



INDUSTRY CONTENT SERIES

2 The Investment Planning Uses of Alternative, High Yield Marketplace Lending Investments

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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 second 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 alternative asset class that is in high demand due to its high yield, low volatility and low correlation, 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.

Industry Trends

In today's investing environment, financial advisors are looking for new tools, resources and solutions to help them develop the right portfolios for their clients. As a result, the use of alternative investing is growing in popularity and demand.

According to McKinsey & Company's recent research¹, "The Trillion-Dollar Convergence: Capturing the Next Wave of Growth in Alternative Investments," there are now over \$7 trillion globally in alternative assets, with the growth rate predicted to be much faster than the industry as a whole. By 2020, alternatives could comprise 15% of global industry assets and produce 40% of industry revenues, according to McKinsey.

In the post-financial crisis era, the search for non-correlated assets is at the top of investors' and their advisors' minds. After experiencing all asset classes decline dramatically in unison during 2008-2009, investors' demand for alternative approaches has increased dramatically. When combined with the current low interest rate environment, it is clear why alternatives are becoming a much more accepted part of the investment planning process for individual investors.

Another industry driver is the emergence of digital advisory platforms, also known as Robo Advisors. These online players are rapidly commoditizing plain vanilla portfolios, driving advisory prices to a fraction of what human advisors charge. In order to stand out from these industry

¹ http://dailyalts.com/wp-content/uploads/2014/08/McKinsey-Company_2014_Capturing-the-Next-Wave-of-Growth-in-Alternative....pdf

disruptors, advisors will be forced to up their game and bring a fresh approach to investment management.

Further, today's investors, particularly the next generation of investor set to inherit the bulk of the multi-trillion in assets held by their aging parents, are interested in impact investments. This category of investment has a component of social benefit. Individuals in the US are often limited in their ability to access affordable consumer credit, and often fall victim to high interest credit cards. New and innovative solutions are needed to provide an answer to this pressing societal problem, an area that Marketplace Lending addresses head on.

When these macro trends are combined, they reveal a new alternative asset class that can provide diversification to traditional portfolios, provide an attractive yield in a low-interest rate environment, all while providing a positive impact to society.

Marketplace Lending investments meet all of these requirements, a powerful solution advisors can leverage to enhance client portfolios, while providing a new message that enhances client relationships.

Characteristics of Marketplace Lending Investments

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 after the Global Financial Crisis and the implementation of Dodd-Frank. The majority of Marketplace borrowers are individuals looking to pay off high interest credit card debt. In the first quarter of 2015, online originations of consumer loans passed \$10 billion².

The leaders in consumer online lending have been companies such as Prosper and Lending Club who have developed their platforms to tap into this unfilled need and have created a fast-growing niche in consumer finance. Prosper and Lending Club are platforms where individuals, looking for lower-interest loans than they can secure through a bank, are paired up with investors who want a solid, steady return.

²Source: www.lendacademy.com

Lending Club and Prosper work by using powerful algorithms and technology to efficiently enable investors to fund these loans. A single loan of \$1,000 provided by Lending Club or Prosper to a borrower will be carved into forty \$25 pieces. Theoretically, 40 different investors could fund that \$1,000 loan to the tune of \$25 each. Thus, an investor may diversify a \$10,000 investment into 400 different notes of \$25 each. Such diversification is important in managing risk.

To begin investing, an investor may establish an account with Lending Club or Prosper, or a third-party investment manager such as NSR Invest. The process is straightforward and secure. Once the investor has transferred capital to their account, they may direct the investment capital into fractionalized loans available on the platform. Many investors have found this to be a powerful and reliable way to find yield in a low interest rate environment.

According to calculations by NSR Invest, the return on investment for seasoned loans originated at Lending Club and Prosper, net of charge-offs and platform fees, has converged toward 6%-7%.

Vintage	LENDING CLUB			PROSPER MARKETPLACE		
	EST. ROI	LOANS	VOLUME	EST. ROI	LOANS	VOLUME
2012	6.69%	53,367	\$717,942,625	7.79%	19,553	\$153,175,121
2011	6.25%	21,721	\$257,363,650	9.35%	11,228	\$75,138,012
2010	6.08%	12,537	\$126,351,175	10.81%	5,652	\$26,940,486
2009	4.57%	5,281	\$51,814,750	9.82%	2,034	\$886,296

Source: NSR Platform, as of April 3, 2015

How to Invest in Marketplace Lending

There are many ways to invest in Marketplace Lending. Financial advisors can (i) use a “DIY” self-managed approach, (ii) work with an investment management specialist focused on the space, or (iii) take a pooled investment approach through a fund structure.

The table below identifies these three investment approaches and identifies some of the advantages and disadvantages of each. Industry experts agree that guided, or managed investments on these platforms can achieve a materially better result by the application of sophisticated loan selection algorithms and high-speed trading systems.

SELF-MANAGED (DIY)

An individual opens an account directly with an origination platform such as Lending Club or Prosper. The individual (or financial advisor) makes investment selections according to his/her own logic.

ADVANTAGES	DISADVANTAGES
<p>It is easy to set up and fund an investment account.</p> <p>The only fees the individual pays are associated with the platform itself.</p>	<p>Individuals typically do not have consumer credit investment expertise.</p> <p>Individuals are often beat to the punch by fast trading systems when trying to purchase the best loans.</p> <p>Management of accounts can become tedious. If an individual does not pay close attention, returns may diminish.</p> <p>Individuals often do this outside the purview of their financial advisors, without a broader portfolio view.</p> <p>Platforms do not offer discounted fees to individuals.</p> <p>Individual investors must reside in P2P-friendly states.</p>

MANAGED ACCOUNTS

Individuals employ a specialist to direct investments within their individual accounts.

ADVANTAGES	DISADVANTAGES
<p>Some specialists are deeply experienced in consumer credit investment.</p> <p>Some specialists employ the use of fast trading systems to achieve a first-in-line advantage when selecting from the available loans.</p> <p>Some specialists use sophisticated portfolio balancing algorithms to ensure that individuals' accounts are being invested fully and intelligently.</p> <p>Some specialists have reporting features that allow financial advisors to integrate Marketplace Lending into overall portfolio analysis and reporting.</p> <p>Some specialists have negotiated reduced fees with the platforms, somewhat offsetting the additional fees the specialists may charge.</p>	<p>Specialists charge fees for managing individual accounts.</p> <p>Individual investors must reside in P2P-friendly states.</p>

POOLED FUNDS

Individuals invest in a pooled vehicle (fund) controlled by a portfolio manager who invests all assets of the fund. The fund is owned jointly by the investors (limited partners), who share pro-rata in its returns-on-investment.

ADVANTAGES	DISADVANTAGES
<p>Similar advantages as Managed Accounts, plus:</p> <p>As pooled investment vehicles, funds can often offer greater diversification, including investments across multiple origination platforms.</p> <p>Some funds are open-ended, meaning that they allow redemptions, a measure of liquidity.</p> <p>Well-run funds often have independent administrators (accountants), custodians and are subject to an annual audit.</p>	<p>Only accredited investors may invest in private funds, as provided by the 3(c)(1) exemption of the Investment Company Act of 1940.</p> <p>Managers charge fees to manage the funds, which are often higher than the fees associated with Managed Accounts.</p>

Risk Management

Like any investment, there are risks in Marketplace Lending. Returns on Marketplace Lending investments – and consumer credit in general – are highly correlated with employment rates. When employment is strong, consumer credit defaults are low. When the economy falters and unemployment spikes, defaults increase. When defaults increase in a Marketplace Lending portfolio, returns will be impacted. Therefore, prudent risk management indicates that more conservative lending portfolios will withstand economic shocks better than more aggressive lending portfolios, although both will be affected.

Marketplace Lending investment specialists manage the risks involved through a combination of experience, expertise and the deployment of sophisticated technology.

Credit Expertise. Specialists develop credit algorithms that allow them to target the top performing loans among the thousands originated by the platforms, minimizing defaults to increase returns.

Access. Specialists leverage technology to source appropriate volumes in order to meet client demand.

Selection. Specialists use proprietary trading systems to quickly purchase the highest quality notes for their clients.

Portfolio. Specialists constantly monitor client accounts to ensure that each portfolio is kept in balance, and non-productive cash is kept to a minimum.

Diversification. Specialists diversify client capital to dampen volatility while still achieving yield.

Sophisticated Technology. Specialists invest in proprietary technologies, such as trading engines, order management systems, reporting platforms, and intuitive user interfaces.

Marketplace Lending in Portfolio Construction

Many advisors classify Marketplace Lending investments as an alternative to traditional fixed income investments. Due to the nature of their monthly high yield, advisors will implement this type of alternative as part of their overall fixed income allocation.

Allocations can vary according to appropriate risk-tolerance levels and need for income. Generally, industry experts recommend a 10% - 30% allocation of high yielding alternative investments among the total fixed income portion. Of course this allocation varies based on client objectives, portfolio sizes and overall investment objectives, and can vary vastly from client to client.

Typical client profiles include fixed income investors looking for more yield from their portfolios, as well as growth investors looking to enhance the overall return from their portfolio.

Hypothetical Example

PRE	POST
\$1 mm fixed income portfolio	Deploy 30% of bond funds (\$210,000) into Marketplace Investments, returning 7%
70% Bond funds	
20% CDs	New blended rate of return is ~5%, generating an additional \$20,000 in income
10% dividend/preferred stocks	
Blended rate of return ~ 3%	Extends portfolio another 10 years to fund health care issues or living longer in retirement

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.