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Exploring the potential of crowdfunding in the Dutch consumer market

P2P lending has experienced vast growth over previous years

Abstract

P2P lending has experienced vast growth over previous years. P2P lending allows individuals and institutions to directly lend to and borrow from each other through online platforms. The main advantage that these platforms have, is that they are able to operate more cost-efficiently than banks, allowing them to offer higher interest rates to lenders and lower interest rates to borrowers.

Within Europe, the Netherlands ranks 4th in terms of overall P2P lending volumes. Although in most countries the majority of P2P loans are borrowed by consumers, almost all of the Dutch P2P loans are businesses loans. This difference can be explained by the relatively small Dutch market for unsecured consumer debt.

Meanwhile, the Dutch market for consumer mortgage lending is relatively big and growing. This suggests a potential for P2P consumer mortgage lending within the Netherlands, where it could offer an investment opportunity for institutional and retail investors, while being able to provide mortgage loans to borrowers at a competitive interest rate. As of publication, only one P2P lending platform in the Netherlands has yet obtained a license to facilitate this type of mortgage lending (Jungo).

Despite the fact that a Dutch regulatory framework for the P2P lending industry is in place, there are currently no regulations that actively support this industry. Also, involvement from institutional investors in the Netherlands has to date remained low.

Although P2P mortgage lending might be a viable opportunity within the Dutch market, it will only be possible to unlock its value when professional parties, institutional investors and the government will all start embracing the potential of this crowdfunding model.

Exploring the potential of crowdfunding in the Dutch consumer market

Introduction
Deloitte supported Max Barendregt to investigate the potential of crowdfunding in the Dutch consumer market. In a financial climate where interest rates are persistently low and banks are increasingly selective in the borrower-categories they are willing to lend to, crowdfunding platforms have found fertile ground. Over the last decade the concept of online crowdfunding has experienced vast world-wide growth, enabled by technological innovations and the trend towards growing trust in online transactions. Crowdfunding activities within the Netherlands have also increased substantially. However, crowdfunding thus far only gained traction in the Dutch business market, while its activities in the consumer market have remained marginal to date. By assessing different types of crowdfunding in combination with Dutch market characteristics, this article explores the potential for crowdfunding in the Dutch consumer market.

Crowdfunding explained
Crowdfunding is an alternative finance model that allows individuals and institutions to raise funding from 'the crowd' using web-based portals, better known as crowdfunding platforms. Four different types of crowdfunding exist: i) Reward-based, in which funding is provided in exchange for future products and services; ii) donation-based, in which the funding is done on a voluntary basis with no return; iii) equity-based, where the funds are provided in return for an equity stake in the business that is looking for funding and iv) debt-based Peer-to-Peer (P2P) lending, an application of crowdfunding that allows individuals and institutions to directly lend to and borrow from each other, without the necessity and involvement of traditional intermediaries like banks.

Within the term 'Peer-to-Peer lending', the word 'peer' does not necessarily mean 'individual' but is used to indicate an end-user. Therefore, a 'peer' can be a single retail investor or borrower, but might just as well be an institutional investing firm or a company looking for funding. P2P lending can be used for both consumer and business lending, both of which can be funded by institutional and retail investors.

P2P lending is taking the lead thanks to several competitive advantages
Debt-based P2P lending[1] has been the dominant crowdfunding model in Europe, accounting for about 60% of the funds raised through crowdfunding in 2015[2]. By way of comparison, P2P lending has shown to have a similar contribution regarding crowdfunding in the Americas and the Asia Pacific region.

The main competitive advantage that P2P lending platforms have over conventional banks, is that they are able to operate in a more cost-efficient way, consequently allowing them to offer higher interest rates to lenders and lower interest rates to borrowers. This is key, as the debt market is highly price-sensitive.

This cost advantage is for one part enabled by the fact that as P2P lending platforms merely facilitate the connection between lender and borrower, they neither lend nor borrow money themselves. As a result, they are regulated differently than banks and similar financial institutions, and for example do not need to keep cost-imposing capital reserves. Secondly, the focused nature of their activities allows these platforms to operate with relatively low overhead costs compared to traditional financial institutions.

Besides the ability to operate more cost-efficiently, several other competitive advantages are at play, like the ability to provide credit to a growing group of borrowers unable to access bank lending, the perception that P2P lending is more responsible and of greater social value than conventional banking and the fact that efficient deployment of

[1] Within Europe, debt-based crowdfunding is best known as P2P lending. Other commonly used terms for this concept are marketplace lending, market-based financing, non-bank lending and online lending.

[2] Cambridge Centre for Alternative Finance

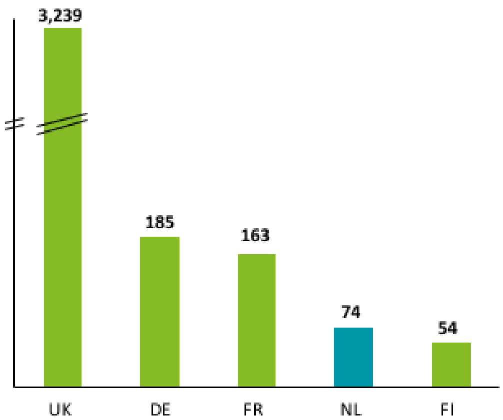
technological innovations allows these platforms to outperform on speed and quality of service towards users.

The Netherlands is the 4th biggest P2P lending market in Europe

On a European outlook, the leading country in terms of absolute P2P lending volumes is the UK – home of Zopa, the world's first P2P lending platform – being accountable for over €3.2 billion in P2P loans in 2015. This volume represents 84% of all European P2P loan volumes in that year.

The European countries making up the remaining 16% show more evenly distributed volumes. Among these, the Netherlands ranks 4th in terms of absolute P2P lending volumes, having serviced over €74 million in loans over 2015. In terms of P2P lending volumes within continental Europe during that year, the Netherlands is followed by Finland (€54 million), while being preceded by Germany (€185 million) and France (€163 million).

P2P lending volume by country (€m, 2015, Europe top five)

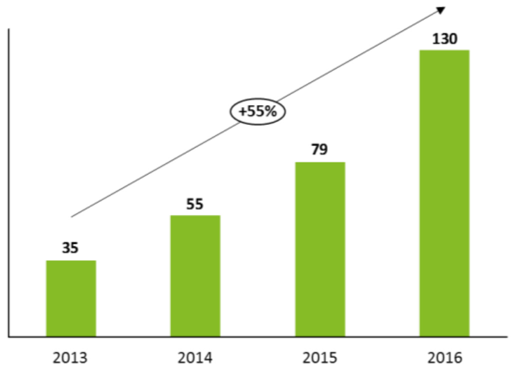


Source: Cambridge Center for Alternative Finance

Dutch P2P consumer lending has remained marginal

Over the period 2013 – 2016, P2P lending in the Netherlands has grown with an average rate of over 55% per year, from just under €35 million in 2013 to over €130 million in 2016.

P2P lending volume in NL (€m, 2013 - 2016)



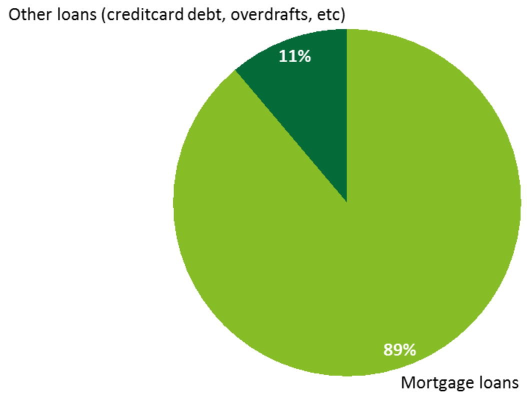
Source: Cambridge Center for Alternative Finance, Douw en Koren

However, as over 95% of the total P2P loan volume within the Netherlands is borrowed by businesses, Dutch P2P consumer lending has to date remained marginal. Interestingly, P2P lending volumes within the other aforementioned countries are all for at least 60% attributable to consumer lending.

One of the most obvious explanations for this would be that the Netherlands has a relatively small market for consumer loans in general. This small market for consumer loans is often explained to be due to a debt-avers stigma within Dutch culture.

However, the significant Dutch consumer mortgage market – with loan volumes comprising an average of 89% of Dutch household debt – could be an interesting market for P2P consumer lending to serve, especially now it is experiencing a booming recovery of the collapse after the 2008 financial crisis. P2P lending could offer a solution to provide mortgage credit to a growing base of Dutch consumers (e.g. freelancers) that fall outside the risk appetite of traditional mortgage lenders. At the same time, this application of crowdfunding could be an attractive alternative investment opportunity to institutional investors and affluent consumers.

Composition of Dutch household debt (avg. 1995 – 2013)



Source: European Credit Research Institute

Is there a future in P2P consumer mortgage lending?

As the Dutch market has shown to be open to the concept of P2P lending and has a big consumer mortgage market that it can potentially address, the question is whether there is a market for P2P consumer mortgage lending in the Netherlands, and what steps will need to be taken to get this potential market started. As the use of crowdfunding for financing mortgage loans has thus far been in its infancy in the Netherlands as well as abroad, it is yet to be seen whether this application has a true potential for success.

Perhaps the biggest implication that will need to be accounted for when using P2P lending to finance mortgage loans, is that the maturity of a conventional mortgage loan is much longer than the maturity of an unsecured consumer (P2P) loan. Whereas the typical consumer loan maturity on a P2P lending platform is between 1 and 8 years, the common maturity of a Dutch mortgage loan is between 22 and 30 years. This means that whenever these loans would be non-transferable, investors would have to wait multiple decades before their loan would be repaid.

An obvious solution to this perceived issue is to make these loans readily transferable among investors. By doing so, investors will no longer have to wait for the loan to mature, as they are able to resell the loan. However, this approach will only pose a solution to this problem when there is sufficient liquidity for this type of loans.

Another solution is to pool investments into a fund from an institutional investor that has the liquidity to facilitate early repayments to smaller investors if necessary (which is very comparable to how a bank works, the difference being that asset classes are based directly on investor choices).

A third possible solution would be to create a hybrid P2P mortgage loan. In this case, one part of the loan has a longer maturity and is financed by an institutional investor, while the remaining part of the loan is financed by the crowd with a maturity similar to that of a regular unsecured P2P loan.

First initiatives are starting to emerge

As mentioned before, the application of P2P lending to the mortgage market has to date been in its infancy in the Netherlands as well as abroad. Because of this, foreign examples of are rare, although Landbay in the UK and SoFi in the US are leading the way. For both these examples the majority of loans is funded by institutions that use P2P lending as an additional capital outlet.

Within the Netherlands, the approach of creating a hybrid P2P mortgage loan is adopted by Jungo, the first Dutch P2P lending platform focused on mortgage lending. Thus far, Jungo has been the only platform that has been licensed by the Dutch Authority for the Financial Markets (AFM) to facilitate in P2P mortgage loans, and expects to provide its first mortgage towards the end of 2017.

Policymakers could accelerate investments

With regard to regulations concerning P2P lending in general, the Netherlands currently has a regulatory framework in place stating what is expected and required from these platforms. Although this framework provides the rules for Dutch P2P lending platforms, there is thus far no policy that actively encourages the use of P2P lending within the Netherlands.

In the UK the introduction of Innovative Finance Individual Savings Accounts (IFISAs) in April 2016 supported P2P (mortgage) lending in the UK. This policy allows UK citizens to invest up to £20.000 via P2P platforms, while being exempted of paying tax over their yields. Not only does this type of support provide an economic incentive to start investing on these platforms, but also gives the market a signal of trust in these kinds of financing methods.

Institutional investors and professional parties are vital for growth
Besides government support, another key factor in the potential success of P2P mortgage lending is the involvement of professional parties and institutional investors. With institutions financing the majority of P2P mortgage loans in the UK and the US, P2P lending could provide an opportunity for Dutch institutional investors as well. These institutional investors are needed to provide sufficient long-term funding, which could also be only the long-term part of a hybrid P2P mortgage loans.

Concluding, although the Netherlands has shown to be open to the concept of P2P lending, the p2p mortgage market is still largely unexplored. For incumbents this could provide a new, cost-efficient concept for distributing mortgages. Government support policies could enable the market to take off and attract sufficient volumes to be viable.

Contact details

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