



INDUSTRY CONTENT SERIES

1 The Rise of Marketplace Lending: Finding Yield in New Places

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Introduction

This industry white paper from NSR Invest, a leading investment manager with deep experience in the Marketplace Lending industry, is the first in a series of industry content designed to help financial advisors, especially Certified Financial Planners and independent Registered Investment Advisers.

Marketplace Lending, also known as P2P Lending for its person-to-person heritage, is a new, high yielding, low volatility alternative asset class that is in high demand, particularly in today's low interest rate environment.

Advisors are finding success in using Marketplace Lending investments to enhance portfolios, and help clients meet their financial goals, while improving their businesses. This report will provide background on the growth of alternative investments among financial advisors, the unique characteristics of Marketplace Lending investments, as well as their investment and financial planning uses in client portfolios.

We invite you to learn more about NSR Invest's complete offering of Marketplace Lending investment products and practice management tools at www.nsrinvest.com.

What is Marketplace Lending?

Marketplace Lending, also known as Peer to Peer lending, is a modern financial transaction that entails individual investors lending money online to individual borrowers. By eliminating the inefficiencies of traditional financial institutions, Marketplace Lending provides lower rates of interest to borrowers and high, non-volatile returns to investors.

Driven by technology innovation and the growing acceptance of crowdfunding, Marketplace Lending is now a major aspect of consumer credit access, particularly as many banks have stepped back from consumer lending. In the first quarter of 2015, online originations of consumer loans passed \$10 billion¹.

Marketplace Lending has grown dramatically over the last several years due to a number of factors. Primarily, the advancement and proliferation of internet and financial technologies made it possible for online lending marketplaces to create a match between the supply and demand of borrowers and lenders. Additionally, the SEC and other regulatory organizations provided a framework for the marketplaces to conduct business under current regulatory structures.

Another driver of growth has been the Global Financial Crisis that created a massive disruption in the ability of traditional financial services firms to serve the needs of consumers and small businesses, as well as a marked, negative shift in perception regarding large financial institutions. The majority of Marketplace borrowers are individuals looking to consolidate and pay off high interest credit card debt, who are often frustrated with the current banking system that does not

¹Source: www.lendacademy.com

provide efficient solutions.

When combined with an extended period of low interest rates from traditional fixed income investments, our free-market economy had the perfect recipe to develop an alternative solution for both borrowers and investors, resulting in the fast growth and acceptance of Marketplace Lending.

To illustrate the mechanics of Marketplace Lending, consider the following descriptions from the perspectives of the Borrower, Investor and Platform.

Value to the Borrower

Individuals seeking to refinance high interest consumer debt, such as credit card debt, can access a solution through the two largest origination platforms: Lending Club and Prosper Marketplace. These two platforms have quickly become the market leaders, and as a result have the largest supply of borrowers and demand by investors, creating an efficient marketplace for consumer loans. Borrowers apply for 36- or 60-month fully-amortizing installment loans, and are subjected to the originators' underwriting process.

If approved, the borrower's loan is listed on the origination platform's website, where investors – individuals, funds, family offices and institutions – are able to view the loan and select it for investment among hundreds of others. Once fully funded, loans are consummated. Due to the attractiveness of the returns, loans typically fund immediately.

At this point, the origination platform delivers money to the borrower, less an origination fee of 2%- 5%, directly into his/her bank account. Every month thereafter for the loan term, the borrower repays the principal and interest in equal payments directly from the bank account via ACH. After all payments have been made, or full prepayment, the loan is retired.

Value to the Investor

Investors seeking non-volatile, high yield investments are attracted to Marketplace Lending, particularly in today's low interest rate environment. They access this opportunity by opening an investment account directly with one of the two leading origination platforms, Lending Club or Prosper Marketplace, or through an independent third party investment manager such as NSR Invest. Investors direct capital to borrower payment dependent notes, which are fractionalized segments of whole loans issued by origination platforms. These notes are registered with the SEC.

After reviewing loans available for investing, the investor decides to invest in a small fraction of the borrower's note, as little as \$25. Once the loan is completely funded, the investor's money is transferred to the borrower. The borrower's monthly payments are transferred automatically from the borrower's bank account through the origination platform to the lender, minus a platform service fee of about 1%.

Origination Platforms

There are multiple common terms for the originators of these loans, including Platforms, Originators and Marketplaces. As mentioned, the industry leaders in the consumer lending segment are Lending Club and Prosper Marketplace. Their role is to provide an aggregated venue for origination and underwriting by balancing supply and demand to foster a healthy, vibrant and liquid marketplace. Key to this goal is to enforce strong underwriting to minimize fraud, delinquencies and defaults.

Marketplace Lending Risks

With all investments, there are various risks that advisors and their clients should understand. The risks for Marketplace Lending fall into 5 categories: Market, Credit, Platform, Trading, Liquidity.

Market risks include the potential for a macroeconomic downturn, which tends to drive an increase in defaults. Consumer credit is especially sensitive to the rate of unemployment, and there are additional general economic factors that could occur to impact borrowers' ability to repay.

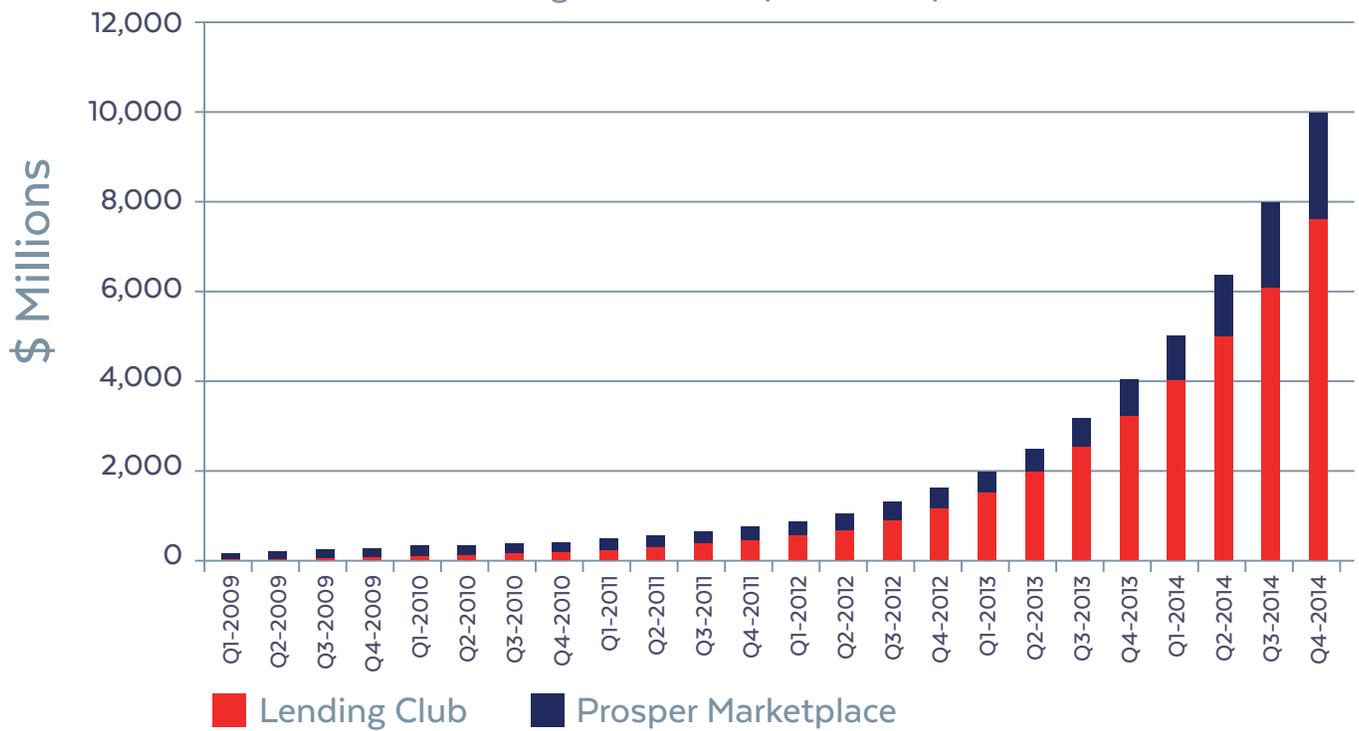
Credit risk comes from the unsecured nature of these loans, which makes Marketplace Lending investments speculative.

Liquidity risks come into play due to the limited secondary market for these loans. When purchasing a loan, investors are generally committed to that investment until it is fully amortized through monthly payments, or through prepayment or default.

Trading risks can occur based on the various investment strategies being deployed, which are dependent upon adequate supply of borrowers on the platforms. Due to the widespread use of algorithmic trading, competition for investing in loans can be fierce, limiting the availability of investment opportunities for do-it-yourself investors.

Platform risk comes from the limited performance data available from the platforms due to their short history. The oldest US-based platform is Prosper Marketplace, which began operations in 2006. All platforms are considered to have limited historical data regarding borrower performance and repayment. As a result, it is difficult to predict how investments in Marketplace Lending will fare in a recessionary environment.

Cumulative Loan Originations 2009-2014 Lending Club & Prosper Marketplace



Source: lendacademy.com

Investing Approaches in Marketplace Lending

Marketplace Lending offers advisors a number of benefits in building portfolios and meeting client needs. Chief among them are the attractive yields and low correlation they provide to enhance portfolios. Additionally, due to the social good that arises from helping consumers access responsible, affordable credit, Marketplace Lending investments fall into the growing category of impact investing that is becoming extremely popular with investors.

For financial advisors, the preferred ways to access Marketplace Lending investments is either through (i) a Managed Account or (ii) a Pooled Fund. Managed accounts are established by a sub-advisor, such as NSR Invest, in your client's name. These can be taxable or qualified accounts. These managed accounts are fairly straightforward to establish and require a low minimum initial investment (\$10,000) to achieve the recommended diversification of at least 400 notes per portfolio.

MANAGED ACCOUNTS:

Managed Accounts can be established at either Lending Club or Prosper and can follow fixed or custom investment strategies. Investors need not be accredited to invest in a managed account. However, all investors in Managed Accounts must be residents of a [P2P-friendly state](#).

Primary advantages:

- Segmented accounts
- Multiple investment strategies (conservative, balanced, assertive & custom)
- Low minimums (\$10,000 minimum investment at NSR Invest)
- Lower fee structure

Primary disadvantages:

- No platform diversification
- Limited liquidity
- Must be a resident of a p2p-friendly state

PRIVATE FUNDS:

Private Funds are another opportunity to access Marketplace Lending investments. As an example, the Lend Academy P2P Fund, LP invests in both consumer and small business loans originated by the Lending Club, Prosper, Funding Circle and Upstart platforms. The Fund targets a 10% net return to investors using a mix of consumer and small business loans. The minimum investment for the Fund is \$250,000. Investors can be residents of any state in the Union. The Fund is a 3(c)1 fund, meaning it can hold a maximum of 100 investors, all of which must be verified accredited investors.

Primary advantages:

- Platform diversification, including Lending Club, Prosper, Upstart and Funding Circle
- Asset diversification, including consumer and small businesses loans
- Traditional limited partner structure, with K-1 tax reporting at year-end
- Investors can be residents of any state in the Union.

Primary disadvantages:

- Must be an Accredited Investor

While advisors and investors can attempt to invest in this sector on their own, industry experts do not recommend this practice due to the fiduciary responsibility of making prudent credit and investment decisions. Most advisors and investors do not have deep underwriting expertise and can benefit from an experienced professional investment manager.

Roles and Responsibilities

Financial Advisor – works with their clients to determine appropriate asset allocation and what percentage to allocate to Marketplace Lending investments.

Investment Manager – provides intelligent access to Marketplace Lending investment opportunities through sophisticated credit underwriting algorithms and proprietary trading platform systems and technology.

Marketplace Platform – originates loans by attracting borrowers to their platforms, screening them using sophisticated underwriting methods, verifying certain information, and then posting online for investment. During the life of the loan, the Marketplaces also service the loan payments, ensuring that payments flow through to investors, and late and delinquent payers are processed accordingly.

Custodian – tracks the cash flows between investor, platform and borrower, ensuring that all transactions are cleared.

Reporting – investment managers leverage order management systems to aggregate account information, holdings, execution statistics, and calculate performance. These reports are provided to financial advisors and their clients via a variety of common protocols, including the Alternative Investment Platform of the DTCC, which serves automated reporting of positions to the leading RIA custodians.

Growing Your Business with Marketplace Lending

With the financial advisory industry becoming more complex and competitive, advisors are seeking new ways to enhance the service they provide to attract and retain high net worth clients. Due to a lack of yield in traditional fixed income investments and a desire to diversify client portfolios, many advisors are seeking alternative investments as a solution to meet these desirable clients' needs.

As an emerging alternative asset class, Marketplace Lending investments are playing a key role for savvy advisors, particularly as advancements in technology, loan selection algorithms and proprietary trading technology offer an easy and transparent way for advisors to allocate client assets to a predictable, high yielding sector.

This type of alternative investment can help you differentiate your business from the competition. While some of the most sophisticated hedge funds in the world have invested billions into online lending investments, and tens of thousands of self-directed individuals have done the same, few advisors are aware of investments in Marketplace Lending, providing a new opportunity to elevate your firm.

Further, as impact investing becomes a bigger factor in investors' goals, Marketplace Lending can position your business as the go-to firm to access socially beneficial investments.

To communicate Marketplace Lending's appeal, top advisors are promoting the key elements of these investments in conversations with clients, including their high yield, low volatility, stable cash flows, financial innovation, and professional management by sub-advisors with deep expertise and experience. These powerful messages show that their advisor is looking out for them by providing access to a specialized investment opportunity.

About NSR Invest

NSR Invest is a leading investment management specialist focused on the Marketplace Lending industry. Our mission is to help rebuild the fabric of our economy by providing a direct, guided connection between investors and borrowers, helping to streamline the inefficiencies of our financial system.

We enable financial advisors to offer Marketplace Lending investment opportunities to their clients, resulting in a positive impact on client wealth and the society in which we live. Through our advanced, proprietary technologies financial advisors are able to create a positive impact while generating solid returns for their clients. The NSR Invest team is comprised of veterans and leaders in the Marketplace Lending industry. NSR Platform was the first of its kind in the industry and continues to set the standard for stability and performance today. In 2014 NSR Invest became a Registered Investment Adviser and is actively providing innovative Marketplace Lending investment opportunities to financial advisors. To learn more, visit www.nsrinvest.com.