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The Benefits of Securitisation in the European Peer to Peer Lending Industry

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Abstract:

The 2008 global financial crisis fermented the creation of a financing gap between small borrowers and lending institutions, which may come in scope once again following the global pandemic. Individuals and SMEs requesting funding will get better access to capital if lenders can de-risk their position and hence mitigate their liquidity and cash flow risks. The advent of alternative finance in recent years has brought with it a source of liquidity through the power of the crowd and how this can be maximised through the use of securitisation.

Securitisation has been around for a long time and since 2013 this has also been used to de-risk alternative finance and loans generated on a peer to peer ("P2P") basis. The authors, herein delve into the different risks faced by lenders that offer loans via peer to peer lending platforms and the role that securitisation may play in addressing such risks. The discussion within this article delves further into how securitisation could be regulated and what benefits will be derived from the regulation of securitisation of peer to peer lending. The focus is placed on some themes elicited from the regulatory analysis that is the foundation for any regulatory framework for the regulation of securitisation with peer to peer loans as the securitisation assets.

Keywords: *Peer to peer lending, securitisation, de-risking, alternative finance, finance gap.*

JEL codes: *E24, J21, J43, O13, Q13, Q14.*

Paper Type: *Research Article.*

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1. Introduction

The primary aim of this paper is to analyse the role that can be played by using different sources of finance to de-risk, with a focus on securitisation and the use of alternative means of financing within a securitisation framework. The impact that adequate regulation of the different types of securitisation will be discussed within this paper with the ultimate purpose of demonstrating whether the crowd can assist in reducing liquidity risk within a securitisation scenario, whilst also bringing about positive financial returns for the investors. The assessment of the current European Union ("EU") regulatory framework regarding this de-risking mechanism will be crucial within this paper, assessing the most relevant beneficiary entities for this source of finance and those that might be more adept to this type of de-risking. Following on from the above discussion the authors intend to present a series of proposals to address the regulatory deficiencies for securitisation, especially with the proposed involvement of the crowd requiring a substantial element of protection. The main problem is that lenders are taking on substantial risk by venturing into P2P lending, causing most potential lenders to be wary of venturing towards this sort of financing and there is very limited data present exhibiting the problems that investors face when lending money on a P2P lending platform. The authors hence intend to address this gap in research through this study, by also analysing whether the existing regulatory framework addresses such risks or understanding the weaknesses that remain.

The purpose of this research is to address the questions as to whether the risks faced by lenders in a P2P lending scenario can be addressed through securitisation. How can this be regulated in such a way as to properly mitigate risk without shifting it onto someone else or putting the wider economy at risk and effecting the volume growth of securitisation of P2P loans.

2. Risk Management

Since the 2008 financial crisis financial institutions were adopting more risk-averse approaches whereby loans would generally be offered only in highly collateralized situations[4]. This trend can be exhibited through the situation in the United Kingdom whereby from 2008 until the end of 2017 the percentage of secured lending had increased but the percentages of unsecured lending to individuals and productive lending (i.e. loans that have a positive effect on the GDP of a country), had decreased slightly[5]. The elevated risk mitigation attitude by banks can also be seen across the Atlantic Ocean in the USA where the number of bank loans overall only increased marginally, but even the ratio of bank assets to bank loans increased,

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[4] *Dr Stuart Fraser, 'The Impact of the Financial Crisis on Bank Lending to SMEs' [2012] Economic and Social Research Council.*

[5] *Konstantin Bikas, 'How has Bank Lending Fared Since the Crisis?' (PositiveMoney, 5th June) <https://positivemoney.org/> accessed 27 December 2019.*

meaning that banks are emphasizing on a more collateral-focused approach when it comes to deciding whether to lend[6]. This shows that banks' risk-sensitive approach towards lending was mitigated through high collateralisation of loans causing the creation of a finance gap, which was mostly felt by Small and Medium Enterprises ("SMEs"), which would normally have fewer assets to offer as collateral when compared to larger, possibly multinational, corporations that would have significant asset holdings. The effect of this de-risking approach across the globe can be seen in a variety of countries, such as the United Kingdom whereby before the 2008 financial crisis 25.9% failed to obtain the necessary funding from their first source, while in 2010, 52.2% were unsuccessful at their first attempt, showing increasing difficulty to obtain such financing[7]. The lack of the required funding for SMEs, besides other entities, was seen as a factor that held the global economy from recovering at a more expedited pace and governments who focused on growth intervened to bridge the funding gap through state funding. Other countries which focused on austerity, an attitude seen to ferment from the fact that many countries were wary of taking significant risks in an unstable economic environment, and their economies were seen to take longer to recover in this regard.

Risk can be defined as the uncertainty of profits or danger of loss due to some unforeseen events in the future.[8] Within a business environment, there are a number of different risks that arise due to the entity's exposure to a number of variables, and these are operational risks, financial risks, strategic risks, market risk, country risks, compliance risks and natural risks. Operational risk is defined as the risk of loss resulting from inadequate or failed internal processes, people, systems or from external events[9]. The reduction of this type of risk hence is dependent on having adequate internal processes and reducing human error compounded with appropriate training being provided to the management to avoid any mismanagement that may come about.[10] Natural risks can also be termed environmental risk that would consider the effect that an environmental catastrophe would have on a business and it is for this reason that business continuity policies are put in place to mitigate the potentially disastrous effects such risk may bring about. The potential impact that could be caused by the political and economic status of a country is defined as country risk, and in an ever more globalised business environment, it is essential to consider the country risk before deciding whether to increase business exposure in a certain jurisdiction among a number of situations that would require assessing the

[6]*Thomas L. Hogan, 'What Caused the Post-Crisis Decline in Bank Lending?' [2019] Rice University's Baker Institute for Public Policy.*

[7]*Neil Lee, 'Credit and the Crisis - Access to Finance for Innovative Small Firms since the Recession' [June 2013] Big Innovation Centre.*

[8]*Simona-Valeria Toma, 'Different Categories of Business Risk' [June 2012] Annals of "Dunarea de Jos" University of Galati.*

[9]*Mitsutoshi Adachi, Principles for the Sound Management of Operational Risk, Bank for International Settlements (Basel Committee on Banking Supervision 2011).*

[10]*Simona-Valeria Toma, 'Different Categories of Business Risk' [June 2012] Annals of "Dunarea de Jos" University of Galati.*

risk of investing in a certain country[11]. Every company starts out and continues to operate with strategic goals in mind as overarching objectives about where the business is heading and this brings about what is termed as strategic risk, whereby the management of the company, normally the Board of Directors sets out targets that may be over-ambitious or too conservative, leading to possible effects on the company and its future[12]. Market risk can be defined as the risk of losses arising from variances in market prices that could affect a company's balance sheet[13]. Market risk can be further subdivided into equity risk, interest rate risk, currency risk and commodity risk where the market prices of shares, interest rates, foreign exchange rates and commodities may change and this will hence have an effect on the company's financial position[14]. Nowadays law and regulation changes are frequent and the struggle for business to keep up to date with regulation is a very big obstacle, especially for smaller enterprises such as startups and SMEs, and this struggle is generally being quantified through the term of the cost of compliance. With every new challenge that comes about, this brings with it a risk that such a challenge may not be met and hence resulting in the compliance risk, also termed the legal risk. Non-compliance can bring with it significant damage to the entity together with the individuals operating such an entity such as penalties or sanctions. A big component of this type of risk is the anti-money laundering compliance obligations that are becoming ever more rigorous as time passes and the spotlight is being placed on jurisdictions to ensure that proper anti-money laundering legislation is in place.

The focus of this paper is to address the financial risk. The term financial risk is very generic and must be broken down further to be properly understood, by providing greater focus and attention to the following components; market risk, credit risk, capital risk and liquidity risk. Market risk can be defined as the risk of losses arising from variances in market prices that could affect a company's balance sheet[15]. Market risk can be further subdivided into equity risk, interest rate risk, currency risk and commodity risk where the market prices of shares, interest rates, foreign exchange rates and commodities may change and this will hence have an effect on the company's financial position[16]. The potential that a borrower or counterparty might fail to satisfy their financial obligations as per a contract or pre-agreed terms

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[11] *Mohammad Almotairi, 'A Case Study "Challenges and Threats for International Business"' [2013] 1(4) American Journal of Research Communication.*

[12] *'Exploring Strategic Risk' [2013] Deloitte.*

[13] *'Proper Conduct of Banking Business [4] (6/19) Measurement and Capital Adequacy—Market Risk' Supervisor of Banks.*

[14] *Simona-Valeria Toma, 'Different Categories of Business Risk' [June 2012] Annals of "Dunarea de Jos" University of Galati.*

[15] *'Proper Conduct of Banking Business [4] (6/19) Measurement and Capital Adequacy—Market Risk' Supervisor of Banks.*

[16] *Simona-Valeria Toma, 'Different Categories of Business Risk' [June 2012] Annals of "Dunarea de Jos" University of Galati.*

can be defined as credit risk[17]. A term that coincides with the term credit risk is default risk and hence this is the exposure of a business resulting from the risk that an individual or an entity that has borrowed money against a number of pre-set conditions and payments terms, defaults on such obligations[18]. The next component of financial risk is capital risk whereby an entity might lose value on their investment due to the investment in their capital suffering a downward trend in value or total eradication of the capital's value as would be the case with equipment that is no longer of value or liquid securities that relate to an entity that has gone bankrupt[19]. Liquidity is the measurement of an entity's ability to meet its financial obligations as they arise by having sufficient financial resources in place to satisfy such demands immediately, and hence it is essential to have adequate cash flow in place. There might be situations where the company would be unable to meet its obligations as they arise and this is a resultant effect of inadequate liquidity risk management.[20] These four components of financial risk can be mitigated in different ways, but tie in with one another and should they be addressed properly the financial health of the company would be less susceptible to failure due to financial reasons.
Risk management is essential in any scenario, especially in a business environment and putting in place policies and procedures to mitigate such risks is important. Risk mitigation measures are implemented in scenarios when the entity is already exposed to the risk but there are other measures for entities to de-risk, such as not exposing themselves to such risk in the first place. The two main considerations before de-risking is implemented are generally whether the potential benefit is worth the cost suffered and the increasing global concerns regarding Anti Money Laundering ("AML") / Combating the Financing of Terrorism ("CFT") risks.

3. Risk Analysis and Control

Within every transaction in the corporate world, there are always risks associated with it. These span between the pre-transaction phase to the post full settlement phase. It is important to first outline such risks before proposing solutions as to how they can be mitigated.
Information Risk: This is involved when a lender provides financing through a loan to a borrower subject to certain conditions as agreed upon between the two contracting parties.
Repayment Risk: This is the risk that the borrower voluntarily or due to reasons beyond their control, do not maintain their loan repayment schedule and default on some loan repayments.

[17] *'Principles for the Management of Credit Risk' Bank for International Settlements.*
[18] *Erika Spuchľáková et al. / Procedia Economics and Finance 24 (2015) 675 – 681.*
[19] *Simona-Valeria Toma, 'Different Categories of Business Risk' [June 2012] Annals of "Dunarea de Jos" University of Galati.*
[20] *'Liquidity Risk Management' [2005] Deposit Insurance Corporation of Ontario.*

Lender’s Financial Situation Risk: The lender must also consider a number of other factors that would affect the conditions that are placed within the terms of the loan agreement, and before that, whether to offer the borrower the loan requested.

3.1 De-risking

De-risking the lender’s financial position from a liquidity and solvency perspective is vital to ensure that bankruptcy is staved off and within a corporate situation, the long term future of the entity is jeopardised. The most common method for lenders to address the risks mentioned above, especially with regards to the reduction of their financial exposure is by looking for other sources of finance or other methods of generating revenue through shorter term loans that would possibly generate a reduced amount of revenue when compared to a long term loan but would not exacerbate the liquidity risk to a level that would put the company in a precarious position. The sources of finance that can address the liquidity risk that lenders may face are tackled through the three broader categories based on the length of the effect such sources of finance may have on the company, ranging from short term financing methods to long term financing solutions[21]. Short term financing solutions would include the factoring, purchasing on credit and overdrafts or short term loans. Medium term financing options include the issuance of preference shares or bonds, lease financing or through medium term loans from governmental authorities, financial institutions or banks. The final category of financing is obtained on a more long term basis on a period that exceeds 5 years and would include equity financing, bond issues, long term loans and asset securitisation amongst others.

3.2 De-Risking in the EU

The EU considers risk analysis as part of its financial stability assessment whereby the following risks were still considered to be present as of May 2019; disproportionate rise in premiums associated with risk, countries were now taking on more debt, besides the doubling of poorly classified corporate debt over the previous five years, bank intermediation costs have risen significantly due to increasing regulatory obligations to comply with raising operating costs and a more aggressive attitude based on a riskier approach being taken by the non-bank financial sector in their search for a better return on investment. Recent years have been symbolized by low interest rates and thus have resulted in companies taking to a more pro-leveraging attitude, seeing it as potentially more profitable than through the use of equity financing. The low default rates have provided impetus to corporate entities to look towards lower rated methods of financing. Exposure to lower classified bond issues and therefore the absorption of more risk leads to such a lender or corporate financier raking in higher interest rates. The fact that asset prices, especially illiquid assets such as property, have continued to rise within the European Union, causing

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[21] *'Sources of Finance' (E-Finance Management) <https://efinancemanagement.com/> accessed 30 March 2020.*

these rises to sometimes be deemed as overvaluation, has increased the risk that should prices stabilise or even more so drop quickly there could be a huge effect on the market liquidity within the EU, as has taken place with the advent of the COVID-crisis. Within the EU there have been a number of steps taken to address such risks, through elevation of capital buffers and implementation of macroprudential measures to put in place more buffers for the property market and reduce its volatility.

The EU has also taken a more cohesive approach to strengthen the regulatory framework through the introduction of the Basel III capital and liquidity standards within the Capital Requirements Regulation and Directive, along with the further development of the banking and capital markets union through the removal of obstacles. The EU has seen significant growth within the NBFI sector, and while risks may differ from those present within the banking sector, the NBFI sector is deemed to be less regulated but with its growth causing its potential impact on the liquidity risk within the EU to be substantial. The EU is de-risking this sector by increasing regulation concerning reporting obligations for the investment funds sector[22].

A lender may choose to de-risk for a number of reasons and once a lender de-risks there are effects on other entities, individuals or the wider economy as a whole. The causes of de-risking many times relate to regulatory obligations or business decisions. Within recent years there has been substantial regulatory development and this has brought about a large number of obligations that must be adhered to, such as the level of risk exposure that certain institutions may be subject to, and capital requirements in proportion to loans offered to borrowers, amongst other obligations causing lenders to venture towards increased de-risking, either by choice or imposition by a regulatory authority. The lender may also carry out de-risking based on a company decision whereby they feel that less risk exposure and increased liquidity is required, even at the cost of foregoing a potentially bigger return on investment in the long term.

When a lender comes to de-risk their financial exposure it is hence important to consider what their primary aim is and what they seek to bear out of the de-risking, whether it is to look for alternative sources of financing to address the liquidity risk in the short term, whether they seek to reduce their risk exposure by maintaining more capital within the company and offering less risky loans, or whether the ultimate aim is to generate liquidity from assets that are deemed to be illiquid. Depending on their target outcome from the de-risking process, the lender will apply specific measures.

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[22] *Luis De Guindos, 'Financial Stability Review, May 2019' [2019] European Central Bank.*

3.3 Securitisation

There is a way for lenders to reduce their risk exposure without reducing the number of loans offered and this can be done through securitisation allowing the entity to derive liquidity from illiquid assets. Securitisation takes place by transferring financial assets that produce revenue, to a separate vehicle, generally termed an SPV, against payment, and the SPV then issues securities to potential investors using the funds generated from such securities issuance to pay off the originator and using the pooled loans purchased as collateral for the mentioned issuance. There are generally two main types of securitisation transactions, termed Asset-Backed Securities ("ABS") and Collateralised Debt Obligations ("CDO") when it comes to the traditional modes of securitisation. ABS are part of securitisation transactions involving the presence of collateral through mortgage or non-mortgage backed securities, whereby the former can include assets backed by both residential and commercial loans, while the latter may be backed by car vehicle loans or returns derived from royalties or other means of transport. CDOs are backed by a pool of financial obligations such as collateralised loan obligations, collateralised fund obligations and collateralised bond obligations. The return generated from the collateral in a securitisation transaction is the profit generated for the SPV, of which the investor would garner a portion of in proportion to their initial capital investment in the SPV. Before the SPV issues such securities to potential investors credit rating agencies undertake an assessment and give a credit risk score to such an issuance so that the potential investor will be able to better understand what they are investing in and acknowledging that a bigger return on investment would be required should the risk be of an elevated nature.

3.4. Credit Enhancement, Bankruptcy Remoteness and Tranching

The rating assigned to the securities, issued through the Securitisation Special Purpose Entity ("SSPE"), must be more attractive for potential investors than had they invested directly in the securities of the originator and there are three methods to arrive at this goal, namely credit enhancement, bankruptcy remoteness and tranching. The ultimate aim is to offer comfort for potential investors so that their interest will result in a tangible investment, and hence it is important to reduce the risk involved by ensuring that there will be constant cash flow. Added credit enhancement is provided within the transaction, via tranching, over-collateralization or formation of a cash reserve, or through the assistance of a third party, via special guarantees or letters of credit refunding up to a certain amount of losses if needed, or through guarantees undertaken through insurance companies.

3.5 Benefits of Securitisation

The biggest benefit and underlying purpose for carrying out securitisation is the generation of liquidity from illiquid assets and this shows that securitisation can be used to raise significant levels of funding. During this de-risking process, even

though the company will benefit from increased liquidity, this will not be done at the cost of the shareholders. The fact that the asset will be transferred to an SPV and securities from that company are issued to finance the purchase of the asset transfer means that no securities will need to be sold directly from the originating entity, keeping the shareholding position of the shareholders in the same situation. A benefit from an investor's point of view is that due to the asset being transferred to an SPV, should the originating business run into bankruptcy problems, this would not have any effect on the SPV. SPV's issuing securities with very good ratings make it easier for regulated entities to invest, widening the pool of potential investors. This is achieved through credit enhancement, bankruptcy remoteness and tranching that ultimately allow certain securities to be issued at a AAA rating, a rating that is uncommon for issuances of corporate entities. The proper rating has assisted in stabilizing the rating assigned to securities issued through SPV's, due to the regulatory obligations and limitations placed on issuing SPV's, especially with regards to the liabilities such entities may undertake. A major benefit for financial institutions and credit institutions is that as issuing entities they will be able to utilize off-balance-sheet debt as the company is being financed without obtaining a loan, allowing banks to further maintain full compliance with their capital requirements' obligations. Banks would gain through securitisation as they would achieve elevated credit ratings, whilst also improving the bank's financial situation on the back of lower borrowing costs[23]. Following the 2008 financial crisis and the role securitisation played in the development of that situation, further emphasis has been placed on originator's obligations, especially when requiring rating by credit rating agencies. Credit rating agencies now shed further light on the financial and operational situation of the originator, through audits, that may prompt the originator to ameliorate its operations to address any functional and financial deficiencies it may have within the entity[24]. Securitisation seen from a market-wide angle, allows the spreading of risk through the use of the capital markets, as it mitigates banks' vulnerabilities. The use of international capital markets systems allows for the abatement of jurisdictional readiness and cost of credit, as a means of providing social and economic perks.

4. Risks of Securitisation

A big problem associated with securitisation is the information asymmetry that could be present vis-a-vis investors in the securities issued by the SPV and originators, as the latter would have full visibility of the risks associated with the underlying assets transferred to the SPV but it may not be the case from the investors point of view. Investors would normally have limited information in their possession and hence

[23] *'Raise long-term funding through debt capital markets - Advantages and disadvantages of raising finance through asset securitisation' (Invest Northern Ireland). <https://www.nibusinessinfo.co.uk/content/advantages-and-disadvantages-raising-finance-through-asset-securitisation> accessed 30 March 2020*

[24] *'Securitisation 101' [September 2019] GCR Ratings.*

would be at a distinct disadvantage when it comes to making an investment decision. The regulatory obligations being placed on SVs' and SPV's would make the raising of capital a complex matter and this can somehow be seen as a barrier to entities' opting for securitisation as a mode of financing. Securitisation, as a mode of structured finance, is considered very complex to structure when compared to the structuring of more traditional debt financing mechanisms[25]. As an added side note on this, the benefit of obtaining off-balance-sheet treatment may not always result from securitisation, and this can be seen in a synthetic securitisation scenario, whereby the risk is still transferred but the asset would remain on the entity's balance sheet, but the fruits derived from the possession of those assets would be enjoyed by the investors of the SPV. When an originator transfers an asset to a SPV it loses its control of those assets, causing the entity's value to reduce and should the company opt for a public listing it would obtain a reduced amount compared to going for flotation before securitisating its assets[26]. The prepayment risk may arise, whereby investors would not obtain the financial return expected, maybe even over an extended period of time, due to the fact that the securitisation assets would consist of mortgages that would be paid before their maturity date. A bigger risk is the default risk whereby the borrowers in the underlying assets would default on their financial obligations for repayment of loans and investors would lose out on the return on their investment and possibly a portion of the initial amount invested. A drawback can also be seen to be the cost involved to structure the transaction and set it up accordingly, including preparation of the pertinent documentation and procedural mechanisms for reporting, besides the fact that due to the complex nature of the transaction the procedures to be implemented need to be in full compliance with the entity's reporting obligations.

5. Regulation of Securitisation in the EU

EU started working on securitisation in 2014, when the European Commission elicited a number of priorities to kickstart its Investment Plan for Europe. As part of this plan the Commission felt the need to develop securitisation markets through the formation of Simple, Transparent and Standardised Securitisations ("STS") transactions, to allow for the creation of a level playing field that would foster cross-border transactions in light of the Commission's Capital Markets Union plan, whilst at the same time preventing the notion of forum shopping. The regulation elicited a variety of definitions, including the precise meaning of securitisation, the exclusion of certain transactions from being considered as exposures within the securitisation definition and the rights and obligations of the sponsor / originator.

The European Commission introduced the Securitisation Regulation that would support STS. One of the most important aspects of this Regulation is the prohibition

[25]*Giulio Rocca, 'Advantages & Disadvantages of Securitization for Issuers & Investors' [2019] The Nest.*

[26]*'Securitisation 101' [September 2019] GCR Ratings.*

of resecuritisations, except for limited scenarios, as resecuritisations counter the intentions of the Commission that underline transparency as one of the paramount purposes of this Regulation. Institutional investors are subjected to a number of due diligence obligations to gauge the risk presented by the securitisation transaction, with the intention to protect the ultimate investors. Information published by securitising parties also aids investors in undertaking the required due diligence before investing with the securitisation scheme or an STS securitisation, especially through the provision of information via STS notifications. The originator, sponsor or original lender must hold a material net economic exposure to the underlying risks and thus to prevent a situation whereby the retention requirement is circumvented through the setting up of certain legal structures, and this should be included within the STS notification.

One measure introduced with the intention to address the information asymmetry problem, between the originators and the investors is that information relating to the securitisation assets cannot be withheld intentionally or sanctions would be imposed on the originator. Assets that are subjected to a riskier credit profile when compared to similar assets, must be disclosed to potential investors when the former assets are subjected to a securitisation transaction, while the latter are held by the originator.

Private securitisations operate differently from public securitisations, and in the former scenario certain information is not obliged to be publicly available as generally the transaction would be catered for a specific investor or group of investors. Any information that would need to be relayed by the originator in a private securitisation, to a potential investor would be done privately and directly, especially as there might be sensitive information being relayed.

The Regulation lists certain information that must be disclosed by originators, sponsors and SSPEs within the investor report and disclosure requirements within the investor report vary depending on the different types of securitisations i.e. when the transaction is Asset-Backed Commercial Paper or not.

Only true-sale securitisations can be classified as STS securitisations, that is securitisations wherein the transfer of assets from the originator to the SPV is not subject to certain provisions whereby the originating entity could reobtain ownership of such assets should certain conditions be satisfied. The only exception arises when such a transaction goes contrary to the insolvency law of a member state, whereby the securitisation transaction can be voided. The confirmation that the transfer of assets from the originator to the SPV is a true-sale could be obtained through a legal opinion from a legal professional. Synthetic securitisations run counter to true-sale securitisations, whereby they only transfer the credit risk through a derivative contract rather than transferring the actual asset and hence would not classify under the STS requirements that prohibit synthetic securitisations.

Certain eligibility criteria must be met so that the underlying exposures assigned to the SSPE are not considered active portfolio management on a discretionary basis. The exposures underpinning the securitisation transaction must not involve individuals or entities that owe money or are subject to an obligation for repayment that such latter individuals or entities have been affirmed as bankrupt. The standard of information, on the debtors of the securitised assets, that an originator must provide when transferring exposures must be the 'best knowledge' standard. A cautious position must be adopted regarding exposures that had previously been non-performing and were restructured. The restructuring must have taken place at least one year prior to securitising those exposures and during that period from restructuring to securitisation of the exposure there must have been no repayment issues. When it comes to the investors undertaking the necessary due diligence on the risks posed by the securitised assets, the assets that are going to be securitised must be similar in nature, and cannot include transferable securities or bonds listed on trading venues. The underwriting standards to be applied for assets to be securitised cannot be less rigorous than the underwriting standards utilised for the originator's other assets, that shall be be subjected to a transfer for the purposes of securitisation, and any significant amendments to such standards must be completely divulged.

For the purpose of the securitisation being considered a STS securitisation, investors, the relevant authorities and European Securities and Markets Authority ("ESMA") must be informed that the STS criteria are satisfied. ESMA would then proceed to circulate it via the list of STS securitisations on its website although this should not be deemed as a certification that STS criteria have been satisfied, as the latter obligation rests solely with the originators, sponsors and SSPEs. Should the STS criteria no longer be satisfied the originator and sponsor must inform ESMA and the relevant national authority, and the latter authority is also obliged to inform ESMA should penalties or fines have been levied on the originator.

The European Banking Authority ("EBA") has been authorised to issue regulatory technical standards to systematize the procedures for risk retention, measurement of such risk retention, constraints in this regard and dispensation from specified transactions, including the detailing of homogeneity requirements especially for the underlying exposures. Regulatory technical standards must also delineate the information that must be provided and the way how this is provided with regards to data on underlying exposures and frequent investor reports and conditions for resecuritisations to be allowed. Implementing standards must also cater for the form and basic information required to be provided from SSPEs to investors, mainly within the securitisation repositories, allowing investors easily understandable information to allow them to carry out the necessary due diligence and analysis prior and during their involvement[27].

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[27]*Regulation (EU) 2017/2402 of The European Parliament and of The Council of 12 December 2017 laying down a general framework for securitisation and creating a specific*

6. Peer-to-peer securitisation

The use of crowdfunding for investment purposes, loans and other financial instruments has increased significantly over the past decade and have served as a good alternative means of finance to allow an entity to address its liquidity risk. P2P lending has developed to such an extent that European jurisdictions are regulating it. The P2P lending market in Europe has grown to an estimated €11 billion, enhanced by the regulation put in place in jurisdictions such as the UK[28]. The EU seems to be following the UK's lead and in March 2018 proposed the regulation of investment-based crowdfunding and crowdlending. P2P lending is a very good alternative source of finance for entities at different stages of their growth, especially SMEs, but this source of finance could be enhanced by allowing the lender to de-risk their position through securitisation. The first P2P loan securitisation took place in 2013 when Eaglewood Capital Management was involved in this securitisation transaction that totalled $53 million in relation to securitizing loans offered by Lending Club to consumers[29]. When lenders within the P2P market de-risk their position through securitisation they free up their cash flow to allow for them to carry out further lending, while allowing securitisation of the loans they previously offered to create a secondary market through which potential investors may benefit from the loan repayments as securitised assets. The fact that the P2P lending sector is just now being deemed to be competing and entering the mainstream finance, places bigger responsibility on authorities when it comes to introducing regulation to allow the creation of platforms to be able to securitise P2P loans and cater for the creation of regulated secondary markets.

Lenders within the P2P lending market can either securitise directly through the creation of a SV, but the limitation on this is the fact that a significant volume of loans are needed in the current situation and climate for this endeavour to be cost-effective. The other solution would be the involvement of the banks or other big institutions that would set up, or probably already have in place a SV, whereby the lender would securitize the underlying assets. Where the securitization vehicle would be sourcing a variety of different loans from different lenders, the probability is that each lender or small group of lenders could be pooled and tranched, allowing such securitization vehicle to issue securities in relation to that specific tranche[30].

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framework for simple, transparent and standardised securitisation, and amending Directives 2009/65/EC, 2009/138/EC and 2011/61/EU and Regulations (EC) No 1060/2009 and (EU) No 648/2012 [2017] OJ 2 347/35.

[28]*'P2P Lending & Equity in the EU (Euro)' (P2P Market Data, 29th February 2020) <https://p2pmarketdata.com/p2p-lending-funding-volume-eu/> accessed 31 March 2020.*

[29]*Heena Dhir, 'The Rise of Marketplace Lending Securitisation' (Lending Times, 19th December 2018) <https://lending-times.com/2018/12/19/the-rise-of-marketplace-lending-securitization/> accessed 31 March 2020.*

[30]*Julian Craughan, 'Structuring a marketplace lending platform securitisation in Europe' [June 2017] Hogan Lovells.*

This is a common occurrence due to the signifanct volume needed for securitisation to be cost-effective.

7. Analysis

It is important to start this chapter by eliciting the main points that stood out from the previous chapters and how they relate to the scope of the research being undertaken here. The analysis followed a top down approach starting from how de-risking takes place globally, before venturing to focus on how this takes place within the EU and then going through the advantages and disadvantages of securitization and the way securitization are regulated both from a continental point of view. The case study relating to the securitization of Zopa loans gave a real-life implementation example.

7.1 Effects of De-risking

Loans undertaken in a traditional environment from a credit institution would be subject to rigorous regulation that the latter are subject to, whilst in the case of a P2P loan the transaction is subject to certain regulation within specific jurisdictions, but within the EU the *modus operandi* specific to P2P loans and how they are carried out is not catered for. The rest of the risks that are born out of securitizing P2P loans must be analysed in light of this specific fact, the lack of sector-specific regulation, except for jurisdictions such as the UK, that is currently on the precipice of leaving the EU, so while offering a great example as to how P2P loans may be regulated, cannot be considered much within an EU ambit going forward. The three types of risks considered can generally be compartmentalized into the information-related risks, the repayment risk or the default risk and the risks related to the lender's financial situation. There are 4 major elements involved in the securitization of P2P loans, starting from the underlying loans relating to the borrower, the lender, the securitization vehicle that may be set up by the lender or by a group of loans to pool the loans, and finally the investors that invest in the securities issued by the securitization vehicle. These different parties play different roles in exacerbating or mitigating the risks associated with securitization. The biggest and most obvious benefit bourne out of the whole process is that the lender's financial position will be improved through the provision of increased liquidity and cash flow generated from selling off the P2P loan receivables to the securitization vehicle in exchange for a fixed sum. The amount generated would normally consist of a discounted price of the total value of the securitization assets, in this case, the P2P loans, as there must be a potential return on investment for investors to assume the financial risk previously burdening the lender.

The second risk category is how securitization affects repayment risk and how it mitigates the possibility of defaults. Whilst this risk is present in all types of loans, whereby the borrower may not be able to keep up with their loan repayments, in a relatively unregulated environment of P2P loans this type of risk is exacerbated.

Whilst many P2P lending platforms bind their users with terms of use as a self-regulation mechanism this might not be coherent across all platforms and might lead to situations of regulatory arbitrage whereby potential borrowers would venture for a less regulated platform, in full cognizance of their risk of defaulting on their loan. The individual lenders may protect their position through the imposition of collateral requirements, increased interest rates and written agreements including penalties for non-payment amongst others. The options mentioned might serve to protect the lender's position and hence protection would also be available to investors within the securitization transaction as defaulting on such loans by the borrowers would ultimately impact the investors potential return on investment. This provision of information highlights the final major type of risk that may be present through information asymmetry whereby the lender, and in this case information not available to the lender would also impinge on the position of the securitization vehicle and the ultimate investors in the securities issued by the said securitization vehicle, would be in a position where all the information, that would normally be requested when a credit institution comes to provide a loan to an individual, would not be provided to the lender in a proper manner and therefore the lender would lack full visibility and the risk they assume would be even higher. This problem would perpetuate to the SV and the potential investors, although the probability of the lenders further exacerbating this information asymmetry risk further could be mitigated through the provision of credit ratings, so that potential investors would have full cognizance of the risk they would be investing in and compare it to the potential return on their investment.

In recent years, the EU has low interest rates within its financial ecosystem, pushing more debt financing rather than equity financing and also the fact illiquid assets such as property have continued to rise, presents an opportunity for securitization in relation to de-risking on two fronts. The most obvious use of securitization would be to de-risk a lender's financial position, hence creating more fiscal space for that entity to fund other loans but there is also the opportunity within the securitization sphere to derive liquidity from illiquid assets by pawning them off through a securitization vehicle. The prioritized basis to many recent de-risking initiatives within the EU is to address the default risk that would subsequently make securitization a less risky endeavour, and this has been done through the implementation of regulatory initiatives such as LTV and DSTI ratio amongst others. On a continental basis, the EU has strengthened capital and liquidity requirements to further distance bankruptcy and has focused on enhancing reporting obligations. Strengthening reporting obligations is crucial to address any information gap that may develop between the different parties to a transaction and such reporting obligations would also be crucial within the remit of a securitization transaction.

Credit enhancement is important to cater for a situation whereby the credit rating assigned to the securities to be issued, based on the underlying assets, needs to be improved so that more investors can be attracted, whilst reducing the risk associated

with those securities. On the other hand, credit enhancement generally reduces the return on investment both for the SV and for the investors, at a cost to reduce the risk associated with the securities. Improving the credit ratings of the securities can also be done through bankruptcy remoteness, in a move that separates the assets belonging to the originator, from those of the SV and in this way any risk associated with the originator does not impinge in any way on the SV. Enhancing the credit rating of securities issued by SVs can also be done through tranching, whereby securities issued are assigned different rights that relate to the varying type of underlying assets of the securitization vehicle. This allows the SV to offer investors better returns for riskier investments or lower returns for more risk-averse investors and therefore grading the different securities offered to cater for the specific requests of different investors.

7.2 Zopa Case Study

The fact that the size of the P2P lending market in Europe is at an estimated €11 billion and growing, whilst marrying this to the fact that assets that have formed part of securitization transactions within Europe in 2018 alone amounted to €32.4 billion and since inception, the amount of P2P loans that have been involved as underlying assets in securitisations amounted to an estimated €41 billion by the end of 2018, triggered major P2P lending platforms to venture for this space. One of the biggest P2P lending platforms in the world, Zopa has carried out a total value of €5 billion in P2P loans[31], as of June 2019, and therefore have the necessary capacity for it to aggregate loans and securitise them in the volume necessary to make a securitization worthwhile and cost-efficient. Seeing that it had the necessary volumes, Zopa sought to offer its lenders the possibility of de-risking their financial position, possibly to allow them to obtain the necessary liquidity to then be able to offer more loans via the lending platform. The idea of securitizing P2P loans was initiated by Eaglewood Capital Management Limited in 2013, but in this securitization, Zopa intended to securitise five times the value of P2P loans Eaglewood securitized six years prior. Zopa's securitization was significant since it utilized tranching to issue its securities and one of those tranches was classified with a AAA rating. Zopa's securitization was facilitated as Zopa operates within the UK and there is a solid regulatory framework for P2P loans, therefore significantly reducing the default and repayment risks as the underlying securitization assets operate in a well-regulated environment. The fact that the P2P loans were carried out in a regulated framework provided the SV used through Deutsche Bank and Standard Chartered, more comfort when involving themselves within this securitization, that has such a strong framework in place that it was also listed on the Irish Stock Exchange, that would be subject to stringent EU regulations. It seems the strength of this P2P loan securitization derived from the UK's regulation of P2P loans and therein lies a weakness within the EU, since there is very limited regulation within some jurisdictions of the EU, and in

[31] *'About Zopa' (Zopa) <https://www.zopa.com/invest> accessed 3rd May 2020.*

most of these jurisdictions P2P lending would be regulated under general civil law rather than a specific catered for approach undertaken by the UK.

EU only recently started looking into regulating crowdfunding and related processes of alternative finance and issued a proposal for a regulation of crowdfunding and P2P finance, including crowdlending, as part of its Capital Markets Union plan[32]. This was done mainly since the significant growth within the sector, forced the EU's hand to regulate the sector, but until the whole Single Market is subject to the same regulatory standards vis-à-vis P2P loans, then this might present obstacles for major banks to venture into this type of securitization. The confidence in Zopa's securitization goes further than just the AAA rating assigned to one of the tranches issued, as a number of investment companies have already promised to take up a number of the notes issued by the SV, while the Irish Stock Exchange will list its securities on the Exchange.

Zopa carried out this securitization under the traditional securitization framework and subjected itself to regulatory standards applicable to EU securitizations, but this might present a dilemma for other platforms that might not have the volumes of P2P loans that Zopa has, as they would need to group up with a number of smaller P2P lending platforms to make use of the current EU securitization framework. Another factor that must be considered in the light of the credit rating assigned to a tranche within Zopa's securitization is the standard that has been set, as a sort of benchmark. This was the first tranche of securitization assets comprising of loans sourced through alternative finance, rather than the traditional means of finance, and this shows that now, any other securitization involving P2P loans will be compared to Zopa's when credit rating agencies come to afford a specific classification to tranches of securities.

Credit rating agencies assigning AAA rating to securities within the Zopa securitization is a means of building investors trust in alternative finance and the financial assets derived from it. Zopa's trust, through this classification assigned to a tranche of securitization with P2P loans as the underlying assets, has soared and it remains to be seen what effect this will have on the image of the rest of the industry. The Zopa securitization is relatively recent, and with recent developments that have taken place throughout the globe, especially in relation to the Covid-19 crisis, that has disrupted many financial markets, it remains to be seen whether a trend will emerge within the industry of highly classified securities, as has taken place in this case, and whether that will build the necessary trust within the alternative finance industry to have any impact of sorts on the more mainstream industry. If a trend continues to develop on these lines and more trust is seen to emerge in the alternative finance industry, the possibility of more individuals or entities venturing for loans via P2P platforms will grow, as will the entities offering to lend money via

[32]*European Commission; "Inception Impact Assessment, Legislative proposal for an EU framework on crowd and peer to peer finance." Brussels (1st quarter 2018).*

these platforms, especially with the enticing possibility that they would reap more advantageous financial returns whilst maintaining the benefits assigned to major players in the traditional finance industry, such as the possibility to de-risk their position through securitization.

7.3 Analysis of the Regulation of Securitisation in the EU

There are a number of benefits that can be derived from securitization, but even more so are the risks and pitfalls associated within it, and the latter must be addressed in such a way as to not endanger the wider economy in the process of an entity seeking to de-risk its position. This is where the importance of regulation comes into play, but it is important that regulation serves as a safeguard for all parties involved, and not as a barrier to entry or an obstacle to hinder the development of the sector and it is for this reason that, as with the regulation of many other developing sectors, a fine balance must be sought that affords the necessary protection whilst allowing the sector to grow. It is beneficial that the EU has finally endeavoured to properly regulate the securitization sector, especially by bringing about more harmonization in approaches adopted across the Union. Better harmonization brings about more benefits to the Single Market and allows entities access to a much wider target market rather than that which would be present only within their national borders. The EU Securitisation Regulation shall be analysed based on the intricacies of its regulatory provisions but most importantly it is essential to decipher whether the provisions introduced within the current Securitization Regulation would be beneficial and applicable to securitisations of P2P lending or whether a more subject matter specific approach would be required, whereby the elements of the Securitisation Regulation are taken on board and adapted to a scenario where the underlying assets within the securitization would be borne out of P2P loans. It is also important to consider that it took the EU a number of years to legislate on a pan-European basis with regards to securitization, due to the role securitization played within the 2008 financial crisis, and therefore this must be taken into consideration when opting whether to amend the regulatory path taken by the EU or whether to create a parallel regulatory path as mentioned above.

7.4 Prohibitions and Exemptions

Whilst going through the Securitisation Regulation, there are a number of provisions that would be beneficial and relevant for a securitization involving underlying assets of P2P loans, and it is important to set these out from the rest. The first salient point to be considered is the prohibition of resecuritisation that is applicable in a traditional scenario and would be very beneficial in an alternative finance scenario, which may be considered riskier in nature and therefore to hinder transparency, to a certain extent, through resecuritisation would not be positive. The imposition of retention requirements vis-à-vis the originator, sponsor or original lender, when it comes to ensuring that the subject matter of the securitization transactions, namely the securitization assets are owned by either of the three mentioned parties, makes

sure that the ownership of the underlying assets is not structured in a way that ownership no longer belongs to parties involved in the transaction. Public securitisations must be subjected to the provisions of the Securitization Regulation, while private securitisations do not need to satisfy such obligations. This is a principle that should be reflected in any parallel regulation for P2P loan securitization, as individuals or entities have rights to transact privately without disclosing details of their business dealings to third parties that are not involved in any way within those business transactions.

The obligation for the transfer of securitization assets from the originator to the SV to be a true sale must also be applicable in a P2P loan securitization scenario, to avoid problems being created whereby following a securitization transaction, the underlying assets can be returned to the originator, subject to some conditions. The purpose of this provision is to avoid synthetic securitisations, that are considered to be very risky in nature, and could be considered as much more complex products involving derivatives and seeing that there is enough risk inherent within the alternative finance framework, without the trust normally associated with the traditional finance framework, allowing for synthetic securitization will increase the risk involved, possibly harming the potential growth of trust in alternative finance means such as P2P loans. An important provision that may be very beneficial in a P2P loan scenario would be the prohibition that assets that will be part of a securitization transaction, cannot before being transferred from the originator to the SV involve a borrower that has already been classified to be bankrupt, to avoid the obvious escalation of the default and repayment risks. The issue also remains as to how the originator will possibly come to be in possession of such information, unless disclosed by the borrower themselves, or in a situation whereby securitizing such assets without prior knowledge of such bankruptcy would lead to an issue as to the allocation of responsibility for lack of proper due diligence taking place on the underlying assets.

7.5 Information

A significant issue within any securitization process is the information risk mentioned above in relation to information asymmetry. To address this the Securitisation Regulation states that sanctions should be applied for any information withheld by the originators from the investors. This problem is prevalent within these sort of transactions due to the fact that the visibility on the underlying assets is limited and hence it is important for prospective investors to carry out the necessary due diligence prior to investing, but for this to take place originators are obliged to make available all information they hold. This information transparency, throughout the process and not just prior to investment, is vital within the P2P loan securitization scenario, especially in cases where grouping of loans might take place, as was the Zopa case, whereby the originator is distinct from the original lenders therefore more parties are involved placing a bigger onus on the necessity of transparency and proper due diligence. To build on this, the disclosure requirements

must be delineated as to the obligations of the SV regardless of the type of underlying assets, although it would be beneficial to adapt such disclosure requirements to the specific intricacies of P2P loan securitisations when these are the subject matter of the securitization transaction. It is important to apply such disclosure requirements to have a common standard across all securitisations, for clarity purposes, whilst adapting such requirements to a certain extent without altering the spirit of the provisions helps to guide parties to the transaction on the asset-specific issues.

The information provided by the originators must be of the 'best knowledge' standard to mitigate the possibility of information asymmetry, most importantly when such originator transfers exposures to the SV. This is intended to avoid a situation of negligence or even more so fraudulent intent when an originator comes to de-risk their position and the resultant effect of such a provision would be the decreased possibility that potential investors would suffer due to the negligent or intentional lack of proper information provided. Information relating to borrower's creditworthiness and other pertinent information must be verifiable when it comes to the pooling of loans, to allow for further transparency and potential investors to be able to access all information they require to carry out a proper analysis of their prospective investment. The Regulatory Technical Standards ("RTS") imposed by the EBA in relation to traditional securitization transactions, should also be imposed on securitization transactions involving P2P loans, especially when it comes to information to be provided about publishing regular reports for investors, the verification of such information by securitization repositories, amongst other RTS that may be applied. Sufficient guidelines must be provided as to how information is detailed to facilitate the collation, publication and understandability of such information for all parties involved in the transaction.

8. Solutions to De-Risking

The first point that must be addressed is the regulation of the underlying asset that would be part of the securitization, and therefore an EU framework would be required for the regulation of P2P lending. The second part of the regulatory response would need to involve a decision on the approach to be undertaken when it comes to the regulation of the securitization of the P2P lending, that can take the form of two options. The EU Commission must consider whether to regulate securitization of P2P lending through the traditional framework currently applicable for all forms of securitization and hence maybe tweaking the Securitisation Regulation slightly to bring securitization of P2P lending within scope, including the possibility of the application of the STS regime for P2P loans. The other option is highly dependent on the Commission's belief that this financing niche could really and truly fill a big gap that is currently present and hence allowing for increased sources of financing and a more diversified de-risking approach to be in place for different enterprises. The latter would involve a catered approach whereby a securitization regime would be specifically set up to cater for the securitization of

P2P loans, rather than allowing such a niche product to be regulated under a very all-encompassing regulation. A sector-specific approach, such as the one just mentioned, would seem to be cumbersome on the regulators, but if done properly, whilst also maintaining fundamental principles present within the traditional Securitisation Regulation, it would allow an environment to foster whereby the sector could be supervised more closely and the regulation would be flexible, since should any changes need to be made for P2P securitization specific problems, there would be no need to modify the Securitisation Regulation applicable to all sectors, possibly leading to regulatory fatigue for traditional industry players.

Regardless of the approach taken to address the second prong of the regulatory response, there are a number of underlying principles that must be maintained throughout. One fundamental principle that must be implemented is the proper regulation of P2P loans, as this is crucial for the growth of the sector, as can be seen in the UK, where adequate regulation has fermented trust in P2P loans, allowing the alternative financing industry to develop. The fact that across the EU member states there is limited specific regulation when it comes to regulating P2P lending has led to a distorted approach across the EU, countering the intentions promulgated through the move towards a closer Single Market. The P2P lending sector involves a number of risks, as elicited previously, with the default risk being the biggest issue, and therefore do not provide ad hoc regulation for such a sector might prove counter-productive, and even perilous, so to mitigate such inherent risk within the sector before venturing towards securitization, the underlying asset must be regulated to prevent a situation where the risk is exacerbated further through securitization. The self-regulatory approach of such platforms and loans undertaken through these platforms has its limits as to its effectiveness and the approach taken by the UK can be seen to be a model approach on which the EU can build its regulatory framework, due to the UK's approach catering for crucial points such as obligations by all parties to the transaction, the role of the platform within the transaction and also the provisions to mitigate the default risk and ultimately what would happen in case the borrower defaults. Regulation of the underlying asset, that is the P2P loan transaction, would then allow the EU to move onto tackling the second phase of this de-risking process i.e. the regulation of the securitization of such loans.

When it comes to the regulation of the securitization transactions with P2P loans as underlying assets the Commission may opt for not rocking the boat and just tweaking the current securitization framework or going for an ad hoc approach. Whichever approach the Commission decides on, there are a number of key components that must be catered for within the regulatory framework of P2P loan securitisations. The main areas that can be categorized into three main themes are prohibitions and exemptions, information obligations and supervisory duties, as these three tranches are essential to address the risks associated with securitization, both from an originator point of view but more importantly from an investors point of view. The first theme relates to the prohibitions and exemptions applicable, and this theme gathers a number of important points that must be present regardless of

whether P2P loan securitization is regulated through a tweaked version of the current regulations or an ad hoc framework. Resecuritisation is deemed to be very risky even within a more entrusted scenario of traditional financing, and it would be advantageous to implement a prohibition in that regard vis-à-vis P2P loans to ensure there is full transparency. A clear delineation as to who owns the underlying assets is important and there must be restrictions in place to ensure that such securitisations are kept in an as simple manner as possible without too much over structuring, that might inhibit transparency, especially to prohibit synthetic securitisations being carried out.

While the importance should be placed on regulating public securitisations to protect the general public there should be guidance also in regard to private securitisations. Prohibition on the involvement in an underlying asset within a securitization transaction of a bankrupt borrower is crucial and there must be technical standards put in place for platforms carrying out these loans to have full visibility of the credit situation of the borrower and this comes through the regulation of P2P lending. There must be strict provisions to prohibit P2P loans that had to be restructured within the previous period, to be subjected to a securitization transaction and it would be highly suggested to go beyond the period in place within the Securitisation Regulation i.e. one year, and extend such period to a 3 year period of proper credit repayment or else impose that this period be calculated on the basis of the agreed repayment length of the loan, to avoid a situation mentioned previously whereby collateralization would need to be involved.

One of the biggest risks present within any securitization transaction is the information asymmetry between the parties to the transaction and therefore addressing this problem should be one of the utmost priorities for regulators. The first principle that should be implemented within any regulation is harsh penalties being imposed for situations where either party is found to have abstained from their duty to adhere the ‘best knowledge’ when providing information, so that this would act as a strict deterrent. Strict disclosure requirements must be put in place both at the platform level when the P2P loan takes place, and even more so at securitization stage, especially in common scenarios where loans are grouped as part of a securitization transaction. Within such disclosure requirements should be creditworthiness related information that needs to be provided by the borrower to mitigate the information asymmetry problem to a certain extent. Reporting obligations must me clear, defined and regular so that investors would have full visibility on their ongoing investments and also to allow potential investors to get a good snapshot of their potential investments. These reporting obligations can be assimilated to those applicable to fund managers or administrators, and also a good basis that can be used to cater these for P2P loans are the reporting obligations imposed for P2P lending platforms and the regulatory technical standards issued by the EBA to traditional securitisations.

This would lead us to the final theme as to where such information would be stored and hence it is beneficial both for supervisory oversight and ease of access for investors have a centralised securitization repository, similar to that applicable in a traditional scenario, but it would be best to have this distinct from the traditional securitization repository so that potential investors will be fully aware they might be dealing in investments that tend to be riskier in nature, especially until P2P loans, and their subsequent securitization, become more mainstream. ESMA would be most adept to supervise this sector, also to have cross-sectorial oversight on the whole securitization sector. The biggest challenge that will be faced when coming to decide on the relationship with third states and essentially underlying assets sourced from those third states. This will place a big onus on ESMA to foster relationships with third state supervisors, and to ensure equivalence of procedures when market players that fall within a clearly defined scope of the regulatory framework seek to securitise underlying assets that may not have taken place within the ambit of the Single Market. This will be all the more important due to the UK exiting the EU and the lack of clarity present as to what the future relationship with the EU will involve, besides the fact that the biggest player within the alternative finance industry is the USA, and it would be highly beneficial for the ESAs to seek to maintain a proper relationship with supervisory authorities in the USA. This will be crucial when it comes to the formulation of the scope of the regulatory framework and more importantly to establish a collaborative understanding with supervisory authorities of third states when it comes to definitions of terminology used within the sector, especially involving alternative finance in the wider sense.

Whilst the importance of catering for the regulation of P2P loans and the securitization of such assets within national legislation cannot be understated, it is important that the Commission takes a more supranational approach with regards to these regulatory frameworks. This will probably still necessitate the tweaking of national legislation such as the Securitisation Act and SCC Regulations but whilst they provide an adequate general basis for the regulation of the securitization sector across the board, a more cursory focus needs to be placed on regulating the securitization of assets within the alternative finance sector, and hence it would be beneficial to venture for a supranational approach, especially if this is undertaken also in line with the regulation of the underlying assets, therefore leading the Commission to inspire the growth of the P2P lending sector as an option for entities to diversify to other sources of finance and de-risk their financial position through a regulated sector bringing in added liquidity through the power of the crowd.

9. Conclusions, Proposals, and Recommendations

It is clear that de-risking the financial position of individuals or entities will allow them to be in a better financial position to offer P2P loans and securitisation could be a very good solution for such de-risking. Under the existing regulatory environment, a substantial volume of loans is needed as part of the securitisation transaction. This is achieved through the grouping of a large number of loans and if need be tranching

to cater for the risk appetite of investors. The effectiveness and success of securitising P2P loans can be seen through the Zopa securitisation, with one tranche being assigned a AAA credit rating for the first time since alternative financing started to be securitised in 2013, through the Eaglewood securitisation. The biggest challenge of the securitisation sector is the regulatory framework in place, that must be such that mitigates the risks presented by such transactions, especially due to the role it played before the 2008 financial crisis, but at the same time ensuring that it is not considered placing big barriers to entry to set up such a securitisation transaction of the nature Zopa did, especially if the interplay between alternative financings, such as P2P lending, and securitisation is to be encouraged and nurtured for growth. The balance required, as is the case with so many other sectors, is crucial here and it should be a supranational approach taken by the Commission that ventures towards an appropriate study as to how best to bring alternative financing into the mainstream market by offering the same opportunities, such as is the case with securitising P2P loans.

As can be seen from the literature analysis, it is only recently that the Commission started to be more at ease with securitisation, essentially due to the crucial role it can play in the development of the Single Market. The mitigation of the three crucial types of risk, namely the information risk, repayment risk and risk associated with the lender's financial situation must be done in such as way that it takes into consideration the protection of the interests of the 'crowd' and investor protection, but the flexible nature of alternative finance must also be catered for in such a way that hefty fees, such as transaction costs, and regulatory compliance costs, are kept at a minimum. The biggest risk associated with the securitisation of P2P loans is associated with the risks of the underlying assets and mitigating these risks will ensure the success and growth of the securitisation of P2P lending sector. This can only be done through the regulation of P2P loans and the platforms that carry out such activities. Such regulation should come at European level, to ensure that cross-border transactions are facilitated and that once the Commission comes to regulate the securitisation of such financial assets, there will be an easier way of tackling it due to a common regulatory framework across EU.

De-risking can take place through a number of different methods beyond just securitisation, but to ensure the trust is built within the alternative finance sector it would be beneficial to use tested means. The result of securitising groups of P2P loans would not be the only solution to addressing the funding gap, but it would help especially with regards to SMEs. The traditional sources of finance will still maintain the majority of the market share when it comes to funding sources, but if the small gaps can be plugged in through such initiatives, across the EU there could be a substantial effect on the economy within the Single Market.

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