

## Marketplace Lending Turbulence

Given the recent headlines regarding the downsizing of the biggest platforms in the US and the exit of the CEO Renaud Laplanche of LendingClub ('LC'), we want to revisit some of our closely-held views on loan investing.

### Recent Headlines

The news about LC, the leading P2P platform, is one of the biggest setbacks for the business. LC had altered application dates on \$3 million of loans, the company said in a statement on 9 May. The debts were part of a \$22 million bundle of near-prime loans sold to an institutional investor. The sale was found to be in contravention of the investor's express instructions. The US SEC is now examining what happened. The board of LC already did its own inquiry. While the financial impact was minor, a violation of the company's business practices along with a lack of full disclosure during the review was unacceptable to the board. The review discovered another matter unrelated to the sale of loans, involving failure to inform the board's Risk Committee of personal interests held in a third party fund (investing in P2P loans of LC among others), while LC was contemplating an investment in the fund. The face of the online lending world resigned (has been forced out) after these findings. LC's stock plummeted after this news with 35%.

Last week Prosper and On Deck, two of the largest market place lenders in the US, announced that they will slow down expansion plans this months as institutional investors scaled back loan purchases. Both Prosper and On Deck cut their workforce due to tightening of the capital markets. Add on the increase in loan delinquencies in the lower quality loan categories in the first quarter and you've got an industry looking for some good news. Obviously LC didn't help.

The big question now is whether the P2P platforms can rebuild trust in their ability to price risks on loans made online? Besides the fact that business practices of platforms have to remain compliant, platforms will only succeed if their loan portfolios meet investors' expectations in the next quarters.

### New Industry

We see these developments as 'growing pains' of the industry. The advantage of all the recent negative news is that platforms should now be extra keen on their risk models, pricing and procedures to restore funding. Lending is another ball game than for example Uber. Uber succeeds due to its scale: they have a lot of drivers in many places. Another car service probably can't get the same scale over a viable period. Lending is not about scale but mostly about price as most people choose to borrow at the lowest possible rate. To achieve higher volumes, marketplace lenders can be forced to lower rates and seek out riskier borrowers but this will result in disappointing returns for investors.

Rate sensitivity of buyers is a key driver to keep the industry sound because if market place lenders lower their rates too far or if defaults increase unexpectedly, investor capital will decrease significantly until

platforms raise lending rates. If more buyers become less rate sensitive due to investment products that give them indirect access to this loan category or fewer fixed income alternatives, platforms can become too slow to raise lending rates. Especially the performance of lower quality loans will suffer in this environment.

This highlights the importance of an active management that makes decisions based on the rates offered by the lender and the quality of the borrowers.

## Investment Decisions

Over the last year we were and have stayed focused on high-quality P2P loans.

We have therefore decided only to invest in prime consumer credit (high quality loans) and not in low quality loans (near-prime or sub-prime) or equity of emerging platforms. We resist the urge to purchase low-quality loans or to use leverage. Yes, doing so could improve returns dramatically in the short run but we are convinced that a more conservative stance suits investor's goals best and will pay off in the long run. We will mark conservatively, with any non-performing asset written down near zero.

This approach will be more resilient in different economic cycles and less vulnerable to large risk tolerance of P2P platforms.

**For further information or enquiries, please contact us at [info@hjco.nl](mailto:info@hjco.nl) or 010-205 12 60.**

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