P2P Lending: A Regulatory Perspective
April 2017
BANK BORROWING COSTS AT AN ALL-TIME LOW, NET YIELD AT ALL-TIME HIGH

Historical Short-Term Unsecured Loans Interest Rate

Growing Spread

2Y Treasury Yield

Interest Rate

0% 5% 10% 15% 20%

The Problem With Banks

- Oligopoly
  - Harms Customers

- “Too Big To Fail”
  - Moral Hazard for Economy

- Unwillingness to serve smaller loan volumes
  - Ever Increasing Overhead
  - Legacy Processes
The Problem For Customers

- **Inflation**: 1.3%
- **3 Year GIC**: 0.95%
- **P2P Loans**: >7%

**Borrowers**
- Low Cost (Prime)
- High Cost (Sub-Prime)

**Lenders**
- 1.3% Inflation
- 0.95% 3 Year GIC
- >7% P2P Loans

- **Banks**
- **Alternative Lenders**
What is Peer-to-Peer Lending?

• Facilitation of an online credit marketplace operating at a lower cost than traditional bank loan programs, passing the savings on to borrowers in the form of lower rates and to investors in the form of solid returns.

• Borrowers receive more affordable financing because the costly intermediary is removed (bank)

• Lenders receive a higher return because they are capturing more of the spread that was traditionally captured by a bank
# Platform Revenue Model

We charge Borrowers an origination fee

<table>
<thead>
<tr>
<th>Loan</th>
<th>$50,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Business ABC</td>
<td>$47,500</td>
</tr>
<tr>
<td>Lending Loop</td>
<td>$2,500</td>
</tr>
</tbody>
</table>

We charge lenders a servicing fee

<table>
<thead>
<tr>
<th>Loan</th>
<th>$50,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Borrower Repayment</td>
<td>$61,958</td>
</tr>
<tr>
<td>Lending Loop</td>
<td>$1,165</td>
</tr>
</tbody>
</table>
Why P2P Lending
Traditional Lending vs P2P

Financial intermediation is a tax on capital; it’s the toll paid by both the people who have it and the people who put it to productive use.

Michael Lewis
Author of Liars Poker & The Big Short
A Proven Asset Class
## Eg. Importance of SMEs in Canada

<table>
<thead>
<tr>
<th>Percentage</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>90%</td>
<td>Private Labour Force Works For an SME</td>
</tr>
<tr>
<td>27%</td>
<td>Contribution to Canada’s GDP</td>
</tr>
<tr>
<td>2008</td>
<td>Jobs Least Affected by Recession</td>
</tr>
</tbody>
</table>
International Perspective
US and UK Platform Growth

UK P2P Originations

- £2,160,088,597
- £2,160,000,000
- £968,745,058

US P2P Originations

- $24,646,800,629
- $6,060,652,487
## Lending Platforms: A Comparison

<table>
<thead>
<tr>
<th>Country</th>
<th>Retail/Institutional Platforms</th>
<th>Institutional Platforms</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Canada</strong></td>
<td>2 Originators</td>
<td>50+ Originators</td>
</tr>
<tr>
<td><strong>UK</strong></td>
<td>100+ Originators</td>
<td>25+ Originators</td>
</tr>
</tbody>
</table>
Evolution of Peer-to-Peer Lending: UK

• 2005: P2P Lending is introduced in the UK with the launch of Zopa, Lenders connect with Borrowers through a Direct Contract (where P2P platform is agent)

• 2011: Incumbents self-regulate, form P2PFA to “promote high standards of conduct and consumer protection”

• 2005 – 2014: Forward-looking supervisory visits were undertaken by the Financial Conduct Authority (FCA) to assess the governance, management and controls of five market participants to understand the risk that the sector posed to their statutory objectives

• April 2014 - FCA Begins Regulating P2P Lending requiring all Peer-to-Peer Lending platforms to go through an authorization process:
Success of Peer-to-Peer Lending: UK

- Government-backed British Business Bank programme has lent £100M through Peer-to-peer lending platforms to ensure capital is in the hands of small business owners
- Government has marked P2P loans as eligible for ISAs to help boost the returns of investors, thus growing investment in the sector
- The top 9 Peer-to-peer Lending platforms in the UK have originated > £7B since 2005
- P2P is one of the most important vehicles to removing the “too big to fail” bank mentality

“We believe that Peer to Peer lending (P2P) is a brilliantly innovative new form of finance – which we want to see continue to grow and evolve.

So many of our small businesses tell us about the difficulty of accessing finance. Many of you in the audience know exactly what I mean! Peer-to-peer lending can plug that gap. Proportionate regulation will protect consumers lending and borrowing via a P2P platform and allow the sector to continue to grow.”

- Harriett Baldwin, UK Economic Secretary
Evolution of Peer-to-Peer Lending: NZ

• 2013: Financial Markets Conduct Bill (FMCB) passed by Parliament
  • “Dominated by four Australian owned and protected banks, New Zealand’s financial market has grown stagnant. Our “Big-4” banks are protected by Aussie legislation known as the “four pillar” policy, which has not only allowed the creation an artificial oligopoly, but also made those four banks among the most profitable in the world – even more than their Australian counterparts. Without much in the way of serious challenge, these banks have dominated the market with neither need nor motivation to change.”

• The FMCB created two separate license categories
  1. Crowdfunding Service
     • “When you invest via crowdfunding you're buying shares - usually in a start-up or growing business.” – NZ Financial Markets Authority
  2. Peer-to-Peer Lending Service
     • “When you invest via peer-to-peer lending, you're earning interest by loaning your money directly to an individual, small business, community group or charity.” – NZ Financial Markets Authority
Conclusion: Canada
Why is Canada Lagging?

1. Lack of Direct Government Support (Contrasted to UK)
   1. Bank Referral Program
   2. Open Access to Banking Data
   3. Investment Promotion (ISA)
   4. Direct Investment (BBB)
   5. Vocal Government Support Increased Legitimacy

2. Historically Unfavourable Regulatory Environment

3. Absence of Adequate Funding

4. Banking Oligopoly Leading to Unfair Competitive Practices
   1. Challenger Bank Licenses
We’re Catching up Quickly

Origination Volume

Loan Characteristics by Band
We Don’t Need to Reinvent the Wheel!

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