

# Marketplace Lending Index

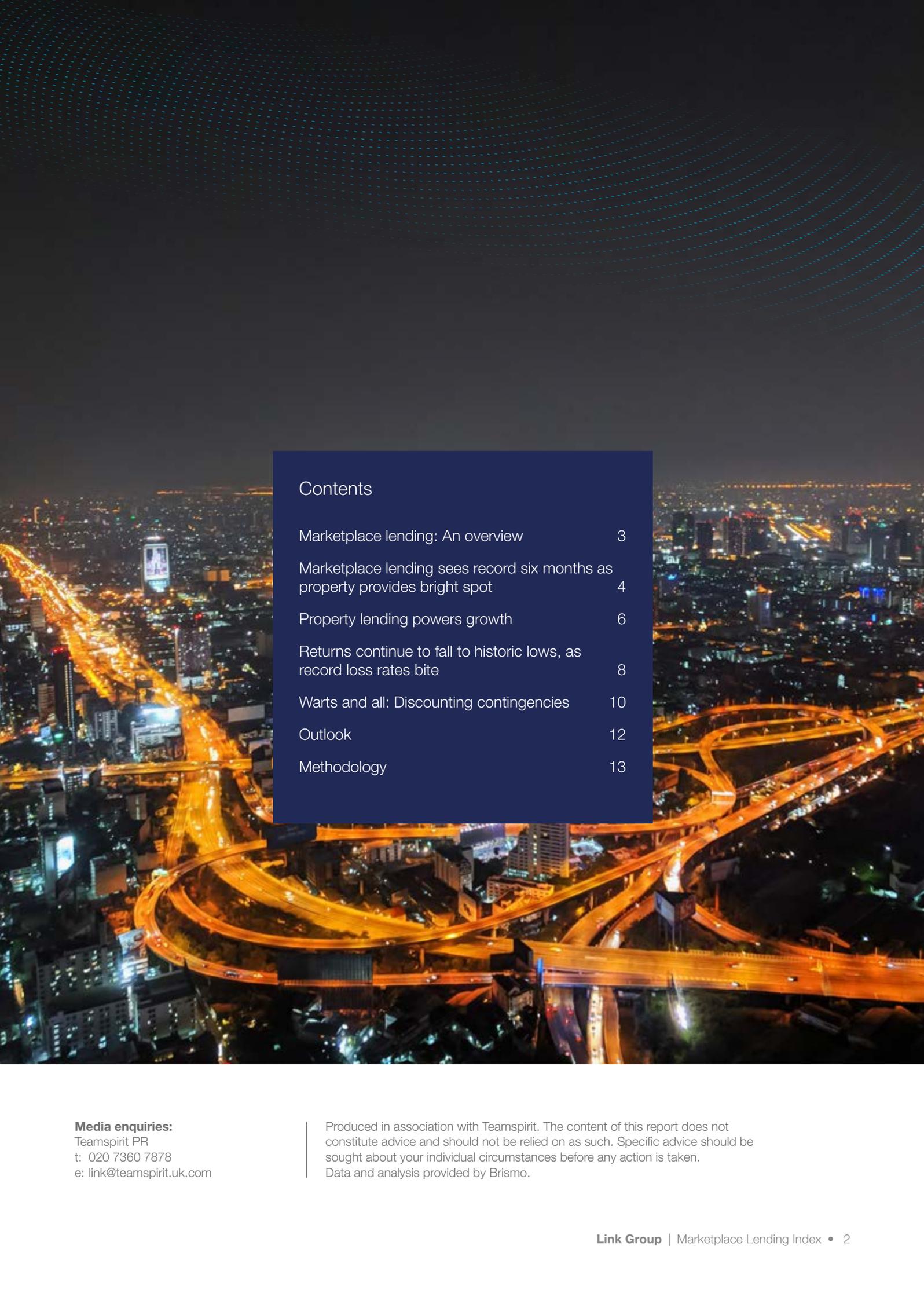
**LINK**Group

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Data and analysis provided by Brismo.

# Marketplace lending: An overview

## **Peer-to-peer and marketplace lending has witnessed a tumultuous time since the inaugural Link Marketplace Lending Index, powered by Brismo.**

The sector has been beset by controversy and regulatory change. May saw Lendy fall into administration, following an unsustainable level of loan defaults. Funding Circle too has had well-publicised issues, having cut its forecast revenue growth in half to 20%; the subsequent sell-off by investors caused it to fall from the FTSE 250. At the same time, broader economic concerns in the face of Brexit uncertainty provide a troubling backdrop for both business and consumer lending.

In spite of all this, marketplace lending continues to grow, and lending will total more than £6bn this year. However, as losses rise, and the potential for an economic downturn looms on the horizon, it is clear that marketplace lenders are heading into new territory. Should we see the economy slow further, the risk management, loan-servicing and recovery practices these platforms have in place are likely to face significant testing across the board for the first time.

Meanwhile, the FCA released its policy statement for the sector, PS19/14. The

new rules are aimed at greater consumer protection, and improving standards within the sector. These include capping investments to 10% of retail investors' investible assets, ensuring platforms have appropriate risk management frameworks in place, and set out minimum disclosure requirements. This is a step forward as the sector expands and matures, and enhanced regulation will be welcomed by the institutional investors that are able to provide large-scale funding with a low cost of capital.

The new regulation stops short of insisting lenders adopt the same methodology for measuring the risk and returns for investors, although the FCA will 'keep this under review'. It is vital that industry does not take its foot off the pedal in the meantime, but adopts a standardised methodology for measuring performance. Only then will investors be truly able to compare like with like. Should experience of loss increase in an economic downturn, disclosure will be more important than ever. Platforms that can enable investors to easily evaluate the risk and return trade-off, will ensure consistent demand for the assets they originate, will build trust among larger-scale institutions, thereby building the deep and diversified funding base that will stand the test of time.

# Marketplace lending sees record six months as property provides bright spot



First half of 2019 saw £3.0bn in new gross lending, **highest 6-month total on record**



Lending **rose by 21.6%** compared to H1 2018

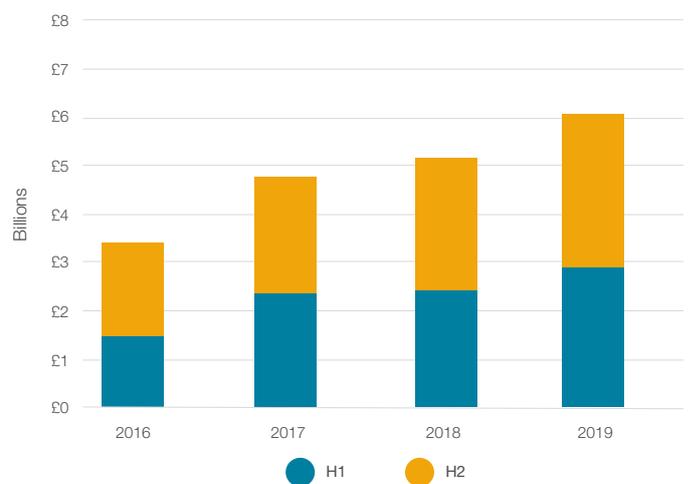


Property lenders account for **three fifths of the increase** over the period

**Marketplace lending rose to a new record high in the first half of 2019, with £3.0bn of gross lending, in spite of the uncertain economic backdrop, and sector specific challenges it faced<sup>1</sup>. This equates to £16m of lending every single day.**

In the second quarter of 2019, gross lending was surprisingly strong. It totalled £1.5bn, up 24.3% on the second quarter of 2018. As a result, the total amount lent by the sector in H1 2019 was £528m more than in the same period of 2018, an increase of 21.6%. This was powered by an exceptional period of growth for property lenders – they accounted for three fifths of the growth in all new lending over the first half of the year.

Gross new lending



<sup>1</sup> Link/Brismo has revised the historic data series for lending volumes to account for changes to the constituents of its index. These include the exclusion of MarketInvoice due to insufficient data disclosure. Brismo's data set now includes 31 constituents, up from 28 last year, accounting for c.80% of all gross lending in the sector.

## Gross marketplace lending (£m)

Year	Q1	Q2	Q3	Q4	Full year
2016	£846	£711	£801	£1,107	£3,466
2017	£1,142	£1,207	£1,098	£1,281	£4,729
yoy	35%	70%	37%	16%	36%
2018	£1,205	£1,240	£1,354	£1,488	£5,289
yoy	5%	2%	23%	16%	11%
2019e	1432	1542	1516	1681	6172
yoy	18%	24%	12%	13%	16%

Slower growth in net lending, however, points to a maturing sector. Positive net lending shows that lenders' loan books are still growing. They are doing so at a slower rate, however, as the value of repayment has risen quickly too. For instance, our analysis of the net lending of three of the largest marketplace lenders, RateSetter, Zopa and Funding Circle, totalled £191m in the second quarter of 2019. This was down from £252m in the first quarter of the year, and £244m in the second quarter of 2018.



# Property lending powers growth



Property sees growth of **54.5%** in H1, with total of £848m



Business lending remains largest category, with £1.1bn lent in H1 2019



Consumer lending growth lags behind, reflecting weaker spending

In spite of the very public collapse of Lendy, and a sluggish housing market, property lending saw the fastest growth of all marketplace lending. In the first half of 2019, property lending totalled of £848m, up by 54.5% compared to the same period a year ago. This contrasts with the performance of the wider mortgage market; FCA data shows that over the same period, the value of gross mortgage lending was broadly static, suggesting marketplace lenders are increasing their market share among traditional or mainstream lenders.

LendInvest and Landbay were key drivers of growth. Both more more than doubled their lending, collectively originating £334m more in the first six months of the year than over the same period in 2018. LendInvest's impressive growth was capped by a securitisation of buy-to-let mortgage assets in June, which saw it raise £259m, highlighting the trend of well-established lenders targeting funding from institutional investors. However, growth was fairly widespread in the property category, with lenders focussed on development finance performing well, as well as those targeting longer-term buy-to-let.

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## Business lending is the largest category within the marketplace lending sector

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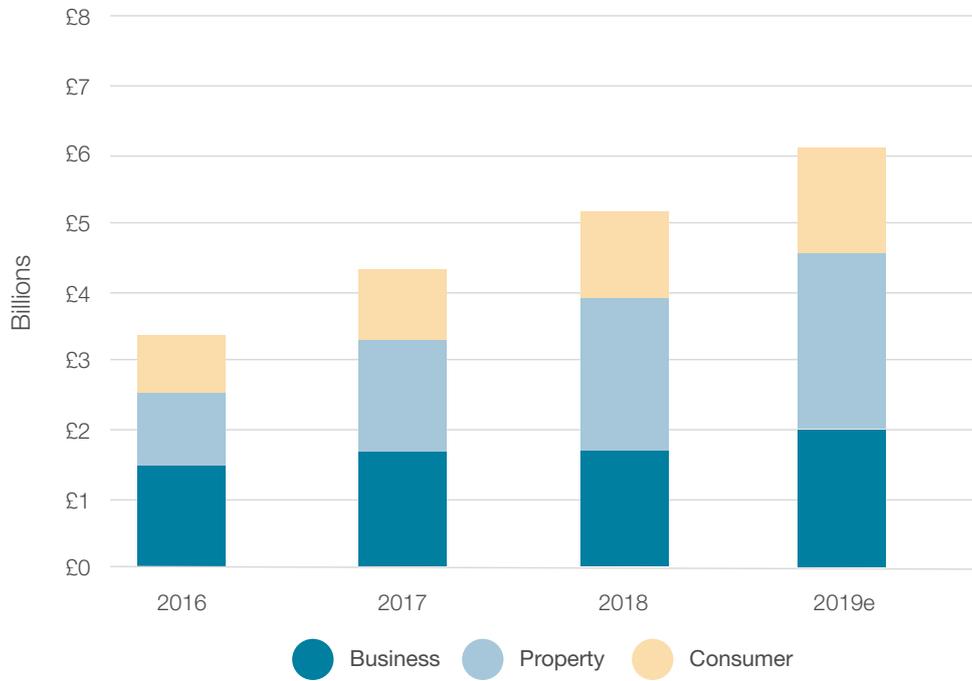
Business lending is the largest category within the marketplace lending sector. It involves companies borrowing to invest, buy new premises, make acquisitions, or refinance. Within this category, we also include invoice finance, which allows businesses to borrow against money due from customers and clients<sup>2</sup>. In the first half of 2019, marketplace lenders originated a shade over £1.1bn to businesses. This represented a rise of 14.5% on the same period in 2018. However, this rate of growth has slowed from 17.4% a year. Indeed, looking at the quarterly figures, the drop off is more significant. In the second quarter, business lending actually fell (-0.7%) from the first quarter, reflecting the wider economic malaise, and the uncertainty Brexit is placing on businesses' decision-making on investment.

Consumer lending, frequently used for large-scale discretionary spending, home improvement or debt consolidation, saw more steady growth. Gross lending rose by just 9.4% in the first half of the year, climbing to £990m, reflecting weaker consumer spending. As well as softer consumer demand, slower growth here, contrasting to rapid growth in property lending, could also indicate investors' current preference for lending secured against hard assets.

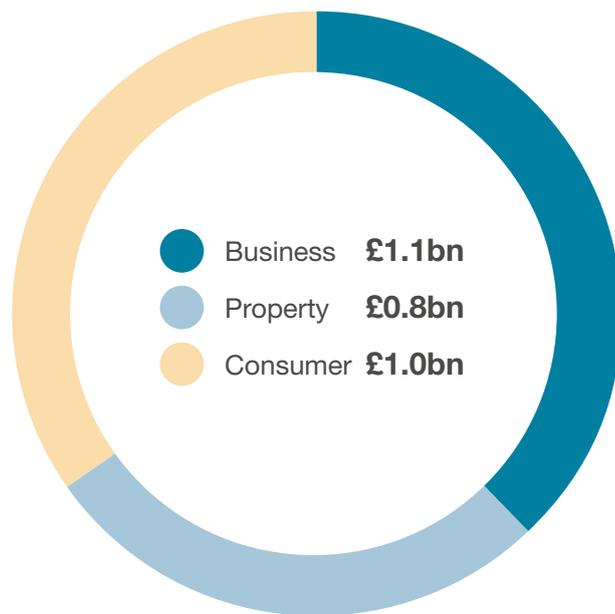
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<sup>2</sup> Following changes to the constituents of our index, and the removal of MarketInvoice we have amalgamated the invoice finance and business lending sectors, and reflected this within the historic series to allow like-for-like comparison with previous years.

### Annual gross new lending, by category



### 2019 H1 lending, by sector (£bn)



# Returns continue to fall to historic lows, as record loss rates bite



Net returns **fall to 3.8%** as losses rise once more, the lowest level on record



Losses now **shave 3.4 percentage points** from net returns



**Net yields stable** as competitive market prevents lenders from increasing interest rates

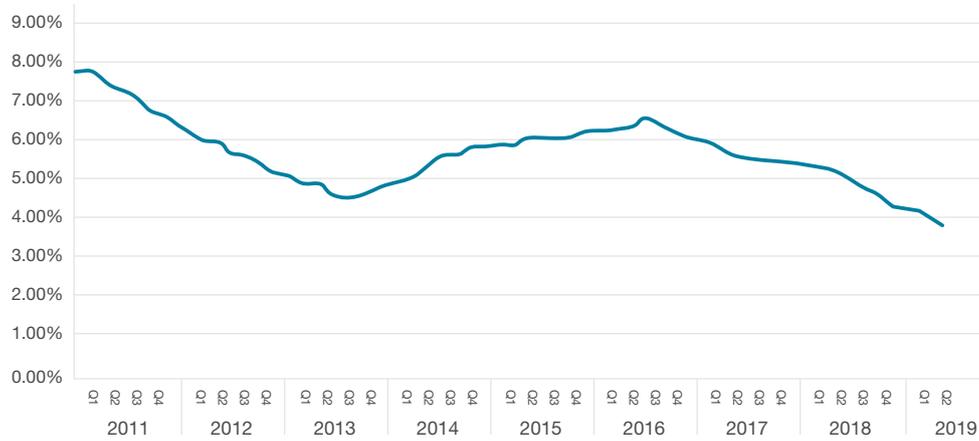


Across the industry, there is considerable variation in fees, terms, default and recovery rates, let alone interest rates. This makes it difficult for an investor to assess what return they can expect from their investment. These differences reflect the range of loan types and origination methods prevailing across the industry. However, it is critical to acknowledge that the performance of any loan type is simply a series of cash flows made up of interest and principal repayments. Those cash flows may arrive to a different schedule but ultimately, if default timing and impairment amount can be independently verified using a consistent methodology, then performance can be accurately compared. Our lending returns index accounts for all of these moving parts to provide a single benchmark figure for the industry; i.e. the actual return an investor will have enjoyed over the preceding 12 months<sup>3</sup>.

Net returns across the marketplace lending sector continue to fall. Standing at 3.8%<sup>4</sup>, returns have fallen consistently over the last two years, and are currently at their lowest on record. They have dropped from 4.4% at the end of last year, 5.5% in the second quarter of 2017, and are now a distance from their most recent peak of 6.3% in 2016.

<sup>3</sup> Brismo constructs a portfolio with a fully diversified exposure to all of the outstanding loans of the constituent origination platforms. This portfolio takes an equal exposure to each time cohort. This ensures that performance is not distorted by the effect of variations in the growth of loans outstanding and creates a consistent reference point for performance comparison. Since the previous report, the constituents of Link's index has changed. This has been reflected in revisions to the historic data.

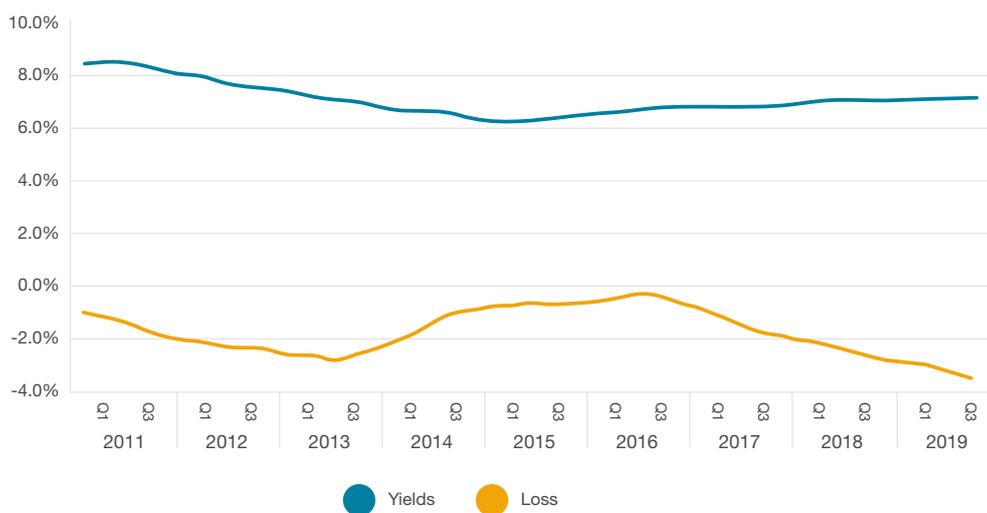
## Net annual returns



The net yield of loans and their loss rate are the two key factors in calculating the sector's net return. The net yield accounts for the initial interest rate and costs such as platform fees, and contingency funds that some platforms use to protect borrowers against defaults. The loss rate on loans is influenced by default and recovery rates, as well as the proportion of loans covered by a contingency fund.

It is rising losses that are weighing on net returns. Losses currently reduce the net return by 3.4 percentage points – the highest level on our record. This compares to a year ago, when losses reduced returns by 2.1 percentage points.

## The components of net returns: yield and loss



4 The latest data available for the returns index is Q2 2019, due to a lag in the reporting of the data.

# Warts and all: Discounting contingencies



**Viewpoint:**

Rupert Taylor,  
CEO of Brismo

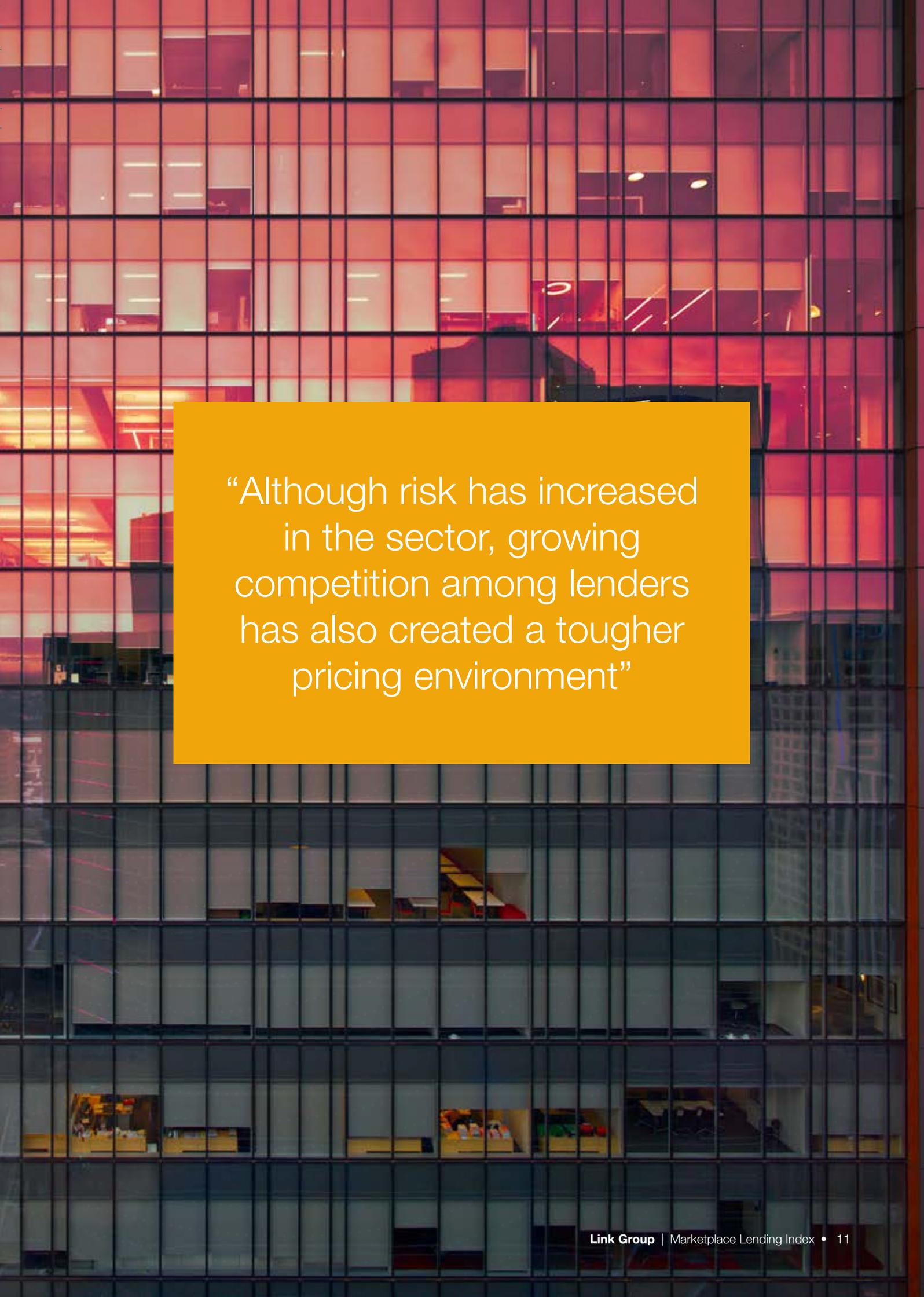
In the last report, we detailed the impact that technical changes by platforms have had on the loss rate; a smaller proportion of loans are covered by a contingency fund, following Zopa's withdrawal of its Safeguard mechanism. This means fewer defaults are now covered, increasing the reported loss rate. This does not obscure the underlying picture. Losses are increasing across the sector. Indeed, within our data we include all loans, including all product types from participating marketplace lenders. In effect we include both 'front book' and 'back book' origination. While underwriting practices may have changed, and products may have been discontinued, the loans remain on lenders' books, and continue to affect the aggregate loss rate. In this way we show the most representative picture, albeit it is unlikely to be the most flattering.

Following the FCA's latest policy statement (PS19/14), from December, lenders will be expected to report loss information without the mitigating effects of a payment from a contingency fund to allow investors to better understand the underlying risk. This will no doubt increase the losses that are disclosed across the industry. To reflect this change, from next year, the Link/Brismo Marketplace Lending index will only detail pre-contingency fund performance data, giving a "warts-and-all" view of the performance of the underlying assets.

A weaker economic environment has been a key factor, undermining a growing minority of businesses and consumers' ability to repay loans. Furthermore, as they grew rapidly, several lenders increased their exposure to riskier borrowers, which has naturally impacted loss rates. Funding Circle, for instance, recently reported a deterioration in default rates among higher risk cohorts, and has tightened its criteria as a result. In addition the trend of rising losses continues to be exacerbated by the dwindling usage of contingency funds, exposing more loans to losses.

Although risk has increased in the sector, growing competition among lenders has also created a tougher pricing environment. This has limited lenders' ability to compensate investors for increasing risk. The net yield of marketplace loans has remained stable. Net yields currently stand at 7.2%, and have been at this level since the start of 2018.

Even so, the current net return continues to compare favourably to other short duration options for investors in the current low-yield environment. Furthermore, current net interest on a typical loan covers net losses by a multiple of 2.11x.



“Although risk has increased in the sector, growing competition among lenders has also created a tougher pricing environment”

# Outlook



Total gross lending to reach **£6.2bn** in 2019, up £800m on 2018

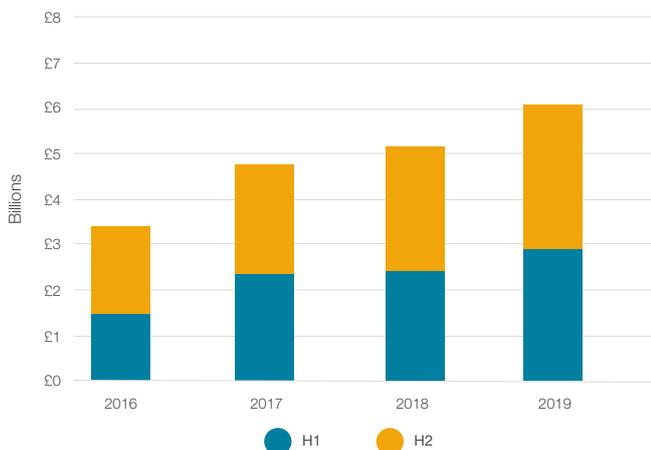


Nonetheless, **pace of growth is set to slow in H2 2019** as economy struggles and sector comes to terms with regulatory change

Link/Brismo forecasts slower growth as we end 2019, as the impact of regulatory change, and an uncertain UK economy, and reputational damage from Lendy's administration dampens demand from borrowers and lenders alike.

Growth is forecast to slow to 13.0% in the final quarter of the year compared to Q4 2018. Even so, this will see lending set a new annual record. We currently forecast that the sector will originate £6.2bn in 2019, up by 16.7% on 2018's full year total – an increase of nearly £900m. While still a healthy level of expansion, it pales in comparison to the 36.4% seen in 2017.

## Gross new lending



Nonetheless, the economic impact of a disorderly Brexit, should it transpire, has the potential to knock growth severely. We would anticipate demand for finance from businesses to reduce, while defaults would naturally rise on the back of job losses or business insolvencies. For those whose risk management strategies have so far been untested, this could prove an acid test. We have

already seen the impact of a sluggish economy on loss rates. A more significant rise in defaults may reduce investor appetite, given the higher risks involved.

Combined with tighter regulation, it is clear that operating conditions look somewhat less rosy for lenders in the sector. In this environment, ensuring a diverse funding model will be central to the long-term prospects of many platforms, especially with regulation likely to reduce the flow of funding from retail investors. Indeed, several of the lenders who have outperformed in the past six months have developed greater levels of institutional funding. However, the durability of this funding will also be tested. Historically 'originate to distribute' funding models have come under pressure in periods of economic stress. Any forthcoming downturn could prove to be the making of the sector if platforms can demonstrate that their funding base is sufficiently deep and diversified to provide certain capital even during a period of higher defaults.

However, if some originators struggle to maintain funding against a more uncertain backdrop they may subsequently struggle to rebuild confidence. The more credibly that an originator can illustrate to investors that prospective returns are adequate compensation for an increase in risk, the more likely it is that funding will continue to flow. This will prove to be a big test of the quality of disclosure as investors require additional scrutiny to provide the reassurance required in a more challenging environment. In this environment ease of comparability will be more critical than ever. In addition, on the retail side, the regulator will be more alert than ever to risks of consumer harm.

# Methodology

Unless stated otherwise, all data within the report is based on data and analysis by Brismo. Origination data is either reported directly to Brismo by originators or is sourced from data published online by the originators themselves. The value and volume of marketplace lending reflects data from 28 lenders, accounting for more than 90% of the market. 2019 is a projected estimate, seasonally adjusted and, based on the latest available data and historic trends.

The lending returns index measures the returns available from a representative sample of tech enabled lenders in the UK. These platforms represent over 60% market share of the UK marketplace lending sector. Index values are published as an annualised return, measuring what an equal time-weighted exposure to every loan originated by the participating platforms would have generated over the preceding 12-month period. Time-weighting ensures that the index reflects a perfectly diversified loan portfolio, which is equally representative of cohorts of all ages. The return has been calculated after fees and is expressed net of losses and recoveries. Due to the lag in the reporting of the data, the latest figures available for the returns index refer to Q3 2018.

For information on the [Lending Index Methodology](#), please contact us at:

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