

6 October 2015

Alternative Finance – Shadow Banking and Crowdfunding

Jacob Ghanty, Partner, K&L Gates London

What are Shadow Banking and Alternative Finance?

“If it looks like a duck, quacks like a duck, and acts like a duck, then it is a duck – or so the saying goes. But what about an institution that looks like a bank and acts like a bank? Often it is not a bank – it is a shadow bank”.

Laura E. Kodres of the IMF

- Lending activities which occur outside the banking system

Types of Institution Engaged in Shadow Banking/Alternative Finance Activity

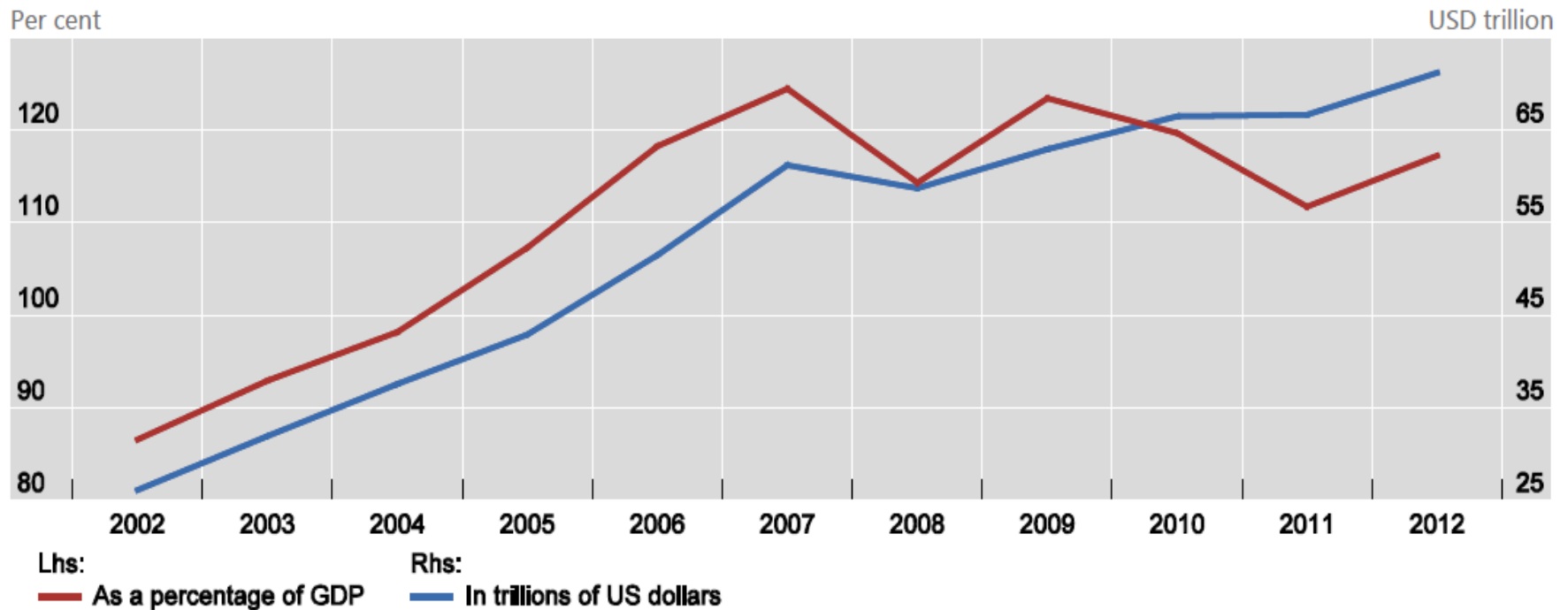
Alternative asset managers, notably private equity firms

Lending platforms, including P2P

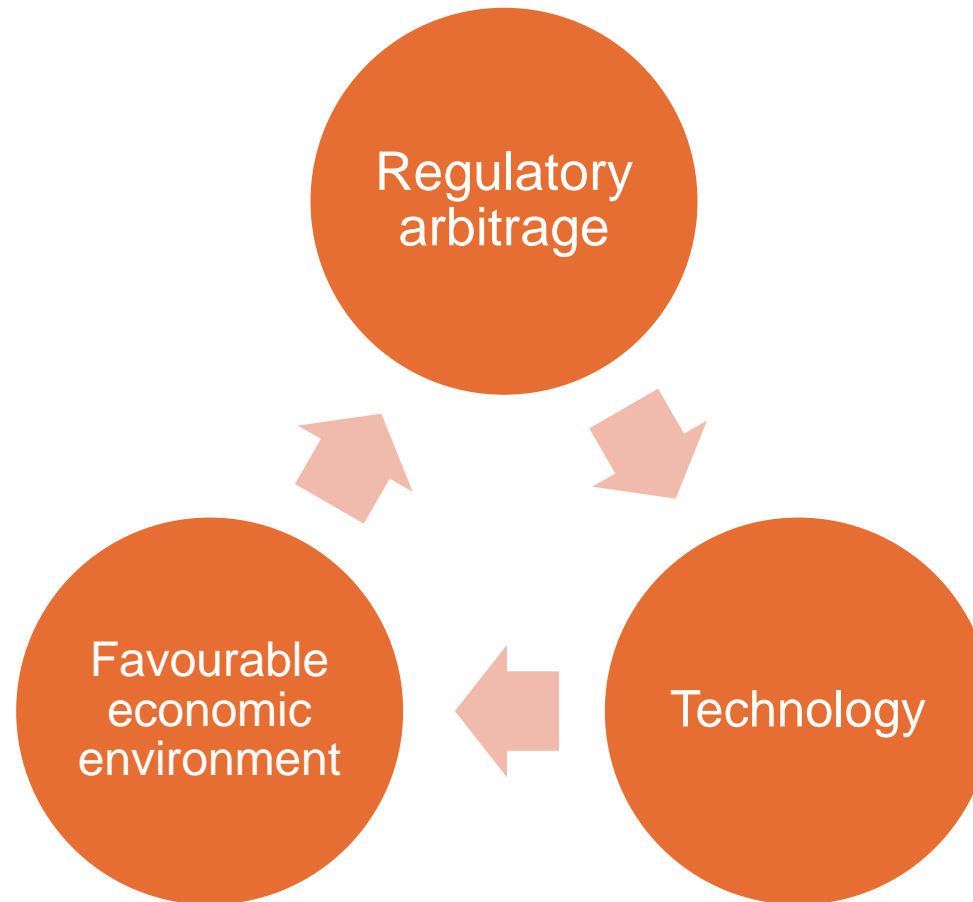
Non-bank mortgage lenders

Size of The Shadow Banking Sector

Assets of non-bank financial intermediaries across 20 jurisdictions and the Euro area



Drivers of Shadow Banking



Shadows on the Horizon?

- The banks will respond
- Increasing regulatory scrutiny
- Will some of the platforms be able to cope with rapid growth?

6 October 2015

Shadow Banking – Credit Considerations

Stephen Moller, Partner, K&L Gates London

May 28, 2015 5:09 pm

ECB warns of risks posed by shadow banking sector

James Shotter in Frankfurt and Claire Jones in Dresden

June 25, 2015 6:30 am

Shadow lending crackdown looms over China's stock market

Gabriel Wildau in Shanghai

May 31, 2015 3:12 pm

Shadow banks grab record US loans share

Ben McLannahan in New York

INSIDE BUSINESS

April 13, 2015 9:50 am

GE Capital tells a cautionary tale for shadow banks

Patrick Jenkins

Shadow banking now poses top risk to US stability, warns IMF

Non-financial lending has reached \$15 trillion since the crisis and is outside the control of authorities warns the Fund's deputy chief

China in numbers: emeralds shine a warning light on shadow banking

Shadow Banking: Credit Considerations

- Which asset and which strategy?
- What else will you be doing?
- Implications for fund structure
- Assignability
- Due diligence

The logo for K&L GATES, featuring the text in white on an orange rectangular background.

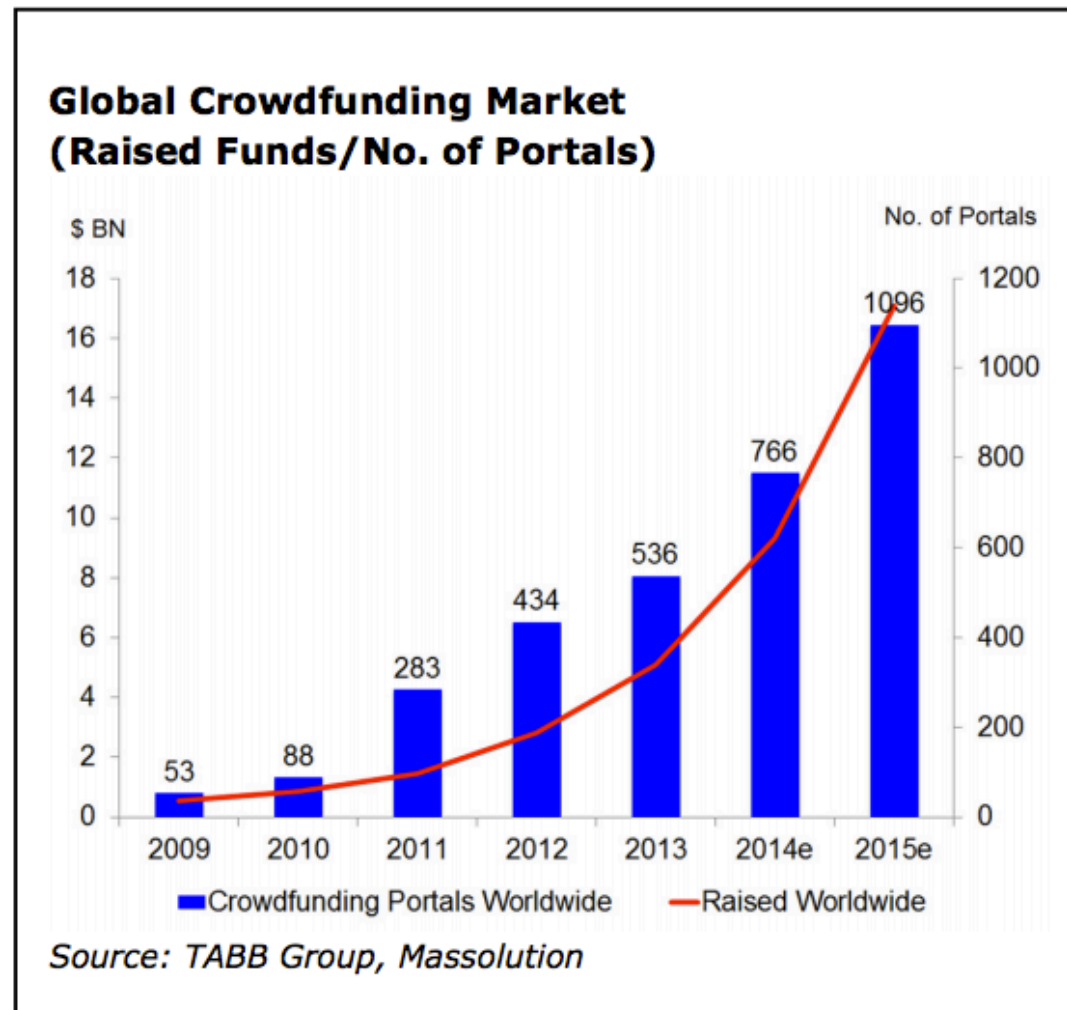
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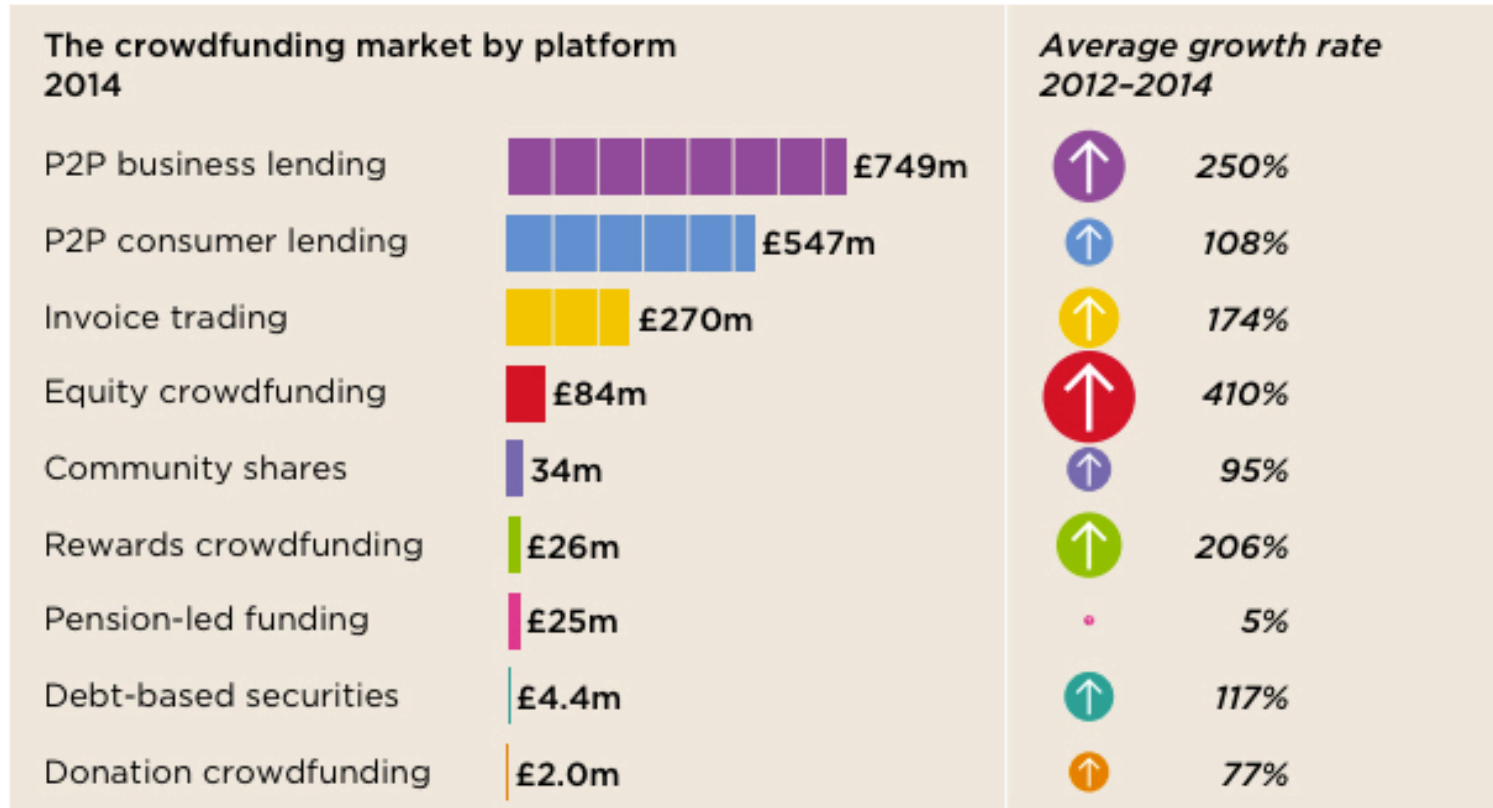
An Overview of the Crowdfunding Marketplace

Tom Wallace, Partner, K&L Gates London

Global Crowdfunding Market



UK Crowdfunding Market by Finance Type

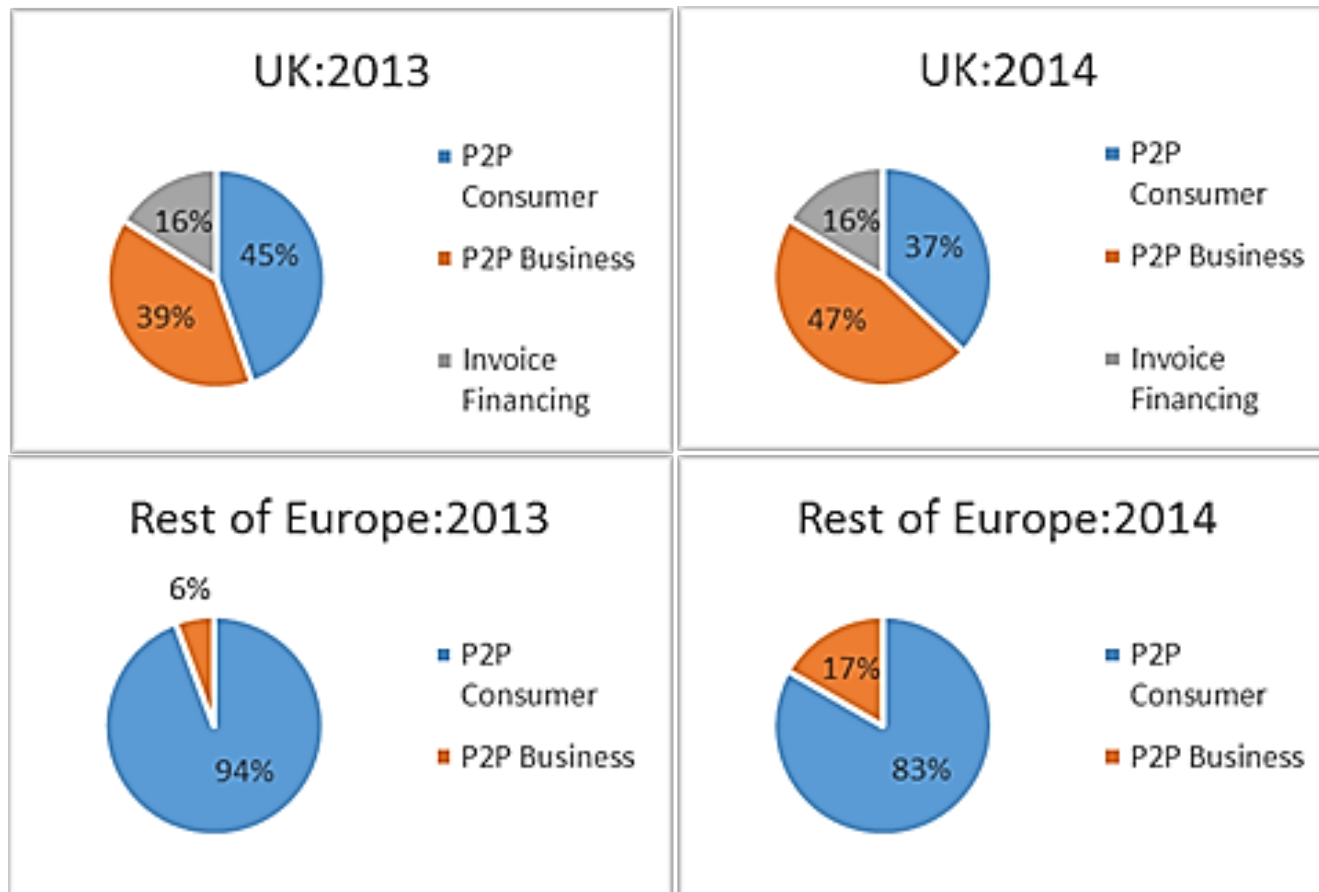


Source: Understanding Alternative Finance, published by Nesta and University of Cambridge, November 2014

Snapshot of UK Equity Crowdfunding Market

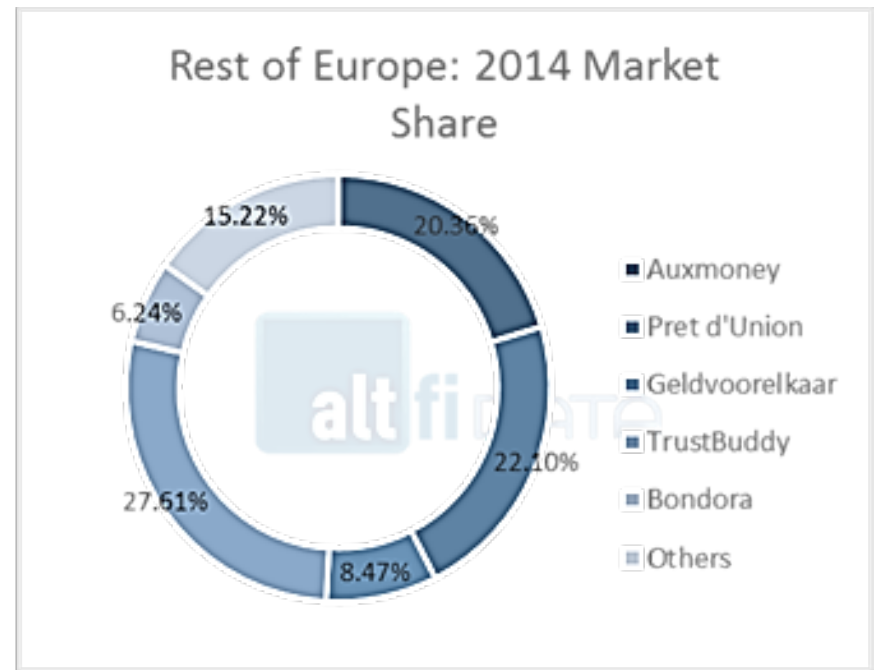
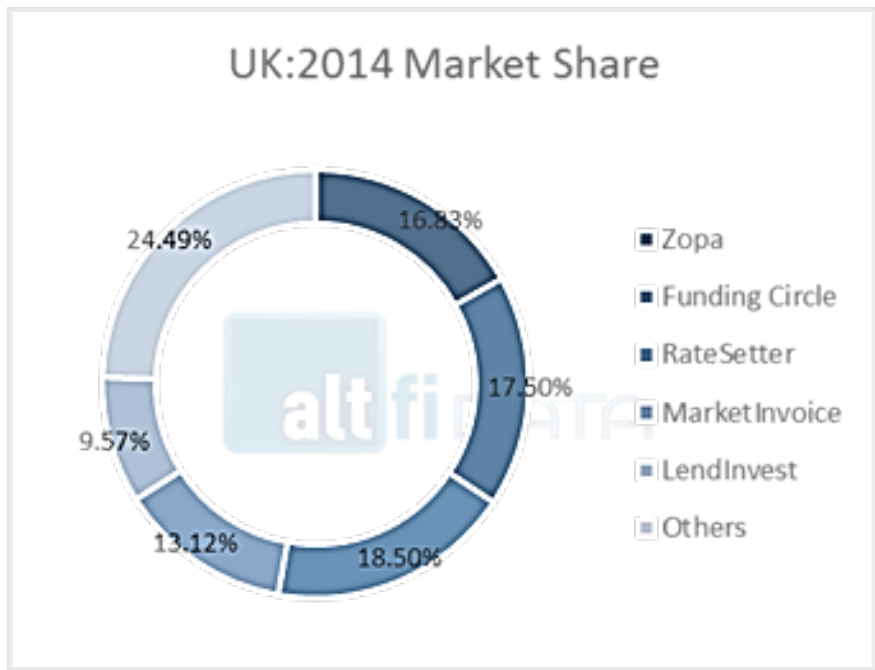


UK/EU P2P Sector Composition



source: AltFi Data, April 2015

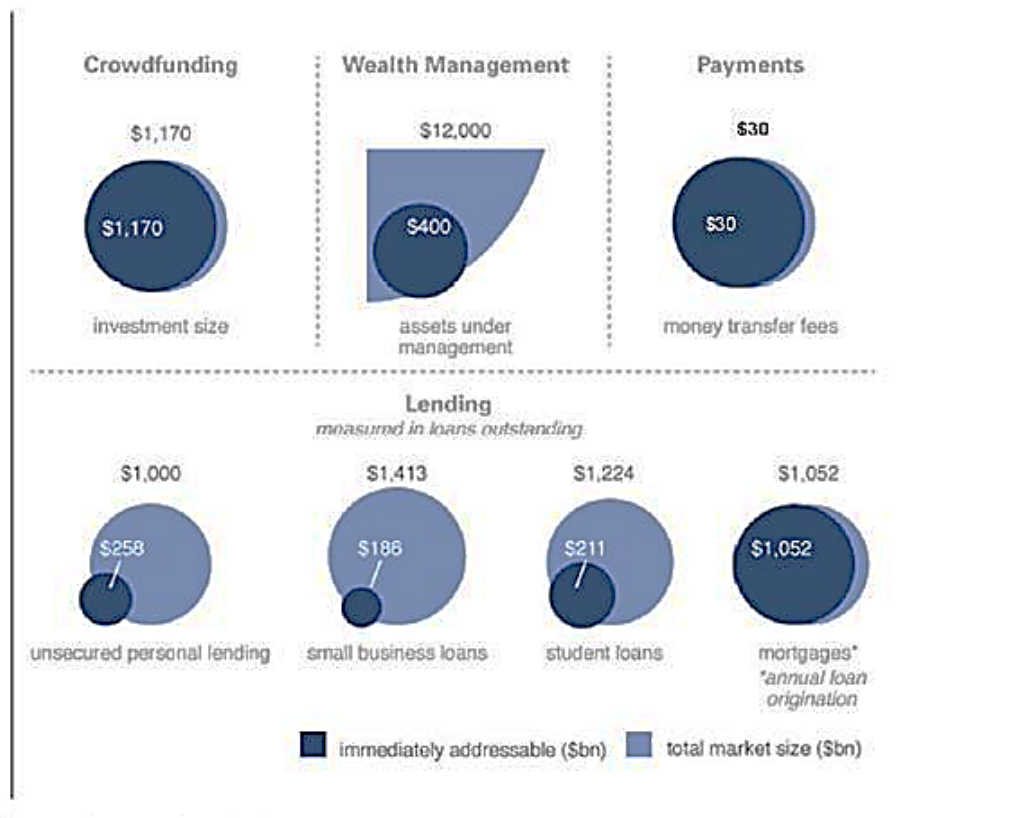
UK/EU P2P Platform Dispersion



source: AlfFi Data, April 2015

“Sizing The \$4tn Addressable Opportunity”

Exhibit 2: Sizing the \$4 trillion addressable opportunity
\$ in billions



source: Goldman Sachs Investment Research, The Future of Finance, March 2015




KICKSTARTER Discover Start Search projects

Potato Salad

by Zack Danger Brown

Home Updates 15 Backers 60 Comments 117

Columbus, OH Food



894 backers
\$5,177 pledged of \$10 goal
26 days to go

[Back This Project](#)
\$1 minimum pledge

This project will be funded on Sat, Aug 2 2014 8:47 AM EDT.

Project by Zack Danger Brown
Columbus, OH

First created · 4 backed

Zack Danger Brown 658 friends

[See full bio](#) [Contact me](#)

I'm making potato salad.

Basically I'm just making potato salad. I haven't decided what kind yet.

UPDATE: WE DID IT

Disrupting the Disrupters



“the lenders of the revolution look familiar”



6 October 2015

Regulation of crowdfunding in the UK

Oliver Lewis, Associate, K&L Gates London

“ Imagine a world in which there are millions of unsophisticated investors who don't have the time or experience to evaluate businesses. Would you expect their returns to be higher or lower than the Venture Capitalists who have spent decades doing this?

Dr Michael J Roberts, Harvard Business School

What is the FCA protecting against?

insufficient consumer understanding

platform failure

risk of cyber-attack

fraud

credit and/or investment risk is mispriced

Peer to Peer lending platforms

Debt based crowdfunding:
*“operating an electronic
system in relation to
lending”*

Additional
protections for
individuals

Minimum
Prudential
Requirements

Investment-based crowdfunding

Regulated activity?

Arranging or
bringing about
deals in
investments

Making
arrangements
with a view to
transactions in
investments

Establishing,
operating or
winding up a
collective
investment
scheme

Investment-based crowdfunding

Offers to the public

- certified or self-certified sophisticated investors
- self-certified high net worth investors
- those who confirm that, in relation to the investment promoted, they will receive regulated investment advice or investment management services from an authorised person
- retail clients that are corporate finance contacts or venture capital contacts
- restricted investors – i.e. those who certify that they have not invested over a 12-month period more than 10% of their net investment portfolio in unlisted shares or unlisted debt securities (excluding their primary residence, pensions and life cover)

Investment-based crowdfunding

Offers to the public

- **“Appropriateness Test”**
 - Where advice is not provided, the FCA expects firms to apply an **“appropriateness test”** to clients before issuing promotions for unlisted equity or debt securities
 - This may involve firms needing to design automated systems to assess client knowledge and experience and to check clients’ understanding of risks

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Crowdfunding and Alternative Finance

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<http://www.jbs.cam.ac.uk/ccaf>

Alternative Finance at the CCAF

- Financial **instruments** & **channels** that emerge outside of the traditional finance system
- Inform policy-making and industry practice
- Core research themes:
 - Online channels
 - Risk analytics
 - Payment systems

CCAF Research

2013



2014



2015



European Benchmarking Research (Feb 2015)

- 1 Online Benchmarking Research Questionnaire
- 3 Months of Fieldwork
- 14 National/Regional Research Partners
- 27 European Countries
- 65 Platforms from the United Kingdom
- 190 Platforms from Outside of the UK
- 255 AltFin Online Platforms in Total
- Captured 85-90% of the Market



Cambridge Global Benchmarking Research Project

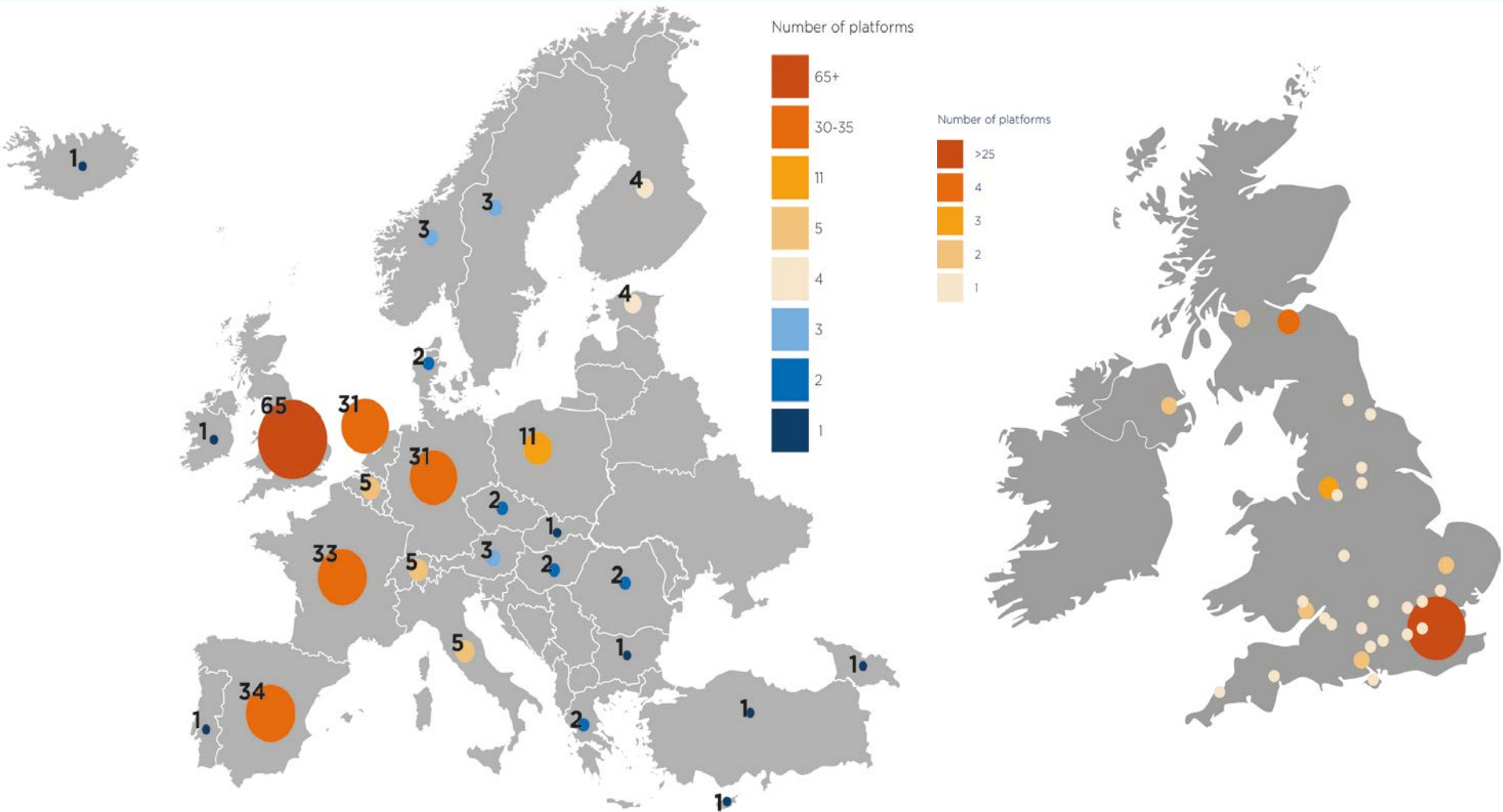
Survey launching in Q4 2015 to cover five global regions

- Americas (launching October 15)
- Asia-Pacific
- Greater China
- UK
- Europe

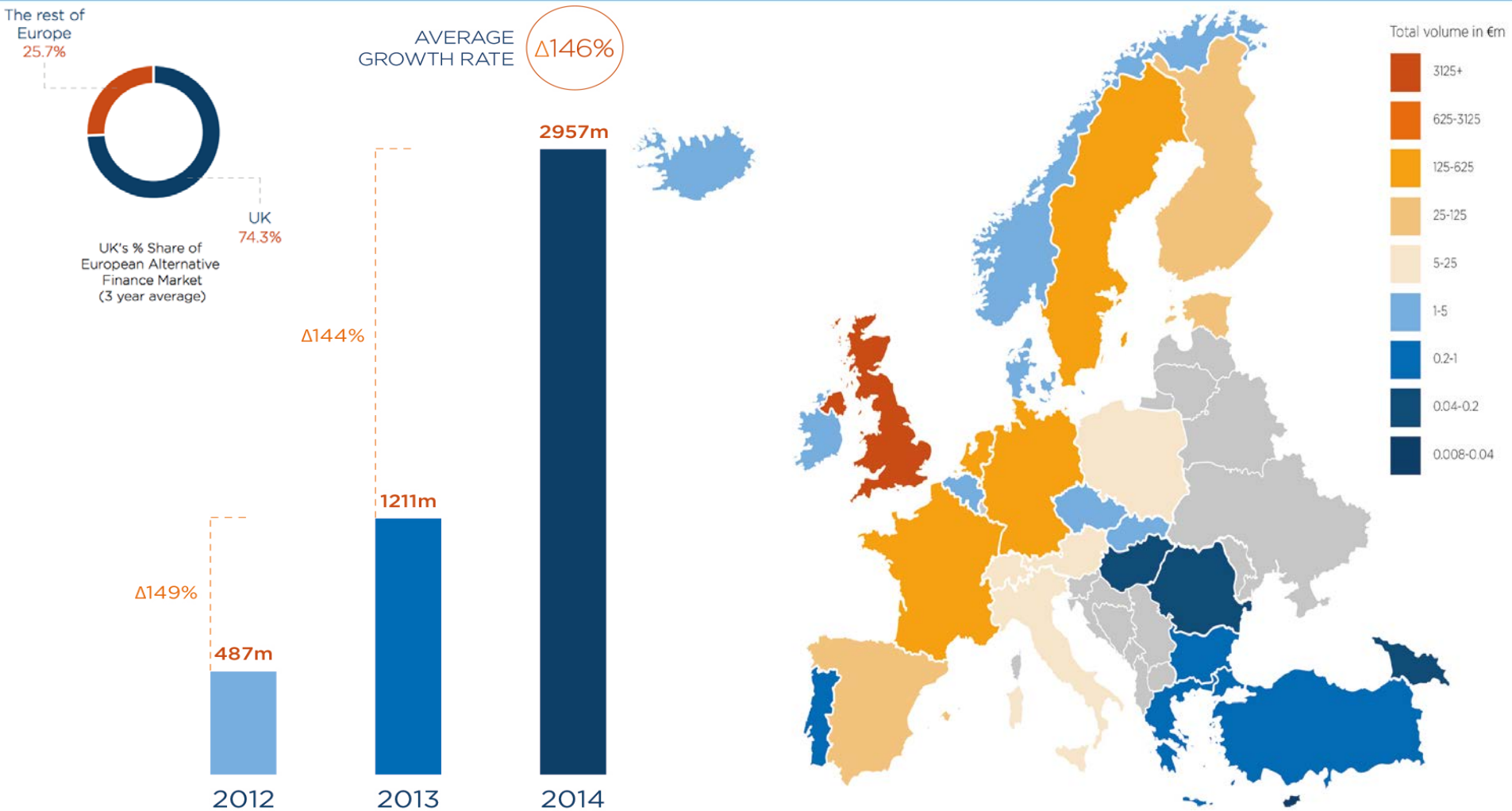
Network of Cambridge research partners in each region

- Americas: University of Chicago (Booth School of Business)
- China: Tsinghua University (Shenzen)
- Asia Pacific: University of Sydney

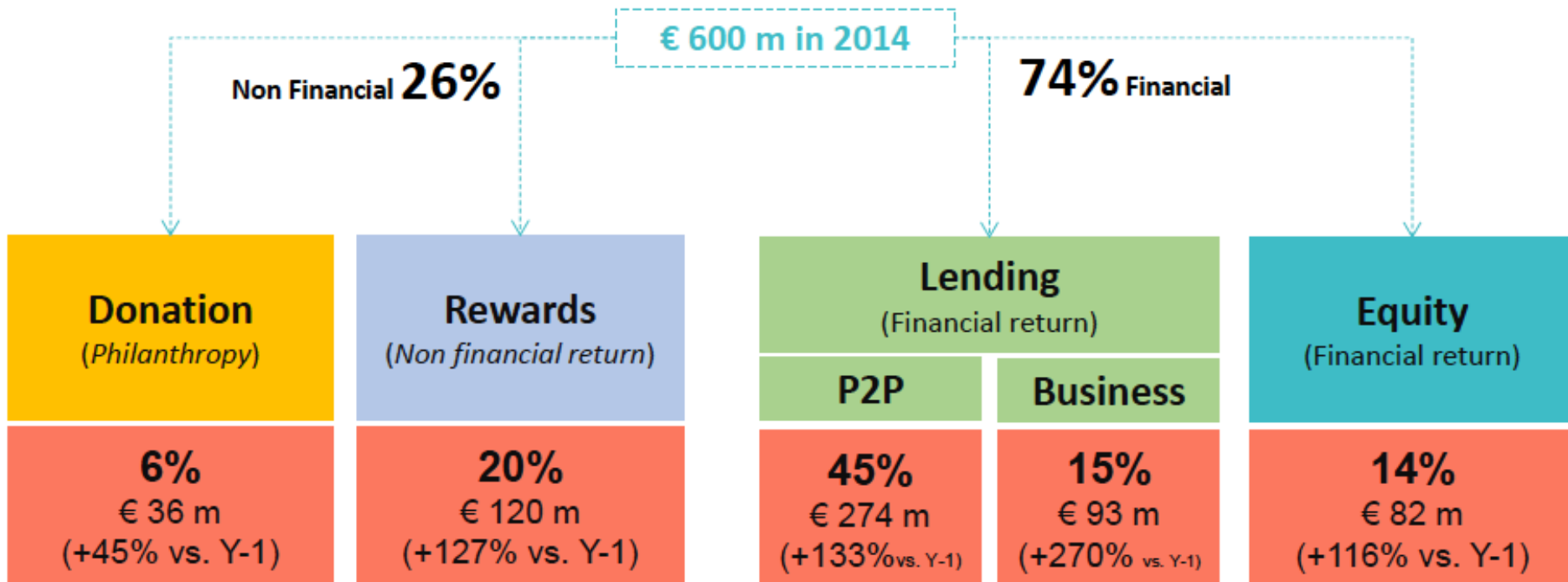
EU Market Data: Geographical Distribution European Platforms: Moving Mainstream 2015



Overall Size of the European Alternative Finance Market 2012-14



Breakdown of European Market 2014 (Excluding UK)



Cambridge-EY (2015)

Marketplace Lending Volumes in 2014 (\$ Million)

Country	Consumer Lending	Business Lending	Total Lending	Annual Growth Rate (2012-2014)
UK	1,234	1,346	2,580	167%
France	106	11	117	190%
Germany	108	8	116	110%
Netherlands	0	47	47	257%
Spain	0	19	19	374%
Nordics	116	37	153	108%
Total (1)	~1,564	~1,468	~3,032	~200%
Total US (2)	~6,200	~4,500	~10,700	~100%

(1) *Moving Mainstream: The European Alternative Finance Benchmarking Report, February 2015*

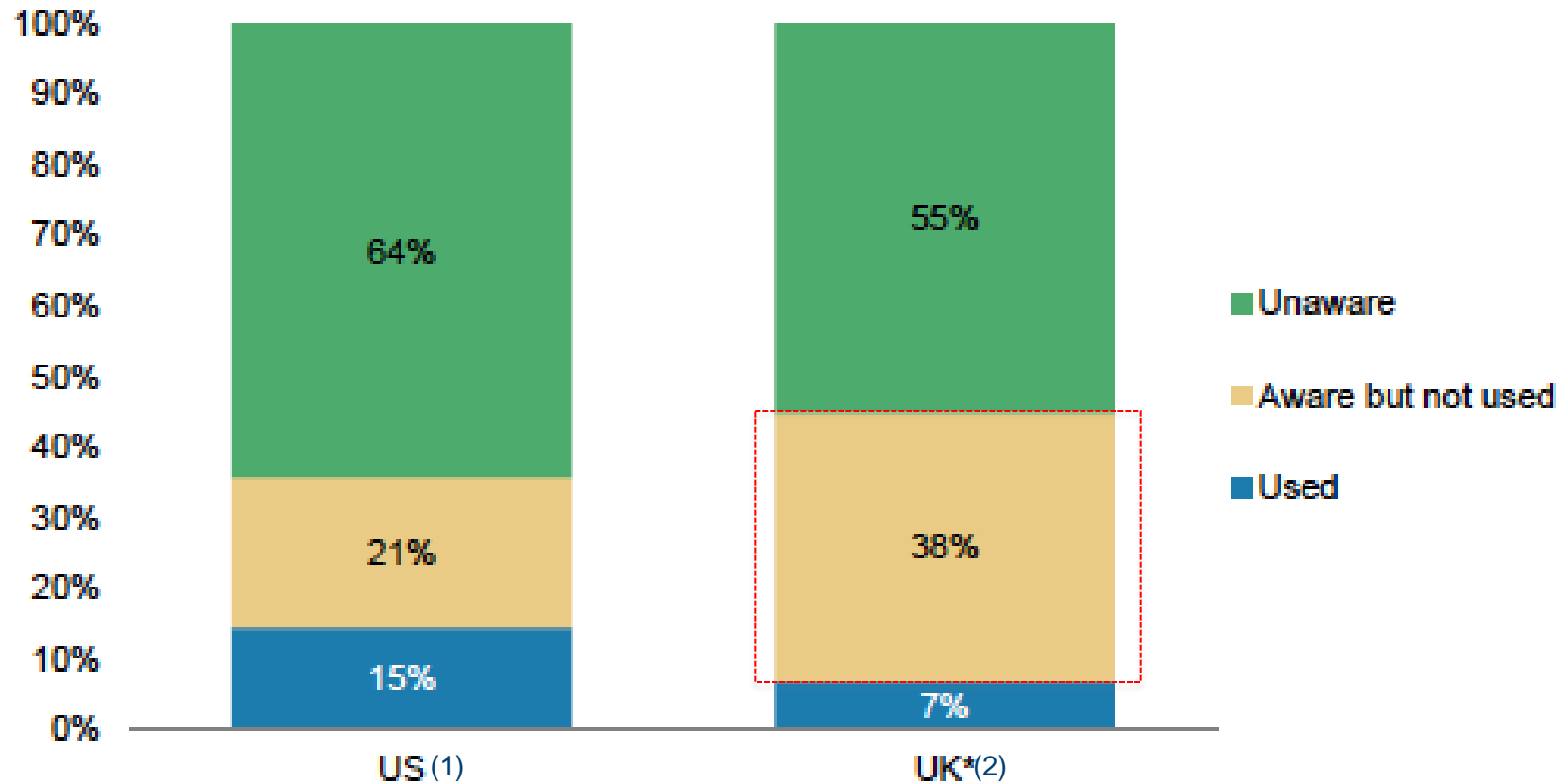
(2) *Morgan Stanley Research, May 2015*

Comparative Data Relative to GDP (2014)

Country	Total Lending (\$ Billion)	GDP (\$ Billion)	Lending as % of GDP
UK	\$2.580	\$2,945	0.0876%
France	\$0.117	\$2,847	0.0041%
Germany	\$0.116	\$3,860	0.003%
Netherlands	\$0.047	\$867	0.0054%
Spain	\$0.019	\$1,407	0.0013%
Nordics	\$0.153	\$1,278	0.012%
US	\$10.700	\$17,420	0.0615%

P2P Awareness is 80% Higher in UK than US Market

P2P Lender Awareness and Use (Among total)



(1) University of Cambridge, November 2015

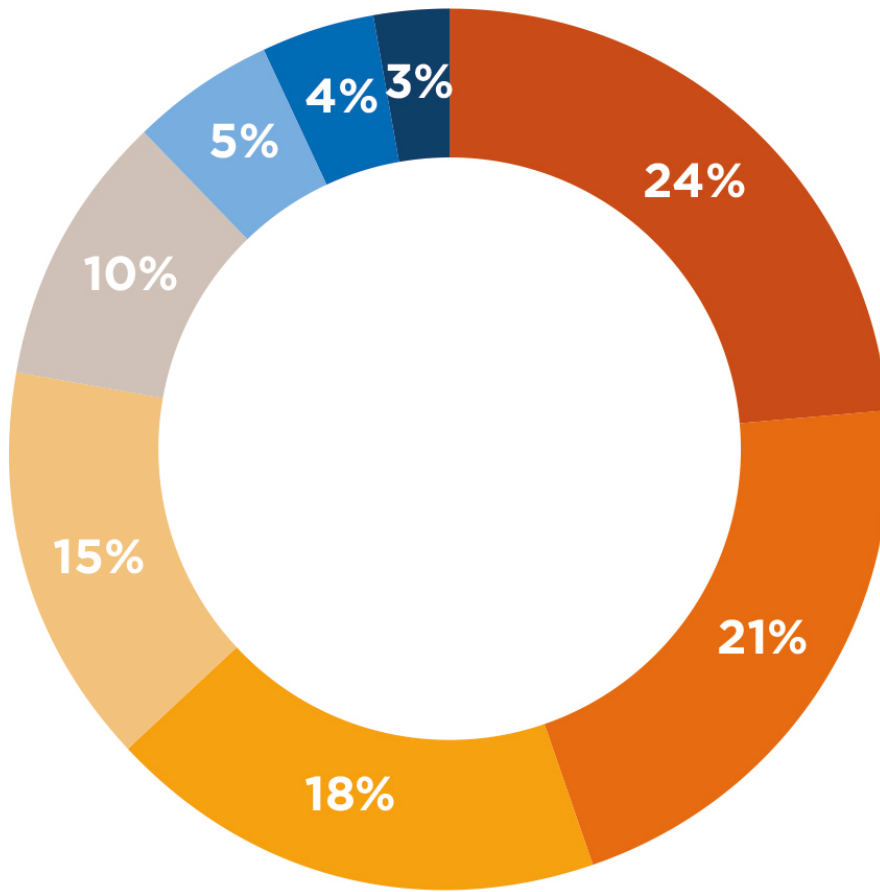
(2) Morgan Stanley Research, May 2015

Cross-Model Comparisons: Average Amount Raised + Micro-Transactions

	Average amount raised	Average number of funders
P2P Consumer Lending	→ £5,471	201
P2P Business Lending	→ £73,222	796
Equity Crowdfunding	→ £199,095	125
Rewards Crowdfunding	→ £3,766	77
Donation Crowdfunding	£6,102	55
Invoice Trading	£56,075	7
Pension-led Funding	£70,257	N/A
Debt-based Securities	£730,000	587
Community Shares	£174,286	474

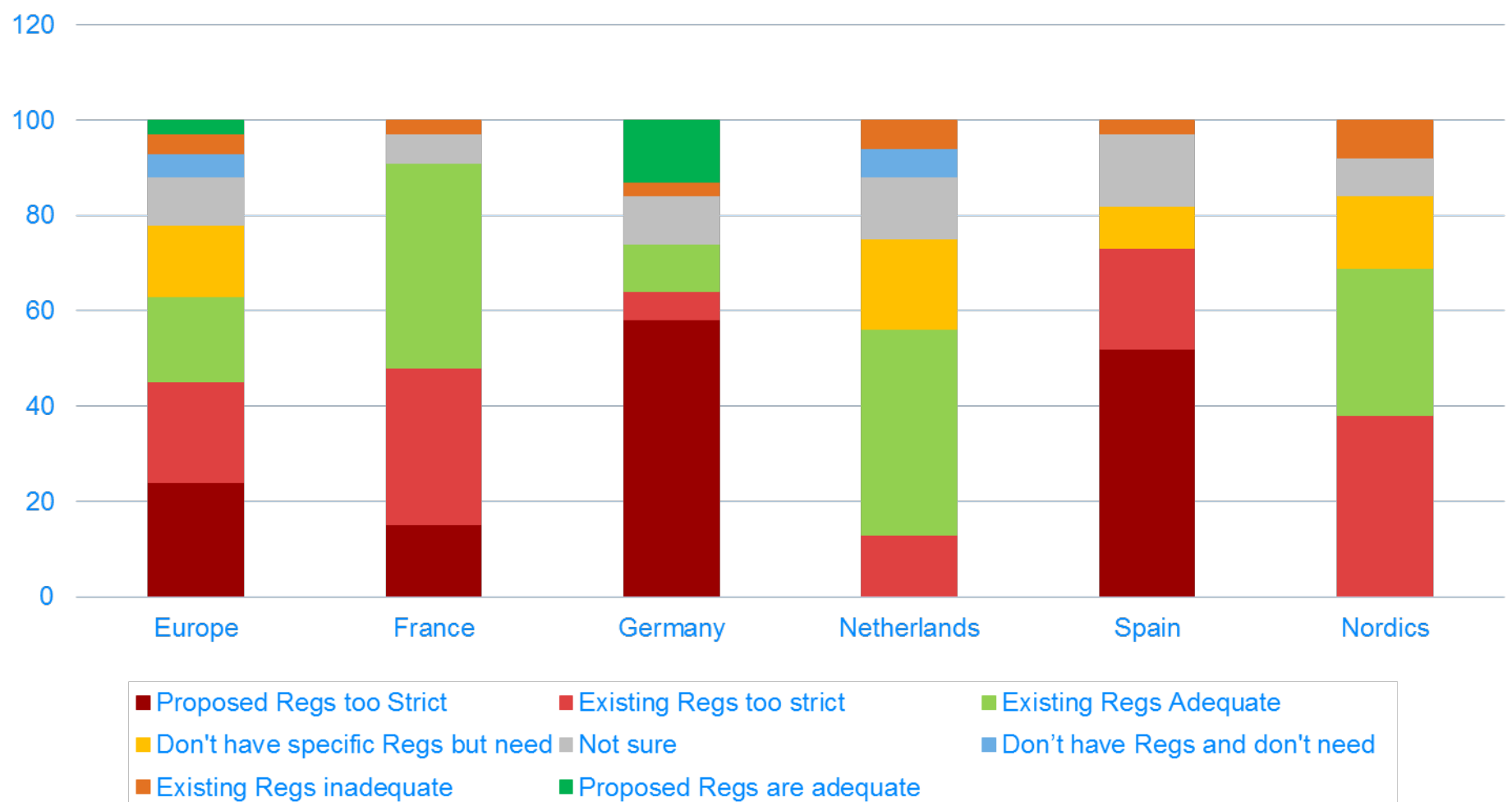
Industry Perspectives: European Regulations

Industrial perspectives of European regulations

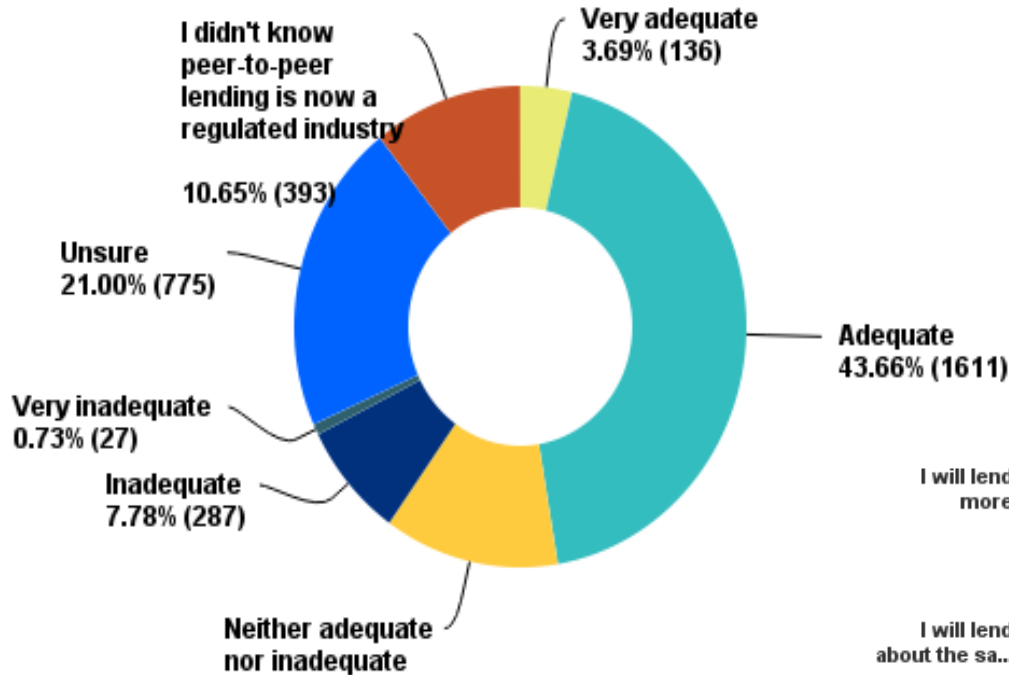


- The proposed regulations in my country are excessive and too strict
- The existing regulations in my country are excessive and too strict
- The existing regulations in my country are adequate and appropriate
- We don't have specific regulations in alternative finance and we need them
- Not sure
- We don't have specific regulations in alternative finance and don't need them
- The existing regulations in my country are inadequate and too relaxed
- The proposed regulations in my country are adequate

Perceptions of Regulation in Europe

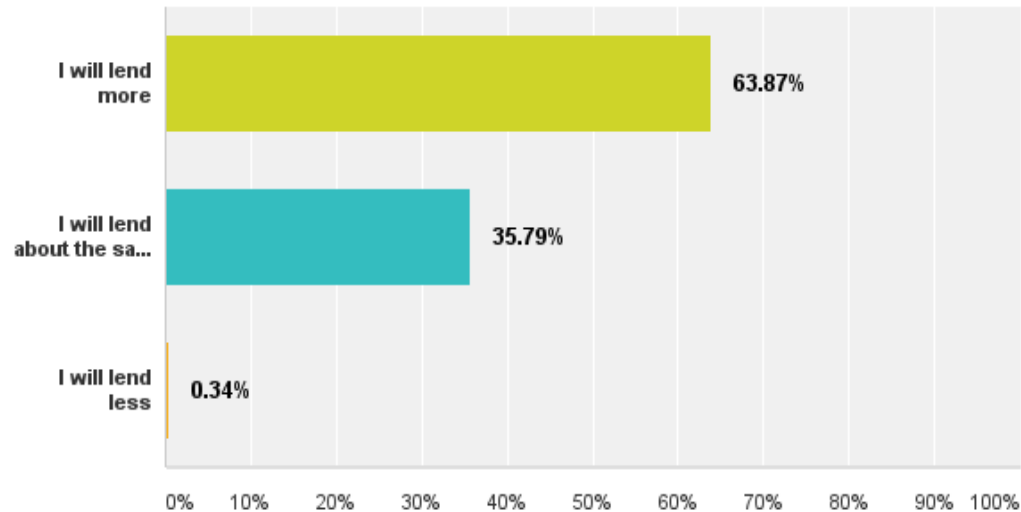


UK - Peer-to-Peer Consumer Lending: Regulations and ISAs

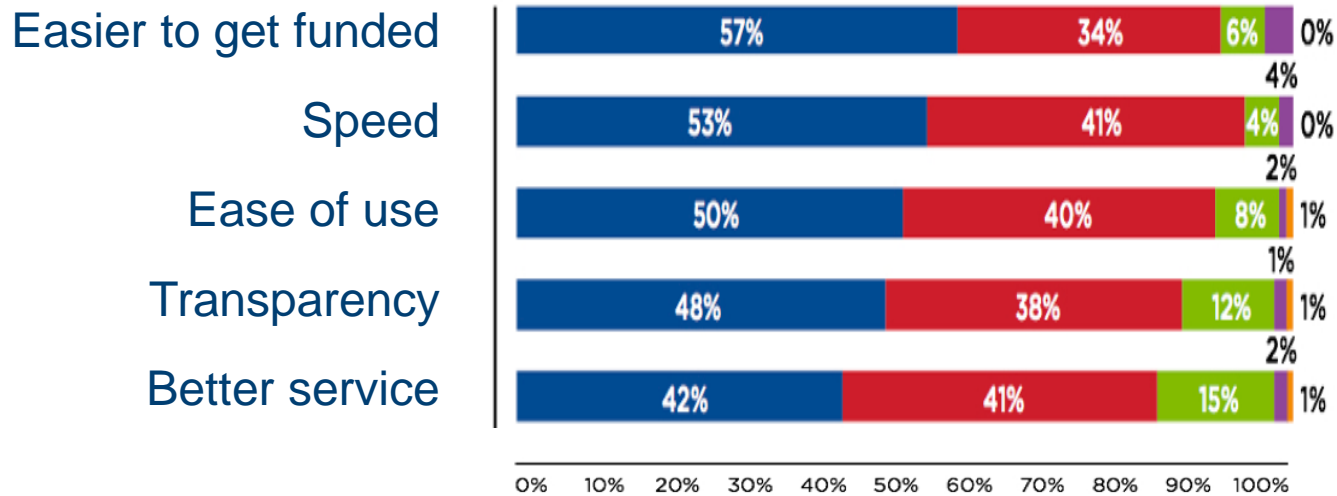


Lenders' view of FCA's regulations in p2p lending

Would a P2P Lending ISA encourage you to lend more?



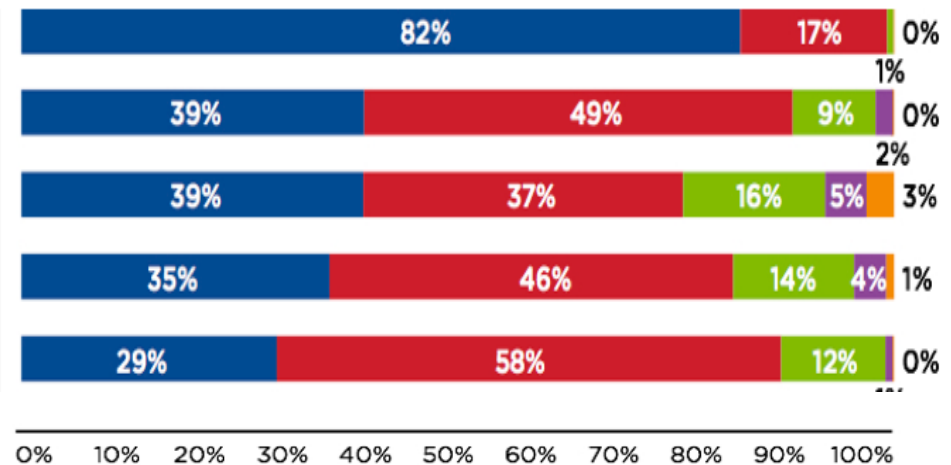
P2P Business Lending: Why SME Borrowers Chose P2P Lending



■ Very important ■ Important ■ Neither important nor unimportant
■ Unimportant ■ Very unimportant

P2P Business Lending: Motivation for Lending

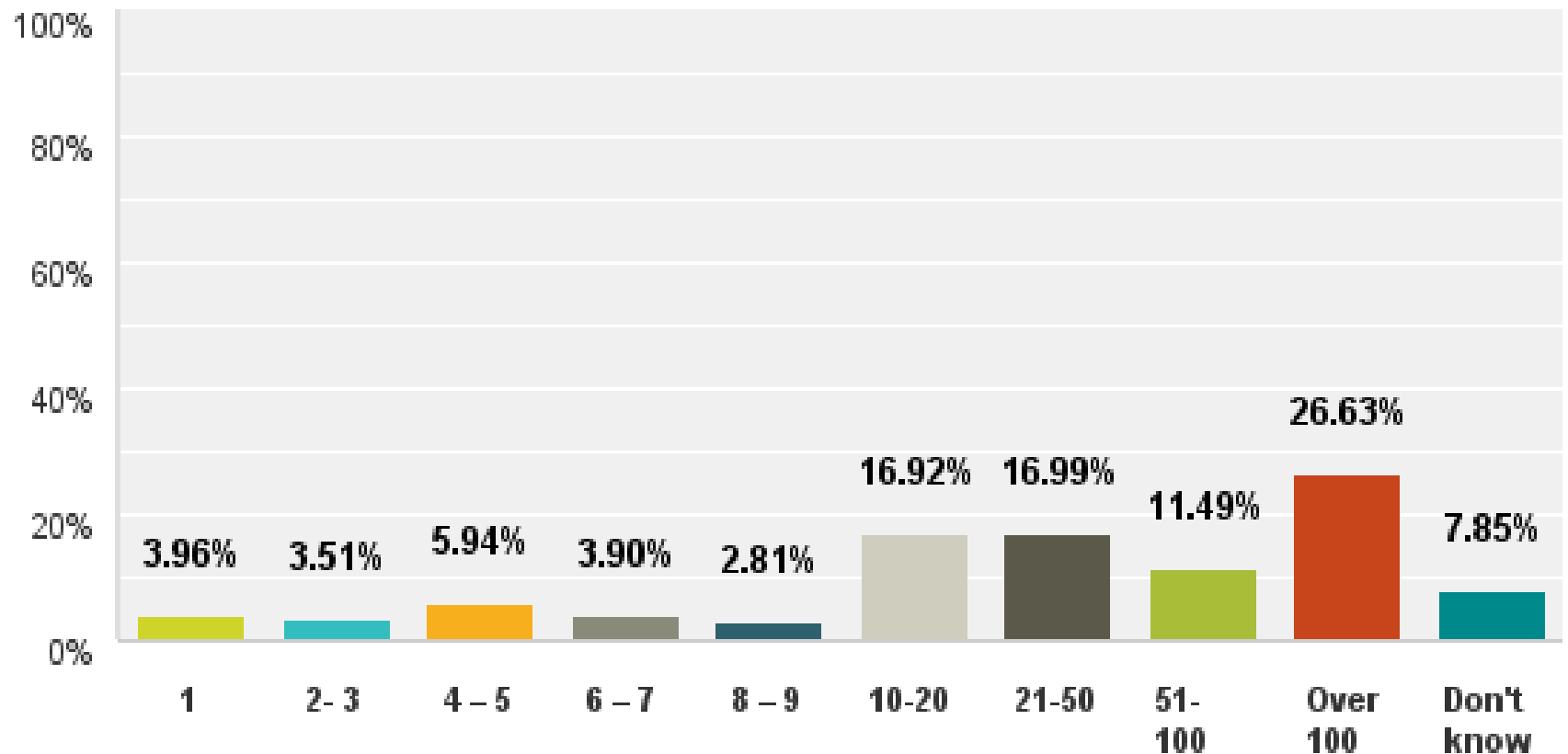
To make a financial return
To diversify my portfolio
Support an alternative to banks
Control where my money goes
Ease of process



■ Very important ■ Important ■ Neither important nor unimportant
■ Unimportant ■ Very unimportant

Lenders are Diversifying

If known, how many business loans in total have you funded through this P2P business lending platform?



Emerging Trends

- Diversification
- Affinity Investment / Social Finance
- Hybridisation (Investors & Platforms)
- Institutionalisation (Investors & Platforms)
- Brands & Crowdfunding
- Internationalisation / Regionalization / Localisation
- Regulations & Governmental Intervention; Tax Regimes



SONY



DODGE



HYUNDAI



Thank You!

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