Global Credit Investments

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An overview of marketplace lending (MPL)

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You have a small business you want to expand, or you're an individual needing short-term funding to wipe out more expensive credit card debt. For a long time, you've had only one option: the bank. That lack of competition made small business and consumer lending one of the most profitable parts of banking.

Because the banks' only real competition was each other, they didn't have to go out of their way to offer excellent rates. They didn't even have to work hard to reward better borrowers with better rates. They averaged out the risk to themselves by offering everyone pretty much the same rate. The good borrowers were left subsidising higher-risk borrowers.

Technology likes to disrupt. A market ripe for disruption is one with little competition, established players with outdated methods and customers getting a bad deal. Banking certainly fitted the bill.

The disintermediation of banking was finally made possible by the confluence of lower cost computing power, advanced data analytics software, cheaper and ubiquitous connectivity, and the ability to serve customers without needing premises.

A marketplace for lending emerges

Online platforms appeared around 2005. They offered what was then called peer-to-peer lending (P2P lending). Businesses and individuals applied to the online platform for a loan. If the platform approved the application, it was posted on the site for an investor or multiple investors to fund. The platform took a cut from both sides.

The marketplace grows up, serious investors see the opportunity

The term “peer-to-peer” made the business sound small-time, like someone tapping a friend for a $100 loan. And it was not wholly dissimilar to that in feel until investors realised the opportunity these platforms created to diversify their portfolios.

Small businesses and consumers were looking for short-term financing, and they were paying a fixed interest rate to get it. One of the most profitable areas of banking was now open directly to savvy investors looking for fixed returns. Previously, investors could get the benefit of this market only by buying banking shares. It was an indirect route, and it exposed investors to the risks involved in all the banks’ other activities and to the external conditions that affect a bank’s share price.

“Peer-to-peer lending” evolves into “marketplace

lending"

As institutions and serious investors started to get in on the act, this new lending market outgrew the "peer-to-peer" label. It became "marketplace lending" (MPL).

Doing it better than the banks

21ST-CENTURY PRACTICES TO REDUCE RISK

The marketplace lending platforms might have been new to the industry, but they started doing the lending better and smarter than the banks.

Like the banks, they use traditional methods to assess the creditworthiness of an applicant. Being 21st-century FinTech companies, they also apply methods more suitable to the social media age. Typically, they approve only 5-10% of loans.

Because they need investors using the platform as well as borrowers, it isn't in their interests to approve bad applications. If investors see too many defaults, they'll abandon the platform and the platform will have destroyed its own business.

EASING CUSTOMERS' PAIN

Few are the businesses or consumers who enjoy dealing with their banks. Small businesses, in particular, were frustrated by banks after the Global Financial Crisis. Banks scaled back lending, raised prices and were slow. MPL is an efficient, competitive and attractive alternative.

THE MPL ADVANTAGE

Marketplace lending platforms have significant advantages over banks, including:

1. Lower fixed costs — no retail branches, no out-dated systems, fewer staff.

Lending Club, the largest MPL platform in the USA, believes it has a 3-5% operating expense advantage vs. traditional lenders, which it can share with borrowers.

2. Speed of funding — using algorithms, minimal bureaucracy and eliminating unnecessary manual processes, MPL platforms can assess borrower risk faster than banks. Funding happens within three days (or less) compared to over two weeks with banks.
3. Customer experience — Net promoter score (NPS) is a measure of customer satisfaction — how willing a customer is to recommend you. The closer the number is to 100, the more likely the customer is to recommend you. Banks average a net promoter score of 15/100. MPL platforms boast an average NPS of 75+.

Where to from here?

A well-balanced investment portfolio should include a high proportion of fixed income assets. Global best practice agrees 15% and 50% of a portfolio should be in credit and fixed income investments.

MPL already has a record of assessing risk well and bringing good returns. As more people become aware of it — on both sides of the transaction — it's only going to grow.

Right now, marketplace lending is in its infancy. Experts (including Morgan Stanley) predict worldwide MPL loan originations will be more than $200b by 2020.

How to access marketplace lending for your portfolio

MPL platforms connect investors with businesses and consumers looking for loans. Anyone can get involved on the investor side if they have the capital to fund a loan.

Alternatively, an investment in the Global Credit Investments (GCI) Diversified Income Fund gives you the ability to take the benefit of investing in MPL but in a way that is highly diversified. Your fund is made up of at least hundreds (if not thousands) of loans rather than just one.

GCI performs due diligence on all MPL platforms from which it buys loans, and our algorithm selects only what we believe to be the best loans from the platforms we deal with. You get the benefit of the returns leveraging off our expertise and in a highly diversified way.

You can read more about how we work **here (/what-we-do)**.

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