equity by the bank) through the platform and the remaining € 700,000 through the bank, at a lower rate than on the platform.

Mr. Verdbois is very clear on the positioning of Look&Fin towards banks. Even if he admitted to have thought at the onset of the activity that it could compete with banks, he later realized that peer-to-peer business lending as offered by Look&Fin is rather complementary to these.

Indeed, as he said, Look&Fin unlocks credits since the banker's function is to lend money but only with guarantees, which is what the platform brings. In addition to this leverage for certain companies, he told us that they have already funded SMEs which had been refused outright by banks. Furthermore, the banking sector seems to be enthusiastic about this online alternative finance model as it sends more and more clients their way. Nevertheless, Look&Fin has so far only entered into informal partnerships with banks and have therefore no exclusivity with any of them.

2.1.3 A model for small and medium-size enterprises

The business model of Look&Fin confines itself to the funding of SMEs and not of startups. As Mr. Verdbois said: "a loan implies credit repayment ability". Indeed, the first repayment of interest and principal takes place as of the first month after the raising of funds, and so the focus for Look&Fin is indeed very financial oriented. However, the majority of startups have little turnover in the early years of their activities and they are typically in a phase of "cash burn". As a result, startups spend a lot before starting to generate profit from their operation. Mr. Verdbois does not find it healthy to borrow in order to cover the loss.

With this in mind, Look&Fin only grants loans to companies with a minimum of three years of activity and a turnover of at least € 600,000. In addition, the amount borrowed

must be at least € 100,000. Indeed, an SME has a certain repayment capacity of which they can make a real financial analysis. Consequently, it allows the platform to keep the investor's confidence and to keep the default rates at a very low level, or almost non-existent (0.66%)[66].

2.1.4 A comparison with bank deposits

During the interview, question were raised regarding the potential threat for banks if the money placed on deposit accounts was to be transferred to the type of investment proposed by Look&Fin. In response, Mr. Verdbois stresses the importance of making a definite distinction between these two types of investments. According to him, transfers from regular deposits to the type of funding proposed by Look&Fin does happen. Nevertheless, as these proposals are in fact subordinated loans, and are repaid practically last in the event of a bankruptcy, they should be considered as being at risk. Therefore, within Look&Fin, the product proposed is considered more as a complementary asset to a portfolio of equities and bonds, rather that as an alternative to deposits. As this represents a new class of assets, it allows investment portfolios to be diversified in order to reduce the risk.

In addition, Mr. Verdbois noticed that most of the investors on the Look&Fin platform have a portfolio approach. As a result, they care less about the business activity of the company, and more about trying to diversify their portfolio between different ratings.

2.2 Peer-to-peer consumer lending

Direct peer-to-peer consumer lending is still prohibited in Belgium. That being said, Mozzeno offers an alternative to this model by proposing an online indirect lending-based approach between individuals (cfr supra p.49). In order to understand this innovative model better, we decided to interview Mr. Xavier Laoureux.

2.2.1 The choice of the business model

We started by asking to Mr. Laoureux what pushed him to turn to this form of online alternative finance with Mozzeno, rather than to another. According to him, there were

[66]The default rate is extracted from Look&Fin's website on 15 July 2017.

two main reasons behind his choice. First, he highlighted that there are still no consumer lending platforms in Belgium and as a result, the competition with other models such as online business lending or equity-based crowdfunding is significant.

Second, according to him, consumer lending has more potential than peer-to-peer business lending and other forms of crowdfunding as a whole. Indeed, he noticed for example, that the main problem of business lending is related to the volumes of the deals.

2.2.2 Two different business models

We then asked Mr. Laoureux if, assuming that peer-to-peer consumer lending would be authorized, he was considering shifting to that model, despite the changes this would entail.

First, in terms of operating expenses, Mr. Laoureux believes the difference between his model and the peer-to-peer consumer lending model is minimal. Indeed, the platform will, among other things, always require credit scoring of its borrowers. On the other hand, what would dramatically change for Mozzeno is that the peer-to-peer model would avoid having to publish a prospectus, and as a result would avoid to pay 11,000 € each year for the FSMA approval. Consequently, platforms will most probably reduce their regulatory costs.

In fact, if we legally authorise peer-to-peer consumer lending in Belgium, Mr. Laoureux explained that we would never ask each and every individual borrower to complete a prospectus. This modification in the current law would allow an individual to make public offerings. Mr. Laoureux suggests that the individual would have to fill out a form or at least give some information, but never something as heavy as completing a prospectus. Moreover, the law has already provided an exemption for crowdfunding platforms with the "prospectus law". According to Mr. Laoureux, one can imagine extending the exception to individuals[67]. He insisted that at the same time, platforms would still have access to the Central Individual Credit Register (CICR).

[67]The Law of 18 December 2016 introduces a new exemption in the "Prospectus Law" (Law of 16 June 2006), provided that certain conditions are met. Thus, the total amount of the offer cannot exceed €300,000. The amount subscribed by each investor can not exceed the amount of €5,000.

2.2.3 Positioning of this model on the consumer loan market

In order to assess Mozzeno's positioning relative to banks, we began by asking a series of questions about the credit scoring method set up by the platform. Surprisingly, Mr. Laoureux told us that this credit scoring was done by a credit insurer, and not by their own in-house expert. He justified this choice by the fact that they did not have enough data to build an efficient statistical model, and also that they wished to avoid the need to purchase data. Mozzeno's differentiating factor is that all credits are insured by this credit insurer[68], who has over 20 years of experience in Belgium, with more than 6 million profiles recorded, allowing him to create an ultra efficient statistical model.

Subsequently, in relation to the credit acceptance rate, Mr. Laoureux informed us that a person who is denied credit by a bank is likely to be denied credit by the platform as well. Nevertheless, according to him, it all depends on the interest rate that the person targets. If, for instance, a bank is used to lending at 5%, when it assess the associated risk and cost, it will systematically refuse anyone above this benchmark. This is why according to Mr. Laoureux, Mozzeno differentiates itself by proposing "dynamic pricing", meaning that they offer four different levels of rates. So, contrary to a bank, Mozzeno is able to target different types of risks and therefore different types of profiles. All in all, the major difference is that the bank only has one rate, and it links that rate to a risk profile, while the platform has several different rates. Concretely, this means that a person who has been refused at a rate of 5% in a bank, may very well be accepted on Mozzeno's platform for a rate between 5% and 10%.

In connection with this, but more from an investor perspective now, we asked Mr. Laoureux if Mozzeno was paying attention to the interest rate gap between what they offer on the platform and what a bank offers for a similar level of risk. He answered that they are particularly careful to compare the different interest rates on a specialised Belgian website[69]. He mentioned that the objective was to always ensure that the proposed rate for risks of class A (the least risky) on the platform stays within the range of the first three rates published on the website (considered as the least risky).

[68] At least to a certain extent. The insurer partially protects Mozzeno and indirectly protects investors in case of default (Mozzeno's prospectus)

[69] www.guide-epargne.be

In addition, Mr. Laoureux reminded us that they have set up a reward system for perfect reimbursement. The mechanism is that, if the borrower repays regularly and on time month after month until the end, Mozzeno will pay him back 20% of the administrative fees received.

Then, and still from the investor's perspective, we wanted to know Mr. Laoureux's view on the new class of assets proposed by Mozzeno compared to the more traditional classes coming from financial institutions. His response took the form of a graph with two axes: volatility and yield; this new class of assets would be located somewhere in the middle range. Between on the one hand, assets that are extremely volatile like stocks, and on the other hand, assets that are stable but with low returns, such as government bonds, term accounts and savings accounts.

In terms of liquidity, Mr. Laoureux highlighted the complexity of setting up a secondary market as the volumes traded are currently too low. However, the mechanism used by Mozzeno is based on gradual liquidity[70], which means that every month the borrower reimburses a part of the principal and a part of the interests, and these reimbursements are directly returned to the investors. In order to illustrate that, Mr. Laoureux used a simple example: if an investor places 1,000 € in a 12-month Mozzeno loan, he will receive 1/12 of 1,000 €, plus 1/12 of the interests back each month. This is why it is called gradual liquidity.

Regarding the idea of creating an auto-diversification tool, as is the case in most of the peer-to-peer platforms abroad (cfr supra p56.), Mr. Laoureux is very skeptical as this mechanism currently has many disadvantages because of the legislation in place. He explained that a fund first has to be created, and with the very strict regulation that applies to it, it is almost impossible for a platform to manage the high costs associated with the options. And then, Mozzeno should require that an investor risk profile form be completed, and based on that form, the platform could recommend specific types of loans to their investors[71].

[70] Gradual liquidity is completely different from bonds or stocks.

[71] Directive 2004/39/ EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directive 85/611 / EEC and 93/6 / EEC and Directive 2000/12 / EC of European Parliament and of the Council and repealing Council Directive 93/22 / EEC (abbreviated generally as the Markets in Financial Instruments Directive, hereinafter referred to as the MiFID Directive) was transposed into Belgian law on 1 November 2007.

2.2.4 Vision about the future of the consumer lending-based model

About the future of this model in Belgium, Mr. Laoureux strongly believes that new comers on the market have a much easier task now. As Mozzeno was the first one in Belgium, it took 18 months for them to obtain their approval from the FSMA. Mozzeno had to obtain the approval to be a lender in consumer loans, which is no easy feat according to Mr. Laoureux. And then they had to publish a prospectus, which requires at least six months worth of work and implies significant human and financial resources.

Nowadays, new comers to the market only have to mention that their models are similar to Mozzeno's in order to receive approval from the FSMA. Nevertheless, Mr. Laoureux considers that potential new comers represent a positive factor for the sector. Mr. Laoureux read several studies conducted abroad that state that entering a market where competition already exists allows faster growth compared to entering a market where there is none yet. Precisely because the maturity of the market and the product know how are higher.

All things considered, Mr. Laoureux finds it difficult to predict the development of the Mozzeno platform, but he considers it at this stage as no more than an alternative among others. According to him, it is far too early to pretend competing with banks. He believes that banks are very vigilant about fintechs as a whole. Thus he believes that fintechs will not be able to replace banks, as these have the financial capacity to buy many of them back if they feel that the situation is threatening and somewhat out of control.

2.3 Summary & Analysis

Throughout this second chapter, we reported the state of the current situation in terms of scope and positioning of two platforms: Look&Fin and Mozzeno. Both platforms obviously have different opinions as to which model is most likely to develop in Belgium.

A further highlight of the interviews we conducted was to discover that for both platforms, the determining factor for the players (especially for the investors) appears to be the

financial aspect. Actually, it is not exactly surprising as we already discussed this striking fact in the context of the survey conducted by Baeck & al. (2014) (cfr supra p.36). Investing in the real economy, or investing according to ideological beliefs also plays in favor of peer-to-peer platforms, but only comes in as second. As a rule of thumb, the investors are more focused on diversifying their portfolio. On the Mozzeno platform, they have the opportunity to invest in a multitude of notes ranging from A (less risky) to D (more risky). Look&Fin also encourages investors to invest in several SMEs with different ratings, ranging between A (less risky) and E (speculative). Furthermore, besides the diversification specific to the platform model, a diversification is also possible within a more classical portfolio (stocks, bonds, etc.).

Still from the investor's perspective, we tried to situate this type of investment against other standard investment opportunities by asking the point of view of the Belgian platforms. Both pointed out that it these are not easily comparable in terms of risk-return and liquidity, and that it also depends on the grades chosen by the investors. However, assuming a diversified portfolio is being held, on a graph with two axes (volatility and yield), the product proposed by both Look&Fin and Mozzeno would be located somewhere in the middle. It is interesting to mention that the Oxera study (cfr supra p55.) made the same observations, as they placed peer-to-peer lending between stocks, that are extremely volatile, and government bonds or saving accounts, that are much more stable but with lower returns.

Where liquidity is concerned, none of the two Belgian platforms envision a secondary market in the short to medium term. However, both have found a way of working around this issue to a certain extent by proposing an alternative to the secondary market. Look&Fin has opted for providing transferable loans[72], which means that the investor may withdraw at any time, if he spontaneously finds another investor to take over the loan. Mozzeno decided to offer gradual liquidity[73], which means that every month the borrower reimburses a part of the principal and a part of the interests, and these reimbursements are directly returned to the investors.

[72]Thanks to the regulatory framework in France.
[73]It should be noted that Look&Fin also proposes the gradual liquidity.

Now from the borrower's perspective, after reviewing the studies, our interviews and our intuitions, we wanted to share our strong belief that peer-to-peer consumer lending is the one area where banks are most vulnerable to competition from online platforms. First, after interviewing the platforms, we put forward that they are basically taking a different approach to determining the credit profile of businesses and individuals borrowers on online platforms. Indeed, it seems that peer-to-peer business platforms target companies denied by financial institutions, or SMEs that want to apply a leverage effect on banks. While peer-to-peer consumer platforms are not specifically searching for individuals previously denied by banks[74], as these borrowers could considerably increase the default rate, and thus negatively affect the reputational risk. Furthermore, we can support the view outlined by the Nesta survey, considered in the first part of our thesis (cfr supra p.54), that credit acceptance rates were relatively similar when an individual borrower sought funding from banks, and at the same time requested an online loan on a peer-to-peer consumer platform. On the contrary, a businesses borrower receives different credit rate acceptance depending on the form of funding. Indeed, a small part of these business borrowers who have raised money on platforms, were actually previously granted similar loans by banks.

All in all, we can interpret these results to mean that peer-to-peer platforms and banks operate with different credit models for business loans; at the same time, peer-to-peer platforms are diverting some customers away from banks in the unsecured personal loan field[75].

Another approach to support our view could be to take a look at the interest rates charged to a borrower on platforms and by banks. Look&Fin clearly provides rates[76] to SMEs that are well above those proposed by banks. This makes sense to us, since Look&Fin is specifically targeting companies denied by banks, and thus considered as too risky in the present state of affairs. For Mozzeno, the situation seems to be different as they pay particular attention to the borrower's rate. Indeed, according to Mr. Laoureux, they continuously try to offer a competitive rate to their borrowers, in accordance to the risk-reflective concept. In consequence we consider that this potential competition

[74]The law book seven forbids this practice.
[75]Unsecured loans are not tied to any asset that the lender can take if you default on your loan payments.
[76]The average interest rate was at 7,81% on 17 July 2017.

between banks and peer-to-peer platforms could benefit consumers, as it could result in the emergence of unsecured personal credit availability while at the same time lowering costs.

As peer-to-peer consumer lending appears to be the most potentially disruptive model, we will discuss this alternative finance model in more detail by bringing forward and analyzing the potential reasons behind the current prohibition of this system in Belgium.

Chapter 3

Potential reasons behind the prohibition of peer-to-peer consumer lending in Belgium

As we have already mentioned, peer-to-peer consumer lending is prohibited in Belgium. In this chapter, we discuss the current legislation in Belgium and its consequences on the development of peer-to-peer consumer lending platforms. Moreover, we investigate a potential change in the legislation and regulatory changes required in order to authorise peer-to-peer consumer lending in Belgium. Finally, we illustrate the opinion of supervisory authorities regarding this alternative form of finance from the consumer's perspective.

3.1 The current legislation in Belgium

In this section, Mrs. Catherine Houssa (Simont Braun law firm) reminded us of the importance of the "repayable funds" (cfr supra p.46) notion by explaining that the Belgian State protects investors by leaving the monopoly of repayable funds to the banks. She insisted that the notion of repayable funds is something that could be eminently dangerous. Indeed, banks have capital requirements in order to be able to reimburse the funds, and as she said, it is unthinkable that a platform may be able to benefit from this monopoly and have the opportunity to use those funds without being in a position to reimburse them in case of financial issues.

As she said, in peer-to-peer lending platforms, only borrowers and lenders are directly involved in the loan contract, not the platform. As a result, we could fall outside of the repayable funds notion if we applied the same exception as for legal persons. Indeed, companies are allowed to make public offers if they issue debt securities in return for the collected repayable funds with respect to the Prospectus Act. According to Mrs. Houssa, there are two solutions to overcome the legal obstacle faced by peer-to-peer consumer lending. The first consists in a change in the current legislation by extending the exception to physical persons. The second is about the indirect peer-to-peer lending model

(cfr supra p.49), which is an alternative currently used by the platform Mozzeno in Belgium.

Mrs. Houssa explained that if we extend the legislation to physical persons, questions regarding the legislation on consumer credit regulation come up immediately. Indeed, in order to have a credit agreement within the boundaries of the CDE[77], there must be a "lender", who is legally defined as a person who contracts a credit agreement as part of his commercial or professional activities. Therefore, lenders on P2P lending platforms are not considered as "lenders" as their activity is not driven by commercial or professional purposes.

3.2 Consequences of the non-access to the Central Individual Credit Register

The fact that the peer-to-peer lending activity does not fall within the consumer credit regulation could have potential negative consequences on its development in Belgium. As Mrs. Houssa mentioned, even if this regulation imposes heavy constraints on those "lenders", it legally allows them to consult the database of the Central Individual Credit Register[78]. These lenders have the obligation to consult this database before granting a loan, but they are the only institutions that have access to it. In order to illustrate the consequences, we will highlight the opinion of Mrs. Houssa and Mr. Zurstrassen.

3.2.1 The evaluation of the borrower's creditworthiness

Mrs. Houssa mentioned that the non-access to this database could considerably weaken the peer-to-peer lending model. Indeed, as we have already explained in the first part of this thesis, the default risk (cfr supra p.21) is the main risk of this activity. Even if the statistical tools used to compute the default risk are constantly evolving, the lack of access to a database that registers all loans contracted by physical persons for private purposes is a real issue. If the regulation changes and P2P consumer lending is permitted, we will be forced to extend the new regulation by giving access to the CICR to platforms. Without

[77] Code de droit économique.

[78] Legally regulated in Chapter 3, 7th book of the CDE. The central individual credit register is a database composed of all credit agreement contracted by physical persons for private purposes as part of the CDE. Default of payment are also registered in this database. (Houssa, 2016)

this access, platforms would have difficulties evaluating the borrower's creditworthiness. Mrs Houssa mentioned that evaluating the creditworthiness is a legal duty for the lender. However, there is no restriction regarding the way the lender has to calculate the risk.

Furthermore, she underlined what Mr. David Raes mentioned in his book[79]: if we permit the development of peer-to-peer lending without giving access to the Central Individual Credit Register to platforms, a real shadow banking could be created. Nevertheless, platforms could legally ask borrowers for an extract of their data as it is recorded in the database. However, this process is heavy and there is a risk that borrowers will deliberately modify their data in order to increase their chances of contracting a loan.

Regarding Mozzeno, the only platform in Belgium that proposes an online indirect peer-to-peer consumer lending model, Mrs. Houssa explains that through this system they fall within the exception of the Prospectus Law and are legally considered as "lenders". Therefore, they have access to the CICR.

3.2.2 Data privacy

Mr. Zurstrassen, for his part, considered the non-access as a huge obstacle for the development of peer-to-peer lending platforms in Belgium. He mentioned the presence of two types of countries in Europe: those that are obsessed with data privacy and others that appear to be more tolerant. For instance, it is much easier to compute an individual financial risk in the UK and in Scandinavian countries. In Belgium, it is simply not possible to have access to individuals' financial data, but only to information related to their companies. Due to this significant obstacle, without individual financial profiling, platforms cannot have an accurate idea of the potential default risk they face.

Furthermore, he mentioned the coming into force of the directive regarding personal data protection in the EU that will be applicable as of May 2018[80] . As he said, the objective of this reform is to give European citizens the ability to regain control over their personal data. Every citizen will have the choice to make their information public or to

[79]RAES D. (2015). "Le peer to peer lending en droit belge – Espoir ou désespoir ?" in Digital Finance/La finance numérique, coll. Cahiers AEDBF/EVBFR Belgium, Limal/Anvers, Anthemis/Intersentia.

[80]General data protection regulation (GDPR)

keep it private. Mr. Zurstrassen logically deducted from this that individuals with nothing to hide would make their financial information available to the public, while those with financial issues will keep it private. As a result, he insisted that there is no mechanism in place to allow you to assess the risk of an individual, which is a huge obstacle for the development of peer-to-peer lending platforms.

In addition, another European directive on the payment services (DSP2) related to personal data protection will also be applicable in 2018. With this new regulation, access to banks savings account by third parties (fintechs) will be permitted. The freedom of bank clients to dispose of their banking data would force banks to make those data available to third parties. The goal is to stimulate competition and innovation in the financial sector. As the interviewer said, thanks to this new legal framework, fintechs will be able to interrogate the banks exclusively on two questions. They will be allowed to ask banks if someone is client in their institutions and if so, they will be able to obtain information on the client's bank account balance. As far as Mr. Zurstrassen is concerned, this new framework will be not overly effective, as banks could decide not to cooperate and therefore make the process heavy and slow.

3.3 Towards a change in the legislation?

In order to illustrate if the legislation is likely to change in the future, we decided to point out the opinion of Mrs. Houssa regarding the adoption process of new laws and how peer-to-peer consumer lending could be permitted in Belgium. Before imagining that one day the legislation around peer-to-peer consumer lending might change, Mrs. Houssa reminds us of the process of passing new legislation in the financial sector and the changes required to enable this model. Furthermore, Mr. Christophe Majois (FSMA) stresses the significance of a well-structured legal framework. Finally, Mr. Tom Van den Berghe points out that the legislation could change sooner than expected.

3.3.1 The adoption process of new European laws

As Mrs. Houssa mentioned, Belgium participates side by side with other European countries to the elaboration of new rules. When a European directive is voted, countries have

a certain timeframe to implement the directive into their national law. For Belgium, once that is done, the new European directive is translated into the Belgian law and this directive can no longer be significantly modified. The flexibility given to European countries is extremely low. As a rule of thumb, she insisted that the only thing countries are allowed to be is more severe, which is called "gold-plating".

The Prospectus law is directly linked to Europe. In this case, it was Belgium that decided to be stricter than the other European countries regarding peer-to-peer lending. But, as she said, what is quite annoying is that Belgium has decided to apply "gold-plating" almost on every European financial legislation.

3.3.2 New opportunities often bring risks

According to Mr. Majois, the peer-to-peer lending model can bring new opportunities for both lenders and borrowers. As regards borrowers, the lack of access to credit from banks can lead them to look for another financing alternative. For the lenders, platforms offer them the opportunity to invest in a new class of assets that has never existed before. As new opportunities often bring risks, Mr. Majois stated that a potential change in the regulation has to take those risks into consideration. For instance, on the one hand, the potential risk for borrowers is that the interest rates might be higher and that they would find themselves in an unsustainable level of debt. On the other hand, the potential risk for lenders is to not fundamentally understand the nature of the agreement, and therefore to not be able to correctly evaluate the risks-faced.

As he reminded us, a legal framework for crowdfunding exists in Belgium, and the challenge is to try to understand to which extent peer-to-peer lending will develop if the legislation authorizes it.

3.3.3 Physical persons as an exception to the law

As Mrs. Houssa explained, two solutions to overcome the legal obstacle exist, including a change in the current legislation by extending the exception in place for legal persons to physical persons. The new legal framework will allow physical persons to make public offers if they issue debt securities in return for the collected repayable funds with respect to

the Prospectus law. This current exception allows companies to make public offers without this principle of "repayable funds". Therefore, she mentioned that it would be sufficient to add "physical persons" in this exception in order to allow peer-to-peer consumer lending in Belgium. As far as she is concerned, a change in the law will happen sooner or later.

Furthermore, Mr. Majois mentioned the article of Mrs. Veerle Colaert[81]. According to this article, the Prospectus law has to be modified. That being said, if we extend the exception to physical persons, individuals will be able to make public offers but the legal framework ends here. As he said, with this change, individuals will be able to borrow money without a legal framework to regulate the agreement. Therefore, we find ourselves in a system parallel to the current legislation on consumer credit. He mentioned that the FSMA and the government will probably not authorise this as platforms would not have to respect any legislation and moreover, they would not have access to the CICR, which is an important tool in the handling of indebtedness. As a result, if we decide to change the legislation regarding physical persons, we have to add another legal framework in order to protect the borrowers, so that interest rates do not become excessive, and their credits are registered in the CICR. Besides that, lenders should be protected and be able to obtain enough information regarding the exact nature of the investment. To conclude, Mr. Majois thinks that a more general legal framework should be created if we were to allow physical persons to make public offers. And as it logically appears to him, the new legal framework should be very close to the current legislation for consumer credit as they are very similar.

Notwithstanding the above, the legislation could change sooner than expected as Mr. Van den Berghe from Febelfin explained to us. Indeed, in May 2017, minister Mr. Kris Peeters[82] held discussions with several institutions regarding the peer-to-peer lending sector in Belgium. More precisely, regarding the position of Febelfin on this new form of funding. Mr. Van de Berghe maintains that the idea seems to be on the minister's agenda.

[81] Colaert V. (2016). On the absence of Peer-to-peer Lending in Belgium. Journal of European Consumer and Market law.

[82] The current minister of the economy and employment in Belgium.

3.3.4 A new Prospectus law

As we have discussed during the first chapter, the maximum amounts authorized in Belgium for raising money and for investing are very low. As Mr. Majois mentioned, a new prospectus regulation will soon be established at the European level. The amounts will be higher, roughly speaking around 1.000.000€ but the regulation still has to be adopted by Belgian law.

3.4 A principle of caution or potential bank lobbying?

In this last section, we present the opinion of Mr. Christophe Majois and Mr. Tom Van den Berghe, both working for Belgian supervisory authorities. More particularly, we will review the effect of overprotection of consumers as well as potential lobbying from the banks.

3.4.1 Overprotection of consumers?

Mr. Majois explained to us that the FSMA has, besides the role of protecting the consumers and the markets, a role in analysing trends and vulnerability of the markets. The FSMA conduct their analysis through meetings with the main actors of the sector. If the FSMA notices risk for the consumers, an action plan is proposed to the governments and potentially even a draft legislation. In the case of peer-to-peer lending, as Mr. Majois said, there is no risk for the consumers, except for the risk of not obtaining a credit in Belgium, which is not the case. Indeed, he mentioned that if the FSMA becomes aware of some risks in this sector, such as too many loans granted, or loans with excessive interest rates, which increase the risk of indebtedness, they would probably propose an intervention. But we do not observe this at the moment.

Regarding “Gold-plating”, Mr. Majois mentioned that we needed to be careful with this concept. Indeed, when engaged in discussions, the sector has a tendency to find that the rules are often too strict, but when we look at the facts, there are very few elements that fall within the notion of “Gold-plating”. Furthermore, Mr. Majois highlighted the current

project of an ongoing cooperation between fintechs, banks, regulators and academics that would seem beneficial for the sector.

3.4.2 Potential lobbying from the banks?

The majority of the actors interviewed mentioned the potential lobbying by the banks of the development of peer-to-peer lending in Belgium. This is the main reason why we decided to meet with Mr. Van den Berghe from Febelfin, in order to understand if the Belgian association of the financial sector was against this potential development. During the interview, Mr. Van den Berghe outlined his opinion and went through the letter prepared by Mr. Kris Peeters with us.

Febelfin claims that peer-to-peer lending can be considered as a complement to the traditional bank financing and providers of venture capital. Indeed, we can observe many partnerships between banks and platforms in other countries, in which the experience and expertise of banks seems to be able to work side by side with the flexibility of the innovative platforms. According to Mr. Van den Berghe, peer-to-peer lending models are interesting at first glance because the interest rates could be higher for the investors but this could therefore also imply more risks. It is critical that consumers be made aware of those risks. He claimed that there is a legal framework for each regulated loan[83] in order to protect the consumers. For instance, consumers can benefit from the services of Ombudsfin[84], which is a significant protection for them, as is not the case for the platform's clients[85].

As a result, he said that Febelfin is not against the development of peer-to-peer platforms, but they insist that a regulatory framework must be adapted as platforms offer services that are comparable to the credit offered by banks. The regulation, the protection and the supervision should be similar in both cases. He mentioned the constraining regulation for banks and suggests that the same regulation should apply to peer-to-peer lending platforms.

[83]There are three types of regulated credit which are mortgage loans, consumer credits and business credits.

[84]Each client of a financial institutions that act as a physical persons for private purpose can ask for the services of Ombudsfin.

[85]As we have already mentioned, platforms are not legally considered as "lender", therefore, they do not fall within the consumer credit regulation.

3.5 Summary & Analysis

We believe that an appropriate regulation is extremely important for the development of the peer-to-peer lending sector. To support this position, we will first compare the current regulatory regime between the market leader in Europe, the UK, and Belgium. Then, we will discuss our thoughts regarding the legislation and its potential change.

3.5.1 A comparison between the current legislation in the UK and in Belgium

We propose to compare the legislation implemented in both countries, the UK and Belgium, as we think that the future development and success of peer-to-peer lending will depend a lot on an appropriate framework. Indeed, as a new form of investment, peer-to-peer lending should have a legal framework and be supervised in order to protect investors. The UK registers a huge development in this innovative sector compared to Belgium, and therefore, it is interesting to consider both sides of the regulation.

The first difference between these legislation is the fact that the UK has implemented a legal framework specific to peer-to-peer lending, which is not the case in Belgium. In Belgium, the law of December 18, 2016 regulates crowdfunding, including all types of platforms on which financial investments can be made, but there is no specific legal framework around peer-to-peer lending. In the UK, peer-to-peer lending is regulated since April 2014, and since then, regulators are continuously carefully reviewing this innovative form of financing. UK regulators have the objective of ensuring the supervision of the sector without disrupting financial innovation such as peer-to-peer lending, that provides loans to borrowers who sometimes are unable to borrow from banks.

As we have already mentioned, peer-to-peer consumer lending is prohibited in Belgium, contrary to the UK, where there is a legal framework for it. In the UK, platforms have to apply for an authorisation and have to respect several rules. In Belgium too, “crowdfunding platforms” have to submit an application to the FSMA to obtain the authorisation to actively commercialise financial instruments.

Their highest priority of the UK's regulators is to correctly balance operational risks and customer protection. Indeed, platforms are legally obligated to release appropriate pre-contract information: key risks faced by the borrowers, and the opportunity for investors to withdraw their money within 14 days.

In Belgium also, information has to be released to investors for their protection. Platforms must inform potential investors of the main characteristics of the categories of investment instruments they sell, in order for investors to be in a position to understand the nature of the investment instrument, as well as the related risks, including, where applicable, the specific costs and risks associated (Art.24 of the law of the 18th of December 2016).

Furthermore, in the UK, platforms need to meet a minimum capital requirement, so they have back-up plans in place in case of bankruptcy; these plans will ensure that if they fail, their current loans will continue to be handled and administered by another firm (cfr supra p.41). This requirement is a measure designed to reassure investors. In Belgium, if we examine the consequences of a potential brankruptcy of Mozzeno,we note that the rights of Noteholders may become uncertain and reimbursement of the notes may be limited, suspended or cancelled[86].

As we can notice, the UK has stepped ahead of legislation. We are completely aware that the UK market is so much significant that it required a legal framework but we cannot deny that this continually monitoring of the regulation is favourable for its development. The FCA discuss the existing regulation and requests the peer-to-peer lending actors to immediately participate in the regulation review, which allows them to monitor the market and to build an efficient legal framework.

In Belgium, in order to build a well-structured framework, we encourage discussions between every key stakeholders of the sector. As Mr. Majois informed us, there is a current project of an ongoing cooperation between banks, regulators, fintechs and academics in Belgium and therefore, we recommend a similar approach if a change occur in the legislation.

[86]Information extracted from the prospectus of Mozzeno published on its website.

As the FCA protects consumers, it requires platforms to have systems and controls in place to mitigate the risks. The Financial Services and Markets Authorities should also investigate for the potential risks regarding the consumers the day the legislation will authorise peer-to-peer consumer lending. As Mr. Majois highlights, new opportunities often brings risks, and therefore, it is paramount to protect both investors and borrowers. As a result, if a change occurs, we think that FSMA will investigate the potential risks and will take proper action in order to protect the consumers.

3.5.2 Modification of the legislation

As Mr. Van den Berghe mentioned, the case of peer-to-peer consumer lending seems to be on the minister's agenda. Therefore, we assume that a change in the legislation will occur in the future. Regarding the modification in the Belgian law, we also agree with Mrs. Houssa that we should add an exception for physical persons to the Prospectus law. Indeed, it does not seem appropriate for us to leave platforms deal with repayable funds as they have not similar regulatory requirements than banks. Furthermore, we strongly support the idea that it should not be the only modification in the legislation, and therefore, another legal framework should be implemented to protect borrowers and lenders. First of all, we should simultaneously allow platforms to get access to the CICR, as it appear to us essential for their future development. Of course, the access to the CICR will probably never be allowed to individuals, it must be the platform that need to be in charge to look into the CICR. On the one hand, the access to the CICR will protect borrowers and investors but also will give platforms the opportunity to assess the borrower's creditworthiness. Indeed, without this tool, a correct evaluation of the borrower's financial risk appear to be very challenging. Moreover, we share a common vision with Mr. David Raes on a potential shadow banking if we reach decision to authorise the consumer lending without the loan's registration into the CICR. In order to tackle the over-indebtedness, we should avoid by all means to lend money to individuals with a significant indebtedness.

Regarding this new legal framework, it should be closed to the current consumer credit regulation in order to ensure a well protection for consumers. On the one hand, borrowers should be protected regarding high interest rates and should have the opportunity to

benefit from services such as those offer from Ombudsfin. On the other hand, investors has to clearly understand the nature of the agreement and all the risks involved.

Furthermore, in this chapter, Mr. Zurstrassen highlighted the coming into force of the directive regarding personal data protection in the EU (GDRP) and the directive on the payment services (DSP2). On the one hand, regarding the GDRP, we also agree with Mr. Zurstrassen on the fact that individuals with nothing to hide would make their financial information available to the public, while those with financial issues will keep it private. Therefore, people who will decide to keep it private will have more difficulties to access credit. On the other hand, regarding DSP2, we think that it will offer an opportunity to fintechs to develop, as they will have access to more information in order to compute the financial risk of their client. Nevertheless, Mr. Zurstrassen mentioned that this new legal framework could be not overly effective as banks could make the process heavy and slow.

In the last section of this chapter, we investigate a potential overprotection of consumers or lobbying from the banks as hidden reasons behind this prohibition. On the one hand, regarding the Febelfin's positioning, they told us that they were not against the development of this sector, as long as the regulation constraints are similar to those applying by the banks sector. Indeed, the Febelfin's letter addressed to Mr. Kris Peeters essentially highlights the risks arising from the peer-to-peer consumer lending rather than the potential advantages associated towards this new development. As both peer-to-peer lending platforms and banks do not offer similar product, we think that having such as heavy regulation is unreasonable. Indeed, with such requirements, platforms will probably not survive.

As far as we are concerned, it is paramount for us to accept that the world is changing as we currently leaving in a shared economy. Therefore, we believe that it is undeniable that new financial opportunities, such as the peer-to-peer consumer lending, should be legally permitted in Belgium. On the other hand, regarding the FSMA's positioning, they conduct analysis through meetings with actors of the sector and have the opportunity to propose an action plan to the government in case of risks for the consumers. As Mr. Majois mentioned, individuals in Belgium do not have issues to access credit and therefore, they do not argue for the development of another funding channel. Nevertheless, regarding

Mrs. Houssa, we have the tendency in Belgium to be more strict in the Belgian law than the european directive.

All in all, besides a potential overprotection of consumers or lobbying from the banks, we could highlight other reasons regarding the prohibition, such as the cultural one. Nevertheless, we do not consider cultural reasons as a real pretext of prohibition but more as an obstacle for the potential development of this market. That is the reason why, we will review, in the next chapter, factors that could explain the limits of the peer-to-peer lending as a whole in Belgium.

Chapter 4

Analysis of the opinion of banks on peer-to-peer lending and its potential development in Belgium

Previously, we had the opportunity to discuss the current peer-to-peer lending market in Belgium from the platforms' perspective. Then, we analysed the legislation and discussed a potential new legal framework. We also highlighted some potential reasons hidden behind the prohibition of peer-to-peer lending.

In this chapter, we collect the opinion of banks on this new innovative sector. Moreover, as we believe that the law may change positively towards peer-to-peer consumer lending in the future, an obvious question that comes to mind is: will peer-to-peer consumer lending develop in Belgium if this change occurs? In addition, we investigate if peer-to-peer business lending, already in place in Belgium, could show a strong growth in the coming years.

4.1 Inside the banking sector

As we mentioned in the first part of this essay, peer-to-peer lending platforms could take additional market share in the lending industry in the future, at the expense of banks. After gathering the platforms' perception with regards to their role/positioning in the credit industry, we decided to meet with Mr. Hans Jacobs from BNP Paribas Fortis and Mr. Philippe Hugon from ING Group to capture their opinion on the view of banks.

4.1.1 A potentially disruptive impact

We were wondering if banks in Belgium were concerned about a substantial development of the peer-to-peer lending sector. First of all, Mr. Jacobs honestly tells us that the emergence of new crowdfunding platforms frightened him a lot more a few years ago. Indeed, three years ago the phenomenon was completely new and it blew a wind of panic on the banking sector, among other things, because of the exponential growth experienced

in the UK and the United States (cfr supra p.27).

In the short term, Mr. Jacobs thinks neither of the two models is really capable of competing with banks. Although it is obvious, according to him, that peer-to-peer consumer has the most potential, he thinks that it will be necessary to pay considerable attention to the reputational risks of the platforms for this sector to develop in the coming years. If some of them reach high default rates, this will likely soon become known and, as a result, we could see widespread panic with regards to this kind of financing. Nowadays, according to Mr. Jacobs, banks are much more concerned about other new technologies like online payments or the "wallet" system that are emerging in Belgium (cfr supra p.10).

Furthermore, Mr. Hugon explained that a department responsible for closely monitoring the Fintech sector has been set up within the ING Group. It is important to mention that since the creation of this department, they have never analyzed a crowdfunding platform. Indeed, according to him, Fintechs in Belgium have already understood that everything related to credit is complex and potentially dangerous, and above all, profitability is not guaranteed. Mr. Jacobs also noticed a growing number of Fintechs interested in m-commerce and online payment.

Besides that, as Mr. Hugon mentioned, peer-to-peer lending, and crowdfunding as a whole, is not seen as a threat by banks in Belgium but more as an opportunity/complement that is therefore not a substitute for the credit market of banks.

4.1.2 Partnerships between banks and platforms

A few years ago, ING Belgium conducted research to assess the potential of, and the interest in, investing in the capital of a crowdfunding platform. The results were unequivocal according to Mr. Hugon, because the profitability and the volumes traded in Belgium are too low. As a result, ING decided to favor partnerships with platforms (cfr supra p.66).

The choice made by ING to work exclusively with foreign platforms, such as the French platform KissKissBankBank or the UK-platform Seedrs, was not without significance. Mr. Hugon explained that, at the time they conducted the research, none of the Belgian

platforms came within their criteria, which were to be able to attract investors and manage a large number of projects. Subsequently, Mr. Hugon detailed the partnership between ING Group and the French platform KissKissBankBank. As he mentioned, it is a win-win relationship. Indeed, when a customer is denied credit by the bank for whatever reason, the bank has the option of offering the client the opportunity of obtaining financing through this platform, and therefore to keep the client satisfied with ING. When the bank directs a client to this type of channel, he believes that the request for financing is very likely to be accepted. As a result, the platforms will benefit from the projects referred by ING, as the clients have already been screened, as opposed to having to deal with direct requests that often imply a much lower acceptance rate. All in all, ING provides the financial risk analysis to the platform, which for its part, will look after ING's client applications. As a rule of thumb, this type of cooperation benefits platforms by decreasing their screening costs.

Where BNP Paribas Fortis is concerned, they work closely with Look&Fin, explained by Mr. Jacobs. He is hoping that this collaboration between his bank and the platform will continue in the future. He highlighted the fact that large companies can afford to provide financing by themselves by issuing bonds on the public market, while SMEs and startups cannot. Indeed, this financing system requires a significant structure, and implies management costs that are only bearable if the company has already reached a certain size. As a result, peer-to-peer business lending platforms benefit from the fact that SMEs can continue to provide financing themselves, despite the tightening of bank lending policies, by playing this role of leverage with the banks.

Furthermore, Mr. Jacobs added that we are probably moving towards a proliferation of partnerships between banks and peer-to-peer lending platforms. Another main point on which Mr. Jacobs wants to draw our attention is the low profitability of these platforms. Indeed, he believes that virtually all platforms in Belgium still suffer losses even after several years of activity. Therefore, he believes that one of the only ways to allow these platforms to continue operating is that financial institutions (and therefore banks) invest heavily in such platforms, as is the case in the United States and in the UK (cfr supra p.38).

4.2 Limits to the development of peer-to-peer lending

We saw a significant growth in the UK and in the United States of both peer-to-peer business and consumer lending since they were launched in 2005. In Belgium, when we analyse the market in detail, we observe only one platform actively operating in the business lending industry with relatively low amounts raised[87]. Moreover, regarding online consumer lending, there is only one platform that offers an indirect model and the amounts raised are very low too[88]. Therefore, we may consider that Belgium does not provide an appropriate environment for the development of this sector.

This section will outline several potential factors that may explain the current underdevelopment of peer-to-peer business lending in Belgium and may influence its future expansion. Even if it is challenging to address the foreseeable evolution of peer-to-peer consumer lending in Belgium, we will make assumptions on its potential development based on some factors that are common to the peer-to-peer lending industry in general, and others that are more specific to the consumer market. To this end, we will discuss the limits to the development of the sector with several different actors[89]. Besides those already mentioned in the previous sections, we collected the opinions of two Belgian economists, Mr. Bruno Colmant and Mr. Etienne de Callatay.

4.2.1 Supply and Demand

In order to better understand the various limiting factors, we decided to illustrate them by looking at both the supply and the demand forces in place around these new alternative finance markets. Indeed, several key stakeholders are necessary for the smooth functioning of the peer-to-peer lending sector, namely the platforms, the lenders and the borrowers. We thus make the assumption that if peer-to-peer consumer lending is no longer prohibited, new platforms will emerge[90].

[87] Look&Fin raised an amount of about €20.5 million in July 2017 (Look&Fin's website).

[88] Mozzeno raised an amount of about €200.000 in July 2017 (Mozzeno's website).

[89] We do not detail the actors such as the other section because of the large number of actors involved in this section.

[90] At least Mozzeno because they currently propose an indirect online consumer lending-based model and will probably modify their business model if the legislation changes in in the right direction.

4.2.1.1 Companies and professionals as borrowers on business lending platforms

According to Mr. Hugon, platforms proposing the equity-based model often encounter difficulties in finding investors, whereas platforms proposing peer-to-peer business lending have difficulty finding projects to finance. In this regard, he explained that platforms in Belgium raise funds in a few seconds but do not significantly increase the volumes funded through the platform.

According to Mr. Hugon again, the credit acceptance rate of banks did not significantly change after the financial crisis despite the establishment of Basel III. Indeed, he considers that the credit acceptance rate of banks is very high in Belgium for several different reasons. The first reason is that the quality of debtors is much higher in Belgium than in most other European countries. Companies and professionals generally have an excellent financial structure that makes them solvent. Then, Mr. Hugon noted that the industry/economy has demonstrated its resilience in Belgium, by recovering as soon as the financial crisis was overcome[91]. Third, the repayment behavior is rather favorable in Belgium, thus keeping the average loss truly moderate. According to Mr. Hugon, as long as the loss is under control, the overall environment remains serene.

On the contrary, Mr. Verdbois supports the idea that accessing credit is more difficult for SMEs since the crisis. In order to illustrate his statement, he mentioned a study[92] carried out in-house with the help of the Brussels Enterprises Commerce and Industry (BECI) that shows that around 60% of SMEs in Brussels are facing difficulties in obtaining funding from banks since the crisis. As a result, according to him, there is an enormous amount of space in the credit market where alternative financing could develop, but that would require some form of encouragement.

The legislation, which is currently an obstacle to this development, could be changed to encourage the sector, explains Mr. Jacobs. He maintains that easing the regulation can only be beneficial for the sector. He continues by saying that if you increase the maximum

[91] With the exception of a few banks.
[92] "Financement des PMEs" (BECI and Look&Fin, 2016)

amount loa ned per investor and the maximum amount raised per project, some companies that used Look&Fin to leverage banks could be 100% funded on the platforms; this would also require the creation of an efficient risk management system in order to offer attractive funding rates to SMEs (cfr supra p.56).

Belgium is a country with a relatively high bank culture. Indeed, as Mr. Van den Berghe and Mr. Jacobs mentioned, the American market is fundamentally different from the European market, as companies financed by banks represent only 20% in the United States, versus more than 80% in Europe (excl. the UK). Belgian companies are indeed mainly funded by banks.

4.2.2 Individuals as borrowers on consumer lending platforms

Regarding the individual borrowers in Belgium, Mr. Majois informed us that the FSMA is not aware of a potential risk of not obtaining a credit in Belgium. Indeed, at first glance, according to him, individuals seem not to have difficulties in accessing banks credit as the association for Consumer Protection makes no mention of it[93]. Even if Mr. Hugon does not deny that the financial crisis caused some concerns about mortgages. However, in general, the real estate market in Belgium is stable (unlike in the UK where it is highly volatile) and the bank's credit supply also offers alternatives that are more stable. Moreover, belgian households are relatively rich and therefore do not have the same level of funding requirements as other foreign households do.

In addition, Mr. Colmant gave us further details regarding the ratio loan to deposit, which is the amounts lent versus the amounts borrowed, that represents a country's relative debt position. This ratio in Belgium is relatively low, compared to other countries. He mentioned that it is one of the main reasons why banks have encountered issues in 2008 because of the amount of money that had not found domestic use. Indeed, as the demand in domestic loans was too low, banks had no choice but to invest in risky assets, such as the subprimes.

[93]When we mention that the credit accessibility in Belgium seems not to be difficult, it is only a comparison with other countries. We are aware that some individuals in Belgium have difficulties to access credit. Indeed, the legislation highly regulates consumer credits. For instance, a lender is not legally allowed to contract a loan with interest rates above 10% or to individuals that are registered at the National Bank with an unpaid amount of more than €1,000.

Mr. de Callatay confirmed Mr. Colmant's words by telling us that the Belgian households are relatively rich and are not very indebted. According to him, the economic aggregates[94] have different levels of indebtedness. The public sector is relatively indebted, just above the European average. The companies sector, for its part, is strongly indebted, but those figures should be taken with a grain of salt as many companies have their activities in Belgium because of the notional interests[95]. As to consumers, they appear to be relatively rich as they have a low level of indebtedness, even though a large proportion of them owns real estate property[96].

Furthermore, the legislative framework in Belgium around consumer loans could also be seen as an obstacle. As Mr. Hugon mentioned, the legal framework is very tight for consumer loans in Belgium. If a change occurs in the law, it will thus be necessary to consider the context in which peer-to-peer consumer lending develops, since the legislative context is very binding for the banks. Moreover, since the new Book Seven of the minister[97], banks have become really limited in their ability to grant loans to individuals. Indeed, if the individual applying for credit has had repayment issues with a consumer credit, and is therefore filed with the national bank, the banks can no longer grant a credit to that individual[98]. In addition, Mr. Hugon insists that the consumer loan market is truly confidential in Belgium compared to the UK for example. He also mentioned that the consumer loan market in Wallonia and Brussels is mainly composed of the funding of vehicles. As he said, if we were to remove the funding of vehicles from the consumer loan market, there would be almost nothing left. In the UK, a system of credit cards with large cash reserves is in place (for instance, to finance lifting machines) which is not the case in Belgium.

[94] Three economic aggregates; the public sector, the companies and the households.

[95] The "notional interest deduction", also known as the "tax deduction for venture capital", is an innovative and stimulating measure in International tax law. All companies subject to the belgian corporate tax have the ability to deduct from their taxable income a fictitious interest calculated on their own funds (net assets). (Service Public Federal Finances, n.g).

[96] We make the assumption that being an owner of a property often requires a mortgage loan.

[97] Code de droit économique - Livre VII : Services de paiement et de crédit.

[98] *"In the case of the consumers, an unpaid amount(s) is (are) registered in the CICR of an unpaid total amount of more than 1.000€ in the framework of a consumer credit which have not been repaid, a lender may not contract another loan. In the other cases of unpaid defaults, a lender may not conclude a new credit contract only with a supplementary justification of this credit"* [Our translation] (Book 7 of the CDE)

4.2.2.1 Investors on the peer-to-peer lending market

The main motivation of investors on peer-to-peer lending platforms is pecuniary (cfr supra p.36). Therefore, a substantial number of Belgian investors will accept to move their money from bank deposits to peer-to-peer lending platforms in case of higher interest rates that are risk-reflective. Moreover, Belgium has established fiscal incentives to support investments in crowdfunding platforms and in the development of startups[99]. As we have already highlighted in the third chapter, the legal framework does play a significant role in the potential evolution of this sector. Also, consumer credit seems to have a bad reputation in Belgium, as Mr. Laoureux mentioned. As a result, there are many obstacles in Belgium that potentially limit the growth of this industry.

Regarding the Tax shelter (cfr supra p.32), Mr. Verdbois confided to us that he was of a mixed opinion. Indeed, the tax shelter covers two components: equity-based crowdfunding and lending-based crowdfunding. On the one hand, Mr. Verdbois thinks that the tax shelter is very well adapted to the equity-based system, but not to the lending-based component. Indeed, equity-based crowdfunding allows to truly support startups. On the other hand however, Mr. Verdbois pointed out that with this tax incentive system, the fact that loans to startups are encouraged by the state through lending-based crowdfunding is very dangerous. Indeed, this system allows startups to pay interest on a monthly basis, but to repay the principal only at the end of the term. However, even after 3 years of activity, startups rarely have the capacity to repay the principal. As a result, this could put the entire sector at risk. Mr. Verdbois is therefore of the opinion that the tax shelter should be extended to SMEs and that the withholding tax (30% in Belgium) should also be reduced/eliminated or harmonized throughout Europe on this type of investment.

Regarding the tax incentives that a regulatory regime can offer, such as the tax shelter in Belgium, Mr. Jacobs argues that they are not necessarily mandatory for the development of a sector, as long as the legal framework put in place is truly efficient. He is not a fervent supporter of a major intervention by the state, as he believes that the risk with the tax incentives is that, the day they are removed, people will massively withdraw their money from these investments, causing a rapid collapse of the market.

[99] Platforms with the FSMA's authorisation.

Mr. Verdbois also indicated that it is mainly at the level of the regulator that changes must be made in order to give the market a chance to grow. Belgium is one of the most backward countries in this respect, and he regrets the lack of harmonization across Europe (cfr supra p.50). For instance, he pointed out that Belgium is the country where the limits are the most stringent: the maximum amount one is allowed to invest per project is € 5,000 and the maximum amount raised per project is € 300,000 without the establishment of a prospectus. He finds it inconsistent with the rest of Europe where, for instance, in Holland those two amounts are respectively of € 80,000 and € 5,000,000!

Mr. Jacobs also maintains that easing the regulation can only be beneficial to the sector. However, he considers that a change in regulation is not enough, and that the platforms must put a very efficient risk management system in place, in order to reduce the risk and thus be able to offer more attractive funding rates.

Mr. Laoureux also mentioned the legislation as an obstacle for the development of the sector. As he explained, platform Mozzeno is subject to consumer credit law, which is very restrictive and does not allow much flexibility because of its significant protection of the borrower. In Belgium, interest rates are limited to 10%, which is good news and bad news at the same time. On the one hand, it allows to fight indebtedness, but on the other, it prevents the part of the population with a credit risk superior to 10% from having access to credit. Therefore, as Mozzeno cannot legally lend to individuals with an interest rate superior to 10%, the platform is unable to reach a part of the population that could potentially be interested by a consumer loan.

Mr. Laoureux also insisted on Belgian culture and mentalities being part of the problem. On the one hand, consumer credits have a bad reputation. Indeed, when people think about consumer credit, things like loans for mobile phones or televisions immediately come to mind. On the other hand, lending between individuals also has a poor reputation. Many people believe that these loans are destined to “bad borrowers”, already registered with the National Bank. As is described in book 7 (art. VII. 77 §2.), people with 1000€ of consumer credit outstanding, are not allowed to borrow any more. The only solution they have is to rely on illegal credits between individuals. But as a regulated

lender, Mozzeno does not have the right to lend to these people either. That being said, people often believe that platforms lend to people who are listed at the National Bank and therefore represent a risk. He is truly of the opinion that an in-depth, evangelical effort has to be extended in order to change mentalities and allow this sector to develop.

Mr. Jacobs brings forward another cultural factor as an obstacle for the development of the peer-to-peer lending sector. He does not consider that access to credit through a bank is more difficult beyond the Atlantic. He justifies his reasoning by the fact that the American population is less risk-averse than the Belgians. The financial institutions that propose sophisticated financial instruments are much more powerful than banks, as the Americans are not afraid to invest their money in this kind of higher return investments, thus diminishing the importance of banks in the economy. On the other hand, Belgians are more cautious and have an extreme confidence in the banks; they therefore prefer to leave their money on savings accounts that yield nothing, but where their money is safe.

Indeed, as Mr. Laoureux confirmed, the notion of risk is completely different in the Anglo-Saxon countries where individuals are ready to take more risks. On the contrary, Belgian people are far less open to risk and this results in considerable unproductive amounts of money sleeping on bank savings accounts. As he said, there is also a strong culture of the bank in Belgium, where most individuals who need funds will turn to their bank to obtain a credit.

Finally, Mr. Jacobs is convinced that if peer-to-peer lending does not start to seriously develop in Belgium today, there is no saying when and if it ever will. Today, Belgians leave their money on savings accounts which yield absolutely nothing[100]; the day the credit environment normalizes and the rates start rising again, Belgians will have no incentive whatsoever to invest their money elsewhere.

[100]They even lose money because of inflation as it is explained by Mr. de Callatay during the following subsection.

4.2.3 Cost sensitivity on interest rates

In the previous subsection, we highlighted the different reasons that may explain the current under-development and the potential future evolution of peer-to-peer lending in Belgium. In order to attract investors, interest rates should be risk-reflective. But at the same time, they should not be too much higher than those offered by banks, for fear that borrowers make the comparison and decide not to borrow. In the first part of our work, we raised questions regarding the attractiveness of the business model[101] of both banks and peer-to-peer lending platforms, related to the relative sensitivity of their costs on interest rates when they grant a loan. As Mr. Jacobs mentioned, if peer-to-peer lending does not start to seriously develop in Belgium today, he does not see when it could happen. To clarify this, we asked several questions to Mr. Colmant and Mr. de Callatay in order to find out if according to them, banks have a potential competitive advantage on platforms due to their sensitivity on interest rates.

As Mr. de Callatay reminded us, the business models of banks and peer-to-peer lending platforms are completely different from each other. Indeed, what is important to banks are both the intermediation margin and the transformation margin. Because of the difference between the borrowing rates and the lending rates, banks benefit from an intermediation margin, as their usual margin. Furthermore, banks benefit from a transformation margin, as they take out short-term borrowings and they lend for a long period, due to the positive slope of the yield curve. Therefore, banks are funded by deposits remunerated by low interest rates, and they lend at the highest possible rate for a longer term. As a result, banks charge their loans depending on the funding price and on their margin, which is completely different from the business model of platforms, that typically request fees for their services.

According to Mr. Colmant, this “cheap funding” that banks benefit from is a huge competitive advantage. Moreover, besides this “cheap funding”, banks have extraordinary statistical tools to measure the associated risk. These two things represent significant advantages for banks against peer-to-peer platforms. In addition, Mr. de Callatay estimates that banks benefit from a unique expertise. Indeed, the peer-to-peer lending model, where

[101] For unsecured consumer loans.

loans are funded by Belgians for Belgians, is limited in terms of cultural diversity and diversification[102]. Nevertheless, Mr. Colmant believes that peer-to-peer lending platforms have beautiful days ahead of them because of this new emerging ecosystem. This new ecosystem, characterized by the principle of decentralization, may very well be a real threat for banks.

That being said, the question is: *Will banks continue to benefit from cheap funding for a long time?*

According to Mr. Colmant, we will enter into a scenario of financial repression with its origin in the financing of public debts and the fact that these debts must be funded exclusively through banks and insurance companies. States will prescribe low interest rates for a long time, especially on their own borrowings. Considering the fact that these loans will be financed by the depositor's money, the interest rate on deposits will remain low. As a result, he maintains that we will not see an increase of interest rates for a long time.

Mr. de Callatay's opinion is more nuanced as he believes that the interest rates will eventually increase but not any time soon. Indeed, the signals emitted by monetary authorities seem to lead to the tightening of monetary conditions through the slow and gradual removal of quantitative easing.

Mr. de Callatay explained that the current situation does not make sense from an economic point of view. Indeed, individuals have a strong preference for living in the present and therefore, whoever is in a hurry to spend the money that he does not have yet, has to compensate for whoever accepts the sacrifice of not consuming right away. Nevertheless, in the current economic conditions, the individual who decides to save is still far from being rewarded, and the borrower is far from being punished. We are in a particular situation where real interest rates are negative. For instance, the 10-year belgian government bonds are remunerated at 0.8% whereas the inflation rate is about 2%, meaning that the individual who invested in these bonds lost about 1.2% of his purchasing

[102]The lack of coherent regulatory framework at both the European level and in individual national context, is an important obstacle to the development of cross-border flows.

power. As a result, and as it is counter-logical, the current economic environment induces that interest rates will end up increasing in the future.

4.3 Summary & Analysis

As a rule of thumb, it appears from our interviews that financial institutions in Belgium are far less diversified than elsewhere[103]. This is why we have taken the liberty to only consider the opinion of banks in the next step of our analysis. We will conduct the analysis along three main sub-sections.

4.3.1 The role of a bank in an innovative market in Belgium

In practice, we found that banks have adopted three distinct approaches towards online alternative finance. First, some banks acknowledge that crowdfunding can be a valid alternative source of funding, but they do not take the responsibility of sharing this information with their clients. Most banks in Belgium fall into this category, according to the majority of our interviewees.

We highlighted that some banks had abandoned this passive attitude by 2015, and are now informing their customers by redirecting them to existing crowdfunding platforms with which they have a partnership, visible or not. Thus, Mr. Jacobs of BNP Paribas Fortis explained that they had set up a partnership with the MyMicroInvest platform. Mr. Hugon told us that the ING Group did the same with Seedrs for financial crowdfunding transactions and with KissKissBankBank for the non-financial transactions.

Finally, there are banks that have established a crowdfunding platform that they manage themselves. A very select group of banks has opted for this active approach in Belgium. Indeed, our research shows that KBC inaugurated its crowdfunding platform, Bolero Crowdfunding, at the end of 2014. In addition, according to our interview with Mr. Jacobs, in mid-2015 Hello Bank, a digital subsidiary of BNP Paribas Fortis, launched the platform HelloCrowd. This platform focuses on non-financial crowdfunding campaigns.

[103]For instance, in the United States, there are many more credit institutions than in Belgium.

As a result, we can conclude that in Belgium, where platforms are concerned, financial institutions behave in a different way than those in the UK or in the US. Indeed, according to our analysis in the first part of this brief, a large number of European platforms reported some level of institutional funding, and just under 30% of peer-to-peer consumer lending platforms announced having a majority of institutional shareholders (e.g a bank, a VC, corporate).

This is in striking contrast with the Belgian situation as it appears that only a small minority of banks have funded a crowdfunding platform[104] so far. Furthermore, what is even more worrisome is the fact that none of the banks we interviewed envisages to fund a peer-to-peer lending project on a platform; while at the same time, institutionalisation did take off in Europe, as 24% of peer-to-peer business lending projects and 26% of peer-to-peer consumer lending projects were funded by institutions (cfr supra p.38).

This conclusion leaves us a little bit perplexed as we mentioned several times the low profitability of the sector today and the challenge these platforms will be faced with to find alternative sources of funding besides institutions. In addition, the market being so small in Belgium, we strongly believe that the only way for a Belgian platform to survive is to impose themselves as the leader and crush the competition.

4.3.2 Limits to the development of peer-to-peer lending in Belgium

In order to better understand why banks have so little interest for this sector, and what would be the best way to handle the potential future expansion of P2P lending, we shall now proceed to the synthesis of the potential factors limiting this market.

First of all, we observe a number of different factors that can affect the current peer-to-peer business lending sector in Belgium and its future expansion. Indeed, we live in a country with a relatively strong culture of the bank. The European market is very different from the American market, with more than 80% of the companies being funded by banks. However, according to the study conducted by BECI and Look&Fin, a significant number

[104]KBC with BoleroCrowdfunding and BNP Paribas Fortis with HelloCrowd.

of SMEs have more difficulties accessing credit in Belgium now than before the crisis and therefore, this could turn out to be a huge opportunity for the development of online business lending. As most companies in Belgium are financed by banks, we believe that the business model developed by Look&Fin could potentially expand in the future as long as they are financed by banks or developing partnerships with them. Today SMEs use the Look&Fin platform as a leverage towards banks. However, even if SMEs are not specifically looking for leverage, we assume that the volumes will stay within a certain range that will not be disruptive to the banking sector because of the various factors we mentioned above.

Furthermore, regarding the current legislation surrounding peer-to-peer business lending, the maximum amount loaned per investor and the maximum amount raised per project without prospectus allowed by the law are still too low and therefore represent an obstacle to development. Compared to other countries, the maximum amount raised per project is the lowest and according to Mr. Jacobs, Look&Fin could finance companies up to far more than 300.000€ if the limit amount was higher. All in all, we consider that if the legislator wanted to provide an opportunity for growth to this sector, the amounts should be different, as they are too insignificant today.

Secondly, we decided to address several other factors that could slow down the potential future development of online consumer lending in Belgium. As we deduce from most of the interviews, platforms will probably find it difficult to find borrowers, as these seem to have no issue accessing bank credit. Moreover, Mr. Colmant and Mr. de Callatay pointed out that Belgian households are relatively rich and that their funding requirements are much smaller compared to other countries. Besides that, the notion of risk seems to be completely different in the Anglo-Saxon countries, where individuals are willing to take more risks. Indeed, the Belgian is often considered as cautious. As a rule of thumb, we cannot project the same growth for Belgium compared to the UK and the United States, because these two countries have a very different debt-driven culture.

As far as the lender's market is concerned, the interest rates should be risk-reflective and significantly higher, as most investors are looking for higher returns when they move their money from banks deposits to platforms. Moreover, we see that the legislation in Belgium is built to encourage the crowdfunding sector but not fully, as it only currently supports startups and should extend the tax shelter to SMEs as Mr. Verdbois pointed out.

Also with regards to the legislation, Mr. Laoureux highlighted that the current consumer credit law is restrictive as the interests rates are limited to a maximum of 10%. Indeed, it is clear for us that Mozzeno could reach out to the portion of the population that has a credit risk of more than 10%, as risk credits are not part of the traditional business model of the banks. Subsequently, a significant part of Belgian investors could potentially be interested by higher returns due to the suppression of this rate limit. However, Mr. Laoureux draws our attention to the poor reputation of consumer credits. It could indeed be that the bad reputation consumer credit has in Belgium represents a serious issue for an online lending model such as the one proposed by Mozzeno.

Moreover, Mr. Colmant pointed out the culture as an obstacle to the development of the consumer market in Belgium. Indeed, as described in one of his articles[105], Anglo-Saxon countries function on a model of anticipated consumption and a faster economic cycle, and therefore tend to encourage indebtedness, while Western countries promote savings first and foremost. He confirmed Mr. Laoureux's opinion that the two cultures have indeed a very different notion of risk.

4.3.3 Cost analysis and interest rates sensitivity

Ultimately, we attempted to put in perspective some of Mr. Colmant's and Mr. de Callatay's interesting comments with the Deloitte survey (Doyle & al., 2016) examined in the first part of our work (cfr supra p.62). We compared the relative economics between peer-to-peer platforms and banks in Belgium and in the UK. We would like to stress that this analysis is based on our interviews, as well as our intuitions, and that it does not describe an actual representation of the Belgian market, given that Look&Fin is the only peer-to-peer platform in Belgium today.

[105] "La fiscalité belge favorise asymétriquement l'endettement" (Colmant, 2017)

First of all, Mr. Colmant confirmed that banks will continue to be funded at very low deposit rates, which are less sensitive to fluctuations in base rates than other sources of funding. According to Mr. Colmant, we have every reason to believe that we will enter in a scenario of financial repression with regards to the financing of huge public debts in Belgium, and more generally in Europe. As these debts have to be funded exclusively through banks and insurance companies, states have an incentive to continue to prescribe low interest rates for a while, and particularly on their own borrowings. As we consider that these loans are financed by the depositor's money, we strongly believe that interest rates on deposits will remain low.

What is interesting in this analysis is the fact that no matter the actual level of interest rates on deposits, Mr. Colmant insists that banks will keep a significant competitive advantage over platforms as they still have the benefit of their extraordinary statistical tools to measure the associated risk.

Then, the operation costs emerge from our interviews as a divergence from the Deloitte study. Indeed, according to Doyle & al. (2016), P2P platforms possess a potential competitive advantage on banks because of their ability to create exclusively online channels to manage the on-boarding and servicing processes of loans from scratch, as well as a fully automated procedure for processing and underwriting loans. However, Look&Fin, the market leader in Belgium in peer-to-peer business lending, uses a completely different process. There are almost no automated procedures around the granting and servicing of loans, as a panel of financial analysts assesses each SME in detail on a case by case basis. This is why we believe that loan processing and servicing costs are higher for a Belgian platform like Look&Fin than for a UK platform. Furthermore, as already discussed above, Look&Fin seems to be facing difficulties in attracting good projects and therefore we also deduce that loan acquisition costs, as a part of the operating expenses, are probably higher for a platform in Belgium than those recorded by Deloitte in the UK. All things considered, we do question whether Belgian platforms really possess a structural advantage on the operating expenses compared to banks.

Conclusion

While the phenomenon of peer-to-peer lending is rapidly developing in several countries, this thesis addresses the case of Belgium, where the market is still in its infancy. There are a number of serious obstacles in place that prevent the development of this innovative sector in Belgium. Despite the limited amount of data available to allow a meaningful quantitative analysis, the approach we used in this thesis provides a unique overview of the peer-to-peer lending market in Belgium, as we systematically reviewed and contrasted the opinion of key players in the fields of finance and innovation

In a world where our lives are becoming increasingly digital, we witness the emergence of an economy of sharing, from a community garden all the way to a much wider exchange of financial resources through online platforms. As technology providers continually influence the way we interact with each another, they could just as easily change how we obtain funding even in a country driven by a culture of the bank such as Belgium in the future.

As part of our thesis, we have highlighted the considerable difference of opinion regarding the potential disruptive impact of these platforms and their role in the economy. On the one hand, there are those who present it as sweeping away the traditional archaic financial institutions, and on the other hand, those who think that it is not a few credit and savings handlers who will worry or even impress actors as important as the banks. We argue that online platforms have more reasons to agree with banks than to fight them, as a fair cooperation can only be beneficial to both parties and positively influence the quality and richness of the overall supply of financial services. Indeed, a new online alternative finance such as peer-to-peer business or consumer lending brings a world of opportunities to both borrowers and lenders.

As to the motivations of investing in peer-to-peer platforms, it appears that no matter the model, investors are always looking for a competitive return as their main investment driver. Therefore, we assume that it would be enough for platforms to offer attractive interest rates and risk-reflective to disrupt a significant part of amount invested on the financial institutions the deposit-gathering businesses of the financial institutions.

By contrast, we noticed a difference in the motivation of the borrower when they request a loan from platforms. On the one hand, business borrowers are looking for an easier way to get funding as well as a number of value-added services. On the other hand, the main motivations of individual borrowers were very similar to lenders', as the likelihood to be denied by banks and platforms is similar. Contrary to consumer lending, literature reviews and the current Belgian market show that business lending platforms attract more companies that were previously denied, and particularly in Belgium, where Look&Fin enables SMEs to create a leverage effect on banks. This is why we strongly believe that of these two innovative alternatives, consumer lending is the best positioned model to potentially destabilize our traditional institutions.

Regarding the online business lending model, we strongly believe that its role is more complementary than disruptive in the short-medium term, as we observe a proliferation of partnerships between banks and platforms in Belgium. But in the meantime, we can also imagine a scenario where platforms develop such competitive services in terms of speed and ease, that leaving aside these alternatives would represent a missed opportunity for companies.

But before peer-to-peer business lending is in a position to destabilize financial institutions, a significant number of obstacles must be overcome. Even though Belgian regulators have taken the initiative to implement the law of December 18, 2016 for the recognition and supervision of crowdfunding, there are still many things to put in place regarding peer-to-peer business lending. Our thesis points out that the UK has stepped ahead of legislation, with a specific framework for peer-to-peer lending, which is not the case in Belgium.

Nevertheless, we are pleased with the proactivity of the Belgian regulators for having implemented fiscal incentives through the Tax Shelter. However, as peer-to-peer business lending mainly funds SMEs, we suggest to extend the incentives, currently supporting start-ups to them. We also discuss the establishment of a prospectus where the amounts raised or invested are above a certain threshold, which appear to be comparatively low in Belgium. As far as we are concerned, we support the idea that an increase of these

amounts would benefit platforms in allowing them to raise more funds for each of their projects. Besides the apparent legislative barrier, Belgium is a country with a high culture of the bank, where companies are mainly funded by banks. This culture of the bank, combined with a risk-averse trend, does not lead us to anticipate similar volumes per capita for Belgium as we observe today in Anglo-Saxon countries.

We regret the prohibition of peer-to-peer consumer lending in Belgium, as we believe it would be very beneficial to all the main actors in the field. One cannot assume a potential lobbying from the banks, but in the meantime, the Belgian Financial Sector Federation seems to identify more risks than benefits in this online alternative financing model. We also wonder whether Belgium has a tendency to overprotect consumers. It is obvious to us that a potential new legal framework should be very similar to the existing consumer credit, which is regulated by book 7 of the economic right code.

We strongly consider that the only way to allow peer-to-peer consumer lending in Belgium is to extend the exception in place to legal persons, by covering individuals by the prospectus exception to the prohibition of taking repayable funds from the public. Besides the extension of the law, other measures have to be implemented in order to contain the risks involved. Platforms should be allowed access to the Central Individual Credit Register for a variety of reasons. First, to fight against indebtedness, and also to avoid potential shadow banking, as loans will not be recorded if platforms do not have access to this register. Furthermore, if platforms do not have access to this data, they will not be able to accurately compute creditworthiness, which can put the whole sector in jeopardy. Besides the access to the CICR, we point out the need for a proper legal framework to protect consumers, as well as for strong measures to protect data privacy.

Interest in peer-to-peer consumer lending already exists in Belgium, as Mozzeno, a Belgian platform, currently provides a certain version of this business model. Indeed, the exception for legal persons enables them to implement an indirect consumer lending-based model. It is logical to suggest that the sector would positively evolve if a change in the legislation was to take place. That being said, the obstacles to peer-to-peer business lending mentioned above also apply to a large extent to the online consumer market. In addition, our analysis

shows that consumer credit in Belgium suffers from a relatively bad reputation, which could represent a significant obstacle to potential development. Indeed, it is challenging for platforms to modify such ingrained behavioural patterns.

All things considered, in a world that is in a perpetual state of change, we strongly support these financial alternatives. Far from encouraging indebtedness, the flexibility provided by online lending platforms will benefit all market players. On the one hand, by giving borrowers the opportunity to make their dreams come true and on the other, to offer investors an attractive return on their investment. Besides such flexibility, dealing with an individual rather than with an institution may foster mutual trust. As financial institutions were never able to anticipate tomorrow's problems, and given the current economic wish to revive investment, we should actually embrace innovative ideas, particularly since the primacy of real economy is no longer a reality. Such innovative initiatives would give us new perspectives that may not be perceived as necessarily positive by banks. Therefore, we look forward to a change in the legislation around consumer lending in the coming years, but this change will need to be supported by a better understanding of the sector by individuals, as well as an efficient legal framework to give the sector a chance to grow.

To conclude, we would like to stress that the insignificant volumes traded and the very low numbers of platforms currently active in peer-to-peer lending in Belgium, make predictions extremely difficult, which explains why our analysis may not be a true representation of future developments. In this respect, further research will be required to apprehend this innovative market. We look forward to observing how this innovative online lending market will evolve, taking into consideration its increasing complexity and institutionalisation, as well as a likely increase of the interest rates in the coming years. Ultimately, the potential influence of Big Data on the evolution of the peer-to-peer lending sector may prove interesting to explore in the future.

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