

1 EFFICACY OF LOAN DEFAULT LIKELIHOOD PREDICTIVE MODELS FOR LENDING CLUB DATASET

In this section we compare the models that predict the likelihood of a given loan defaulting. We first describe the experimental setup that was used to compare the predictive models, followed by the comparison itself.

1.1 Experimental setup

All our experiments in this section are performed on the Lending Club¹ dataset obtained from [?]. This dataset contains complete loan data from the period 2007 to 2011. There are 42,538 loans with a total 114 features for each loan. Similar to the Prosper dataset, we first cleaned/analysed as described in Section 3.1. After clean the dataset, we end up with 38,331 loans with 18 features (include response variable). The 17 selected features and the response variable are described in Table 1.

Amongst these 38,331 loans, there are 5,517 defaulted loans. To avoid negative impact of such an unbalanced dataset on the prediction models, we apply the under-sampling technique [?]. Without loss of generality, we construct 5 sample datasets by randomly choosing 5,517 non-defaulting loans along with all 5,517 defaulting loans together as the sample dataset 5 times and show the average performance in this section. For training and testing the prediction algorithms, we split each sample dataset into a ratio of 80:20, indicating 80% of the loans will be used to train the predictive models and the remaining 20% used for testing. In order to avoid over-fitting and under-fitting of the model, we apply 5 Monte Carlo cross-validation (CV) on each sample dataset.

Table 1. Features and response variable description

Feature	Explanation	Type
loan_status	The current status of the loan.	Categorical
dti	Debt to income ratio.	Numerical
delinq_2yrs	The number of delinquency for the past two years.	Numerical
int_rate	The borrower's interest rate for this loan.	Numerical
installment	The monthly payment owed by the borrower.	Numerical
home_ownership	Specifies if the borrower is a homeowner or not.	Categorical
inq_last_6mths	The number of inquiries in past 6 months.	Numerical
emp_length	Employment length in years.	Numerical
revol_bal	Total credit revolving balance.	Numerical
annual_inc	The borrower's annual income.	Numerical
pub_rec_bankruptcies	Number of public record bankruptcies.	Numerical
loan_amnt	The listed amount of the loan applied for by the borrower.	Numerical
grade	LC assigned loan grade.	Numerical
open_acc	The number of open credit lines.	Numerical
addr_state	The state of the borrower.	Categorical
Term	The length of the loan expressed in months.	Numerical
revol_util	Revolving line utilization rate.	Numerical
total_acc	The total number of credit lines.	Numerical

¹www.lendingclub.com

1.2 Comparison of models predicting the likelihood of loan default

In this section, we compare Support Vector Machine (SVM), k-Nearest Neighbors (kNN), Multilayer Perceptron (MLP), Logistic Regression (LOGIT) and Random Forest (RF) models to predict the likelihood of a given loan defaulting, and thereby find the best predictive model. For comparison purposes, we select accuracy, True Positive Rate (TPR) and True Negative Rate (TNR) as the criterion to evaluate the goodness of fit of the model. The definition of these three measures are described in Section 3.2. In particular, the higher the accuracy, the better the model fits the dataset.

Table 2. Results of SVM, kNN, MLP, LOGIT and RF for five sample datasets with the measure: accuracy.

Sample dataset	1	2	3	4	5	Average
SVM	0.49	0.49	0.48	0.51	0.50	0.49
kNN	0.53	0.54	0.55	0.53	0.52	0.54
MLP	0.56	0.58	0.50	0.57	0.58	0.56
LOGIT	0.60	0.62	0.63	0.61	0.62	0.62
RF	0.63	0.66	0.65	0.62	0.64	0.64

Table 3. Results of SVM, kNN, MLP, LOGIT and RF for five sample datasets with the measure: True Positive Rate (TPR).

Sample dataset	1	2	3	4	5	Average
SVM	1.00	1.00	1.00	0	0	0.60
kNN	0.52	0.56	0.53	0.54	0.53	0.54
MLP	0.69	0.74	0	0.63	0.45	0.50
LOGIT	0.74	0.76	0.76	0.73	0.73	0.74
RF	0.56	0.56	0.57	0.54	0.54	0.55

Table 4. Results of SVM, kNN, MLP, LOGIT and RF for five sample datasets with the measure: True Negative Rate (TNR).

Sample dataset	1	2	3	4	5	Average
SVM	0.00	0.00	0.00	1.00	1.00	0.40
kNN	0.54	0.49	0.54	0.55	0.51	0.53
MLP	0.43	0.36	1.00	0.50	0.70	0.60
LOGIT	0.47	0.49	0.50	0.48	0.51	0.49
RF	0.69	0.71	0.71	0.69	0.72	0.70

Tables 2, 3 and 4 show the results of accuracy, TPR and TNR for five sample datasets based on SVM, kNN, MLP, LOGIT and RF models, respectively. From Table 2, it can be observed that RF achieves the highest average accuracy of 0.64 (64%). LOGIT also fits the sample datasets well with average accuracy of prediction of 0.62 (62%). In addition, the average accuracy of SVM, kNN and MLP are 0.49 (49%), 0.54 (54%) and 0.56 (56%), respectively. From Table 3, it can be observed that LOGIT achieves the highest TPR of 0.74 (74%) amongst these five machine learning models.

From Table 4, it can be observed that RF achieves the highest TNR of 0.70 (70%) amongst these five machine learning models. Hence, RF and LOGIT are the two best models to predict the likelihood of a given loan defaulting. However, compared to LOGIT, RF may take longer to execute with a large dataset, and one may select LOGIT as the predictive model with a trade-off of 0.02 (2%) reduced accuracy of prediction.

2 RESULT OF PORTFOLIO OPTIMISATION COMPARISON FOR LENDING CLUB DATASET

In this section we compare the quality of the generated portfolio, by comparing the average portfolio return rates and risk obtained after solving the proposed technique, *MV* model (10) and *IB* model (11). We test these models with 20 different scenarios and 3 lenders. For each scenario, we randomly choose 10 loans from the Lending Club dataset as the loans available for investment and randomly generate the constraints for each lender.

2.1 Model-I comparison

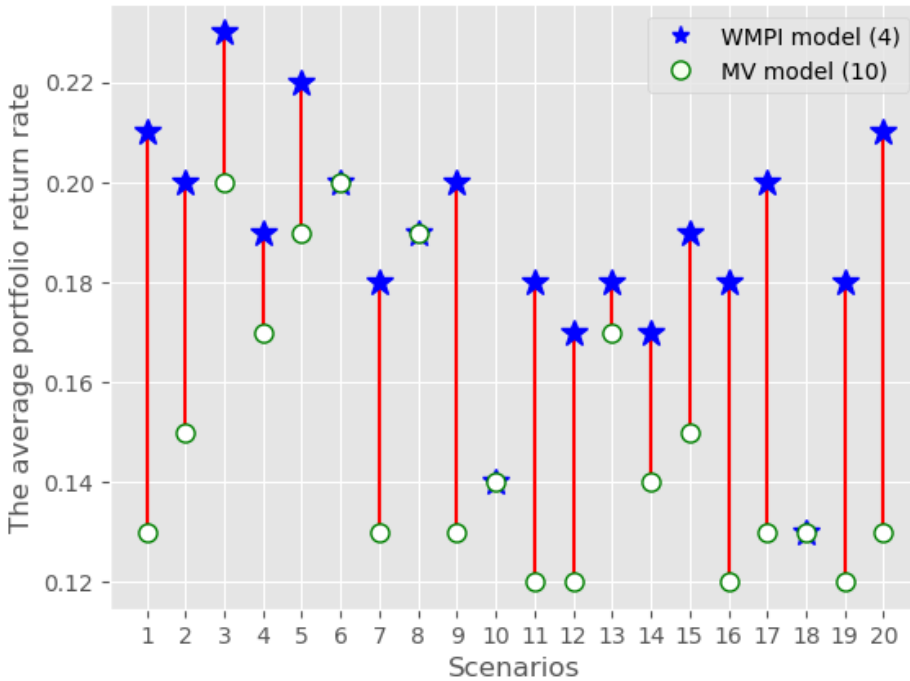


Fig. 1. Average portfolio return rates achieved by solving the proposed *WMPI* model (4) and *MV* model (10) with three lenders

Figure 1 shows the average portfolio return rates with three lenders obtained by solving *WMPI* model (4) and *MV* model (10). We can observe from Figure 1 that *WMPI* model has better results in all 20 scenarios. *WMPI* model achieves an average return rate of 0.19 (19%) based on 20 scenarios.

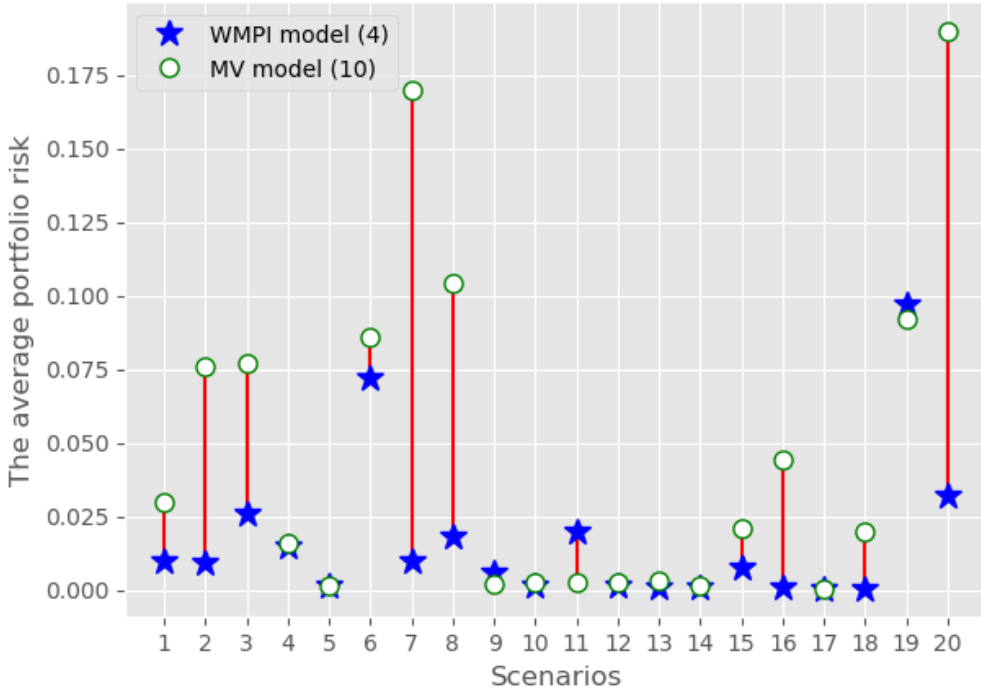


Fig. 2. Average portfolio risk obtained by solving the proposed *WMPI* model (4) and *MV* model (10) with three lenders

Compared to the average return rate of 0.15 (15%) achieved by *MV* model (10), a difference of 0.04 (4%). On average, the proposed model's portfolio return is 4% higher than *MV* model (10).

Figure 2 illustrates the average portfolio risk with three lenders obtained by solving the proposed technique and *MV* model (10). We can observe from Figure 2 that the proposed technique has less or equal risk in 17 out of 20 scenarios. On average, the proposed model has an average portfolio risk of 0.017 (1.7%) based on 20 scenarios. Compare to the average portfolio risk of 0.047 (4.7%) obtained by *MV* model (10), a difference of 0.03 (3%). On average, *WMPI* model's portfolio risk is about 1/3 of that achieved by solving *MV* model (10). Hence, we can conclude that the preferred portfolio achieved by applying our proposed technique will have lower risk than that achieved by applying *MV* model (10). This should be as expected, because *MV* model (10) uses covariance as risk, which is hard if not impossible to compute for unrelated borrowers. Overall, the proposed technique, *WMPI* model (4), approaches a better quality solution than *MV* model (10).

2.2 Model-II comparison

Figure 3 shows the average portfolio return rates for the three lenders achieved by solving the proposed technique and *IB* model (11) with 1,000 training samples. We can observe from Figure 3 that *WMPI* model has better results in all 20 scenarios. Specifically, *WMPI* model achieves an

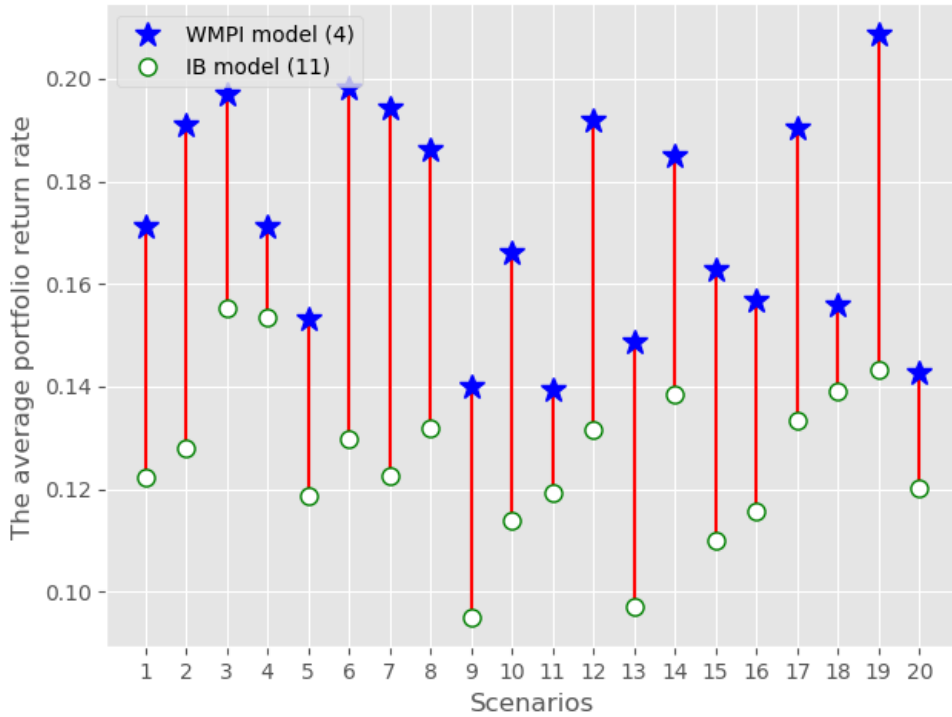


Fig. 3. The average portfolio return rates achieved by solving the proposed *WMPI* model (4) and *IB* model (11) with three lenders

average portfolio return rate of 0.17 (17%) for these 20 scenarios. Compared to the average portfolio return rate of 0.13 (13%) achieved by solving *IB* model (11) — the difference is 0.04 (4%).

Figure 4 compares the average risk of the portfolios obtained from *WMPI* model (4) and *IB* model (11). Similar to the results shown in Figure 3, the proposed technique has better result in all 20 scenarios. Specifically, the proposed model obtained an average portfolio risk of 0.0016 (0.16%) for these 20 scenarios. Compared to the average portfolio risk of 0.013 (1.3%) obtained by solving *IB* model (11) — the difference is 0.011 (1.1%). On average, *WMPI* model's portfolio risk is about 1/8 of that achieved by solving *IB* model (11). Again, this is as expected, because the covariance matrix used as the risk indicator in *IB* model (11), is misleading, since borrowers usually have no relation to each other. The proposed model, fixes this problem, by directly using the total loan default rate as the risk indicator.

Overall, the proposed technique, *WMPI* model (4), approaches a better quality solution than *IB* model (11).

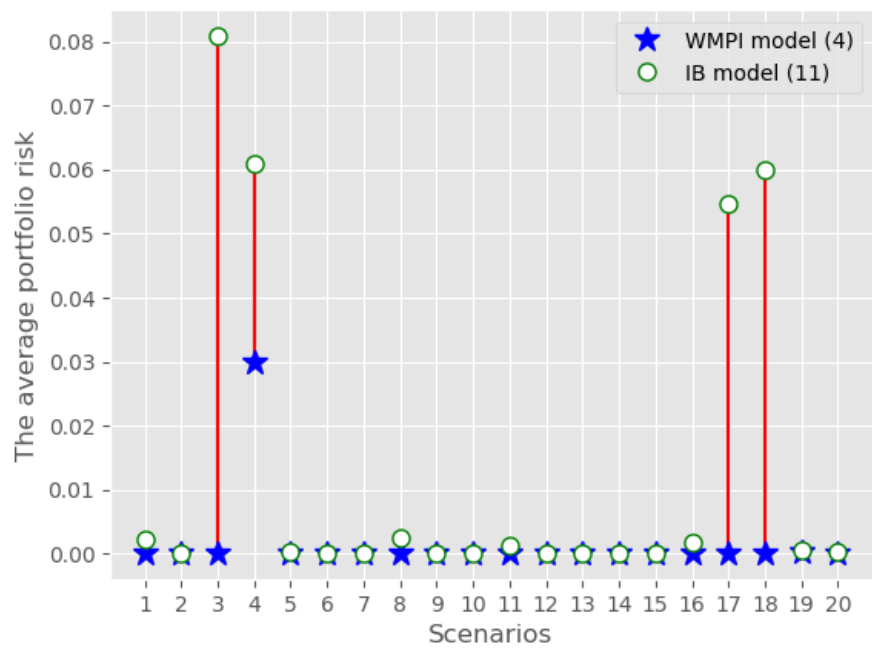


Fig. 4. The average portfolio risk obtained by solving the proposed model (4) and the model (11) with three lenders