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Introduction

The State Of The Alternative Lending Market In The UK And Europe

Eagle-eyed readers of both this report and last year’s version will note that the overall name has changed from Peer-to-Peer Lending to Alternative Lending. “Why?” You might ask.

The overall hyper-growth rate of fintech-driven lending has certainly slowed in terms of the heady days of the peer-to-peer lending boom in the UK, but remains robust in Continental Europe and the Republic of Ireland which is quickly playing catch up.

We have also seen some notable casualties from the peer-to-peer sector including Lendy, Wellelsey, Monedo (formerly Kreditech) in the past year.

Many incumbents, and other fintech players such as digital banks, are also integrating with lending disruptors including partnerships from Starling Bank and Zopa and, respectively, Funding Circle. RateSetter too has been acquired by challenger Metro Bank.

So, what’s going on? Well, quite a lot as it turns out. This would have been true pandemic or no pandemic. Nonetheless, 2020’s machinations look set to change the industry forever in a manner of ways. Perhaps even meaning we have to change the name again next year by dropping ‘alternative’ altogether as things move into the mainstream.

This report will take you behind the headlines and the figures (don’t worry we have got plenty of those too) and look at what else is happening. You’ll find exclusive interviews and data including our survey of nearly 50 CEOs of lending businesses.

We’ll answer questions such as what are some of the new frontiers of lending tech? How is Covid-19 impacting lenders? What do investors in credit think of the sector? We’ve also got deep dives into SME and property lending as well as an exploration of the listed direct lending funds. We hope you enjoy.

Daniel Lanyon
Editor-in-Chief, AltFi
The Covid-19 crunch may have forced alternative lenders to close and shift strategy during 2020 as investor money dries up, but the slowdown had actually already started in 2019.

Figures from data analytics firm Brismo (recently acquired by LoanClear) show 2019 was a year of transition for the UK alternative lending sector as it battled both the external influences and uncertainty of Brexit and prepared for regulatory changes that overhauled the way platforms operate.

This has fed into another year that saw lending growth slow as the sector's target markets of investors, consumers, small businesses and property developers navigated delayed exits from the EU as the Article 50 deadline was extended three times, plus a Conservative party leadership contest and a general election.

That was all while preparing for the launch of new regulations for the sector that introduced tough new retail marketing restrictions and appropriateness tests as well as strict rules on wind-down plans.

There were also plenty of high profile exits that will have stunted lending growth, such as the controversial collapse of property peer-to-peer lender and former Cowes Week sponsor Lendy and decisions to switch from retail to institutional money from big brands such as Landbay and ThinCats.

**Slowing growth**

Total lending among peer-to-peer and marketplace lenders in the UK passed the £6bn mark in 2019 and cumulatively now totals more than £25bn based on data gathered by Brismo since 2011.

There is a caveat behind these big and impressive figures though. Growth is slowing.

Lending during 2019 among P2P and marketplace lenders was up 10.7 per cent annually to £6.26bn. That is slower than the 12 per cent annual growth registered in 2018 and is also well below Brismo's bullish predictions of 20 per cent growth in originations for 2019 in last year's report.

Industry commentators say this slide is not new.

"The slowdown has been a continuation from 2018," says Ben Arram of consultancy Bovill. "It is largely Brexit driven."

This can be seen in the Brismo data as P2P originations reflected the economic and political uncertainty being caused by Brexit negotiations, making platforms more...
Section 1: Alternative Lending In The UK

Overall UK Volume Growth

<table>
<thead>
<tr>
<th>Year</th>
<th>£bn</th>
</tr>
</thead>
<tbody>
<tr>
<td>2011</td>
<td>92.2m</td>
</tr>
<tr>
<td>2012</td>
<td>20.3m</td>
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<tr>
<td>2013</td>
<td>602.2m</td>
</tr>
<tr>
<td>2014</td>
<td>1.47bn</td>
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<td>2015</td>
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<td>2016</td>
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<tr>
<td>2017</td>
<td>5.02bn</td>
</tr>
<tr>
<td>2018</td>
<td>5.68bn</td>
</tr>
<tr>
<td>2019</td>
<td>6.28bn</td>
</tr>
</tbody>
</table>

Source: Brismo/Loanclear.

cautious about lending and hitting borrower demand. Originations dipped from £1.63bn in the first quarter of 2019 to £1.58bn in the second as the UK missed its first Brexit deadline in March and the European Council granted an extension comprising two possible dates, 22 May should the Withdrawal Agreement gain approval from MPs or 12 April if not.

The UK Prime Minister at the time, Theresa May, secured another extension to 31 October in April but uncertainty returned the next month as she announced her resignation and said a new leader would be appointed in July. Boris Johnson was soon appointed on a ticket that he would “get Brexit done” even if it meant leaving with no deal. This new uncertainty saw originations drop to £1.55bn in the third quarter.

Johnson subsequently failed to get MPs to back his new Withdrawal Agreement and gained a further extension until 31 January 2020. He also called an election in October to take place in December, all ensuring further uncertainty for much of the fourth and final quarter of 2019.

The Conservative party gained a surprise majority amid fears of a Corbyn government and the Withdrawal Agreement gained parliamentary approval in December.

But it was too late to boost P2P originations for the year. P2P lending dropped to £1.48bn in the fourth quarter, the lowest since the third quarter of 2018.

Arram said the main downward movements have been around consumer lending as Brexit and political uncertainty hit public confidence. “The small and medium-sized enterprise (SME) space has been showing a slight increase throughout the year,” he says. “There is clearly still a need for firms to access finance.”

This is not just an issue that hit P2P lenders though. The political and economic uncertainty of 2019 had an impact across all types of lending.

Small business lending from banks was down 3.6 per cent in 2019 and consumer lending fell around 10 per cent, according to data from banking trade body UK Finance.

Market share

Total loan originations in the P2P business space hit £2.2bn in 2019, up from £2.1bn in 2019, while consumer lending was flat at £1.9bn, according to Brismo.

“We’ve focused on one asset class – consumer lending – and built real expertise in that.”

Property P2P lending also rose from £1.2bn to £1.7bn, which sounds like a big jump until you dig further into the data. Most of that figure, £994m, is from alternative property platform Lendinvest which is no longer backed by retail money and is purely institutional. Without Lendinvest funds and the £128m from institutional-backed Zorin Finance, retail backed P2P property lending made up just £595m.

Just as Lendinvest dominates in marketplace property lending, there is little change among the incumbents in the business and consumer space. Funding Circle remains the dominant SME lender, originating £1.5bn in 2019. The next closest is Assetz Capital with £291m of loans during the year. For all its size, however, originations were only up by 1.6 per cent at Funding Circle, according to Brismo data.

“2019 was a solid year for the UK business in a challenging economic environment,” says Lisa Jacobs, Europe managing director for Funding Circle. “We grew originations and made progress towards becoming more profitable. Regulation and Brexit both factored into what was happening in the industry in 2019.”

“In response to the deteriorating economic outlook, we took proactive action to tighten our credit criteria in order to protect returns for investors. This was the right decision for customers lending through the platform and has led to positive initial signs for 2019.”

There were also some significant drops, with lending by MoneyThing down 60.5 per cent annually and Ablrate doing 36.2 per cent less. Assetz Capital also recorded a 6.3 per cent drop in lending. This trend of challengers and smaller players kicking at their bigger rivals’ heels is reflected in the property, invoice finance and consumer lending space.

The largest growth in property comes from smaller players. LendInvest may have done the most originations but prime P2P property lender CapitalRise had the largest growth. Its originations were up 312 per cent to £33.9m, helped by a shift to larger loans and securing an institutional funding line from an unnamed financial institution. This was followed by P2P development finance provider CrowdProperty which grew originations by 86 per cent.

MarketFinance (formerly MarketInvoice) continues to dominate the alternative invoice finance space, with £722m on its books in 2019, ahead of the £2,094 funded by Investly. Zopa, the world’s oldest P2P lender, remains top of the pile among consumer lenders, with originations increasing from £1.02bn in 2018 to £1.07bn in 2019.

“We’ve focused on one asset class – consumer lending – and built real expertise in that,” says Natasha Wear, chief executive of Zopa’s P2P business. “Unlike other P2P
consumer lenders in the UK, this has enabled us to attract a very diverse set of investors, from individuals to funds to banks, as well as facilitate multiple securitisations on behalf of our investors. With our retail investors, we have prioritised giving them diversification and full transparency on their loan performance.

Despite Zopa’s dominance, RateSetter was the fastest-growing consumer lender last year, with originations up 8.5 per cent annually to £771m.

**Battle for the ‘big three’**

Despite a strong year of lending, RateSetter’s position in the so-called ‘big three’ appears to be under threat. Funding Circle, Zopa and RateSetter have consistently been the largest lenders, according to the Brismo data. This has given them the title of the ‘big three,’ a reference to their size and standing in the sector. But this year’s figures show the makeup of the ‘big three’ may be set for a shakeup.

RateSetter, which has historically been the third-largest marketplace lender, was pushed into fourth place in 2019 by LendInvest, which even overtook Zopa for originations during the first and fourth quarter of the year.

“To really scale as a platform, you do need to access institutional funding. Once you tap into institutional funding it is in most cases cheaper than retail.”

**Market Share By Sector 2019**
Section 1: Alternative Lending In The UK

tightened its consumer credit criteria.

“What is important to RateSetter is to originate quality loan assets and manage credit well to deliver an attractive level of return and risk to our investors,” says Rhydian Lewis, chief executive of RateSetter. “Other marketplace lenders moved away from retail funding, but RateSetter became the biggest. Our focus was on becoming the biggest provider of the Innovative Finance ISA, which we achieved. We then planned to diversify our funding again.”

RateSetter has now been acquired by challenger Metro Bank, which will solely fund its consumer loans.

Each sector also has its own dominant ‘big three’. Funding Circle, Assetz Capital and ThinCats make up the ‘business big three’ and account for 95 per cent of P2P business lending. Zopa, RateSetter and Lending Works (recently acquired by alternative investment manager Intriva Capital) are the main consumer lenders and make up 97.8 per cent of lending in this group. The ‘big three’ in property consists of LendInvest, Zorin Finance and Octopus Choice. They account for 75 per cent of lending in this space and only the latter is retail focused.

High-profile exits

Some high-profile lenders gave up the pursuit of retail money during 2019. Established brands such as Landbay and ThinCats closed to retail investors, highlighting that it was more cost-effective to work with institutional backers who were supporting most loans.

A smaller lender, MoneyThing, also blamed market conditions as it announced plans to close and is in a managed wind-down.

Other platform closures have been less simple. P2P property lender Lendy collapsed into administration in May 2019, and there is still uncertainty over how much money investors will get back. FundingSecure investors have been left in similar circumstances since it entered administration in November 2019. These issues meant five platforms weren’t active in the final quarter of 2019, which will have hit the level of lending.

Regulatory change

The voluntary exits weren’t directly blamed on the regulations but came ahead of new rules for P2P platforms to follow.

Firms had to prepare for a 9 December deadline after which platforms were restricted to marketing to those who are certified or self-certify as sophisticated investors, those who are certified as high-net-worth investors, people receiving regulated investment advice, or those who certify that they will not invest more than 10 per cent of their net investable portfolio in P2P agreements.

Retail-focused platforms had to develop systems to categorise investors and introduce appropriateness tests to ensure users understood the risks of P2P lending. There were also new requirements to have a wind-down plan in place should a platform fail. All this adds costs to a business.

Arram says regulatory changes have had an impact on the industry. “We were working with clients to get prepared and we saw varying degrees of preparedness,” he says.
Section 1: Alternative Lending In The UK

"Some were well set up as they had intentionally anticipated the new rules, and some more coincidentally as they already had established good models that coincide with the new rules."

He said platforms were also concerned about creating appropriateness tests that don't offend pre-existing investors. "Most firms were able to adapt," says Arram. "It put firms under pressure to have robust strategies that are feasible. If you are in a position to attract institutional investors, that could be a great option with less regulatory burden compared with working with retail customers."

**Competition**

High profile exits and platform failures do present an opportunity for the remaining players to attract new investors and borrowers. Yet it's always the same names at the top, so is there a lack of competition?

A sector breakdown suggests investors and borrowers are still spoilt for choice among business P2P lenders where there are 11 platforms. There are five in the consumer space, two in invoice finance, and 13 in property.

Harwood insists the market is structured better than on the continent where Varengold is also a key institutional funder. "In the UK we have a good spread of lenders but there is a big difference between the big players at the top of the market and very little in the middle," she says. "If you think in terms of the number of players that are out there, the UK is represented a lot better than on the continent."

**Returns**

A slowdown in lending growth has been accompanied by a drop in returns.

Yield data from a diversified portfolio of loans originated by the UK's big four P2P lending platforms—Funding Circle, Zopa, RateSetter, and MarketFinance—compiled by Brismo found average net returns were at 4.05 per cent in first six months of 2019. This was down from 5.26 per cent at the same time in 2018.

These returns will have been pushed down by an increase in defaults, with the average net loss rising from 1.8 per cent in the first six months of 2018 to 2.84 per cent a year later. The returns still beat interest offered in savings accounts or cash ISAs, albeit with a lack of Financial Services Compensation Scheme protection.

"Some platforms are struggling to maintain rates," adds Arram. "It is all about risk perception. Will people take that plunge when they may have uncertainty in their own lives?"

He adds that returns are good for investors and there are still opportunities for platforms, especially with some moving out of the retail space. "There are limits though as you need to attract enough new retail customers to maintain inward investment flows given the cap imposed by the new rules of investing 10 per cent of their net investable assets," he said.

The past couple of years may have been characterised by political and regulatory change for alternative lenders, but the uncertain post-pandemic economic environment means the real test of the strength and attractiveness of the sector is only just beginning.

**Originations By Volume**

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<tr>
<td><strong>Business</strong></td>
<td></td>
<td>408,086,854</td>
<td>712,236,338</td>
<td>1,171,530,683</td>
<td>1,754,353,992</td>
<td>2,137,387,936</td>
<td>2,231,079,131</td>
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<td><strong>Consumer</strong></td>
<td></td>
<td>565,277,760</td>
<td>1,083,628,802</td>
<td>1,457,377,292</td>
<td>1,820,809,178</td>
<td>1,901,090,449</td>
<td>1,952,961,315</td>
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<td><strong>Invoice</strong></td>
<td></td>
<td>170,997,803</td>
<td>252,236,601</td>
<td>283,943,787</td>
<td>278,144,099</td>
<td>359,709,648</td>
<td>362,087,398</td>
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<tr>
<td><strong>Property</strong></td>
<td></td>
<td>324,449,363</td>
<td>535,802,968</td>
<td>830,601,144</td>
<td>1,164,516,868</td>
<td>1,281,905,622</td>
<td>1,717,476,288</td>
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<tr>
<td><strong>Total</strong></td>
<td></td>
<td>1,468,811,780</td>
<td>2,583,904,709</td>
<td>3,743,452,906</td>
<td>5,017,824,137</td>
<td>5,680,093,655</td>
<td>6,263,604,132</td>
</tr>
</tbody>
</table>

Source: Brismo/Loanclear.
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Section 2: Key Themes In Europe

Full Speed Ahead

Alternative lending continues to boom across continental Europe and at a faster rate than the UK as the market is still revelling in its growth phase. Originations grew 80 per cent in 2019 to €6.6bn (£5.9bn), from €3.6bn in 2018, according to data firm Brismo (recently acquired by LoanClear). That is slower than the 97 per cent annual growth experienced in 2018 but it is still faster than across The Channel in the UK.

The value of lending is also close to the £6.2bn originated in the UK—the first time the continent has shown signs of catching up with the UK. The UK and EU figures combined take the total amount of lending across Europe to more than £12bn for 2019, an impressive figure for a sector that was still seen as niche even five years ago.

The EU figures beat Brismo’s forecasts last year when the data company projected growth in originations will almost halve from 90.2 per cent in 2018 to 47.49 per cent in 2019 due to a slowdown in consumer lending. Instead, originations in the P2P consumer lending space were up 92 per cent from €2.5bn to €4.8bn between 2018 and 2019. Growth in EU P2P SME lending was up by a third and invoice finance platforms grew originations by two thirds. The property sector saw an 80 per cent annual increase in lending to £146.5m.

“Alternative lenders started in Europe a little after the UK,” said Rupert Taylor CEO of LoanClear. “We are now seeing strong growth as originators begin to communicate the strong performance track records that they have developed to an audience of investors with an appetite for yield.”

However, while the UK has a few dominant players making up its total originations, 45 per cent of funded P2P loans in the EU came through Latvian lending marketplace Mintos. The consumer lender recorded €3bn of loans through its platform in 2019. The next largest player is also a consumer lending platform, Auxmoney in Germany, which had originations of €700m in 2019, underlining just how much Mintos dominates the continental P2P lending space.

“We are now seeing strong growth as originators begin to communicate the strong performance track records that they have developed to an audience of investors with an appetite for yield.”

Market share

Each lending sector among European lenders has one dominant player but plenty of challengers that are growing fast.

Pan-European lender October dominates in the business lending space. It funded €125.5m of loans in 2019, up 12 per cent on a year before. That is 25 per cent of the total €490m of business loans funded through European alternative lenders in 2019.

German SME lender Creditshelf meanwhile saw a 75 per
Section 2: Key Themes In Europe

cent year-on-year increase, originating €88.5m in 2019, it says, after a bumper Q4. October may have the largest loan book among Europe’s 22 P2P business lenders but others are also growing fast.

Irish business lender Flender grew originations by 591 per cent annually in 2019 to €16m of lending, albeit from a low base of €2.4bn. It was helped by a new €75m funding line from an unnamed institutional partner as well as lowering borrower rates. Rival Irish business lending platform Linked Finance, the largest in the country’s alternative finance market, grew originations by 18.4 per cent with £45m of funds provided in 2019.

Niall Dorrian, chief executive of Linked Finance, says the platform’s lending growth slowed last year as it went through a transition period to prepare for additional scale but it still averages more than £100m of originations over the past three years. “The non-bank lending sector is putting its best foot forward in Ireland and has a significant role to play in funding SMEs,” he says.

There were also some large drops in lending among platforms on the continent. Spanish lender Arboribus didn’t do any lending during the final three quarters of 2019 and originations were down 96.4 per cent to just €102k. This has been attributed to the platform pausing activity while it planned to bring institutional funding on board 2019.

Another Spanish lender, Loanbook, which announced in 2019 that it was winding-down its platform, registered an 84 per cent drop in the value of originations.

The consumer P2P lending space is dominated by Mintos. Its loan book made up 62.5 per cent of consumer P2P originations in 2019 and annual lending at Mintos was up 191 per cent to €3bn. There is a caveat when other P2P lenders refer to Mintos. They highlight that its business model is different as the platform doesn’t facilitate the loans. Instead, it provides a marketplace for 70 loan originators from around the world to list loans that investors can put money into. The originations are based both in and outside the EU so there is an argument that the Mintos loan book, although impressive, is an anomaly and overstates the popularity of the wider European lending market.

The next closest lender to Mintos is Germany-based Auxmoney which did €700m of loans in 2019, up 27 per cent annually. Of 17 other consumer P2P lenders in Europe, only four funded more than €100m of loans last year.

This cohort was led by French lender Younited Credit with €291.6m of lending, followed by Finland-based Fellow Finance with €210m. Pan-European platform Bondora had €167m of originations, up an impressive 177 per cent

EU Originations

<table>
<thead>
<tr>
<th>Year</th>
<th>€bn</th>
</tr>
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<tbody>
<tr>
<td>2019</td>
<td>€6.67bn</td>
</tr>
<tr>
<td>2018</td>
<td>€3.69bn</td>
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<td>2017</td>
<td>€1.87bn</td>
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<td>€988.6m</td>
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<td>€256.8m</td>
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<td>2013</td>
<td>€118.9m</td>
</tr>
<tr>
<td>2012</td>
<td>€49.6m</td>
</tr>
<tr>
<td>2011</td>
<td>€31.1m</td>
</tr>
</tbody>
</table>

Source: Brismo/Loanclear.
in 2019 to €167m, which shows the benefits of operating across different borders within the EU and the extra market opportunities it provides.

The fourth of this €100m group was Latvian lender Twino, which had a slightly quieter year during which its founder and chief executive Armands Broks stood down, it funded three per cent fewer loans at €194m. It is also worth highlighting the success of Estonia-based IUVO, which works similarly to Mintos through loan originators and had a 110 per cent annual boost in originations to €64.7m.

There is more choice of marketplace platforms offering invoice finance products on the continent compared with the UK where MarketFinance dominates. In contrast, Europe has six and the main players are both based in Italy.

Fifty Finance is the dominant player, lending almost half of all invoice finance originations last year at €508m. Its originations were up 90 per cent but this growth was behind Italian invoice finance platform Credimi, which grew its lending by 145 per cent to €485m in 2019. The other players in this space are smaller in comparison, with Spain’s Crealsa and Finexkap in France the next largest having lent €77m and 76m respectively. Italy’s Workinvoice and Investly EU in this space are smaller in comparison, with Spain’s Crealsa and Finexkap in France the next largest having lent €77m and 76m respectively. Italy’s Workinvoice and Investly EU in Estonia funded €49m and €14m respectively. pan-European lender EstateGuru dominates Estonia.

There are just two major lenders in the European P2P property space. Pan-European lender EstateGuru dominates with €84m of originations last year, up 59 per cent. Its rival Club Funding, based in France, had €62m, which is up 120 per cent annually.

Baltic dominance

There is a high proportion of P2P lenders in the Baltic states compared with other countries, often attributed to lower regulatory thresholds. Latvia and Estonia have six each and Lithuania has two.

Most such as Latvia’s Mintos and Twino as well as Bondora and IUVO in Estonia are in the consumer lending space. The presence of Mintos in Latvia makes the country Europe’s largest P2P market with £3.2bn of originations across all its six platforms. Mintos makes up 90 per cent of this figure. Italy is the next largest market where alternative lenders did £1.07bn of originations in 2019.

Its alternative lending sector is dominated by invoice finance providers mainly backed by institutions. Three out of its six alternative lenders, Credimi, Fifty Finance and Workinvoice provide invoice financing. Credimi and Fifty Finance accounted for around £500m each of the total originations in Italy during 2019. The remaining two providers are business lender Borsa del Credito and consumer lenders Prestiamoci and Smartika.

France has the most P2P lenders out of the rest of Europe with eight, five of which are business lenders—the highest number on the continent—such as October. It does have a significant consumer player, with Younited credit which did £291m of originations last year.

French alternative lenders recorded £588m of originations last year.

Key to success

There are two key themes to being a dominant European lender, institutional funding and a cross-border outlook.

Italian invoice finance and business loans platform Credimi only uses institutional money and its founder Ignazio Rocco says this is the key to gaining scale. “We have never been a marketplace,” he says. “We have always funded ourselves with institutional investors. The appetite of retail investors [for] this kind of product is not such a great one.”

“You can’t fund yourself with investors looking for [a] high single return. Credimi has professional investors, they buy something they know is illiquid and won’t be trying to sell the next day. You want to avoid the risk of this alternative market being held by retail investors who are unaware of the risks and may want their money returned.”

The size of Mintos, which takes both retail and institutional funds, shows there is scope for both types of investors, but scale is best achieved by operating in more than one country. October chief executive Olivier Goy puts its success down to an international outlook. The platform has offices in France, Spain, Italy, the Netherlands and Germany.

“You have very few lending marketplaces operating in more than one country in continental Europe,” says Goy. “That generates more volume. If you have more volume you attract larger lenders and then it is a virtuous circle. We have been bold enough to expand after day one. You need to be able to attract lenders and borrowers.”

Goy says investment is split between 80 per cent institutional money and 20 per cent retail, which has happened naturally.

Its nearest competitor in terms of origination growth, Flender, focuses solely on Ireland. Similarly, in the property space, EstateGuru offers loans to developers in Estonia, Latvia, Lithuania, Spain, and Finland and has recently broken into Germany, while Club Funding is only in France. “We are shifting from just P2P to building a real estate finance platform to connect with institutional investors where they can manage and service loans,” Marek Partel, chief executive

76%
The amount of European lending CEOs surveyed that say Covid-19 has adversely impacted them.
Section 2: Key Themes In Europe

of EstateGuru, said. “The business model we are building is a cross border.”

“Our investors can diversify between seven or eight countries on different property and loan types, the more mature a market is, the more it attracts new investors, that has been the reason for success.”

Regulation

The European P2P and marketplace lending sector may be growing faster than the UK but it is still catching up when it comes to regulation.

Some EU countries such as France and Italy have their own systems of rules for crowdfunding and P2P lenders. However, some such as Estonia and Latvia don’t have specific bespoke regulations. Most platforms in these countries still follow anti-money laundering rules and have procedures to keep client money separate, however, the lack of rules has given rise to claims of fraud.

Estonia-based business P2P lender Envestio had one of the fastest-growing loan books in 2019, up 215 per cent. But its platform has since gone bankrupt and police are investigating claims of fraud on the platform.

Latvia-based Grupeer was also one of the fastest-growing lenders in 2019 but has since faced questions and the threat of legal action from investors after suspending activity during the coronavirus pandemic.

Work on harmonised pan-European crowdfunding regulations and minimum standards has finally made progress and the European Council adopted new rules in July 2020 overseeing how crowdfunding platforms operate across the European Union.

It will remove barriers for crowdfunding platforms to provide their services cross-border by harmonising the minimum requirements when operating in their home market and other EU countries and aims to protect investors from scams and ensure they understand the risks. The new rules limit the amount that can be raised through individual projects to €5m euros. All platforms will need to be authorised by their national authorities and follow anti-money laundering and know-your-customer requirements. Platforms will also be required to develop business continuity plans, the rules state and only those based in the EU can apply for authorisation. There will be prudential requirements and platforms will also need a complaints system.

Similar to the UK rules, the regulations distinguish between sophisticated and non-sophisticated investors. Non-sophisticated investors will have to complete an appropriateness test and a maximum investment amount will be set.

The rules go slightly further than the UK regulations by mandating for a reflection period where investors can change their mind without penalty. Platforms expect the regulations to be introduced during 2021.

Goy says October has deliberately chosen to operate in countries where regulations exist. “There is no scandal or fraud in the five countries we operate in,” he says. “It is hard to build trust without regulators as you need a judge or policeman in the room.”

Rocco adds that any regulations mustn’t harm development and suggests the UK model should be followed so platforms are given temporary licences while they get prepared. “Credimi is already fully regulated in Italy, he says. “Protecting investors is legitimate but we shouldn’t be regulated like banks where there have been the biggest mess-ups. The changes need to be proportionate.”

Partel is supportive of regulation but also adds that investors must do their research. “You have to take your own responsibility to research a platform and not just rely on the offered return,” he says. “We have a strong investor community who know to avoid platforms where it is unclear who the founders are and where there are no audited accounts.”

“We have been supporting the idea of pan European regulations, but it would have been harder to get where we are if there had been heavy regulations in place when we started. We are already regulated in the UK, in Lithuania and Finland. I already have 50,000 regulators watching my back from our investor base.”

With increased investor interest and incoming regulation, the European alternative lending market is one that is definitely worth watching.

CEO Poll: Will Defaults Rise in 2020?

Stay the same 51.9%
Rise 38.1%
Fall 10%

Source: AltFi Survey of lending CEOs August 2020
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Section 3: Covid-19 And Alternative Lending’s Future

Testing Times

No-one has ever said we live in ‘precedented’ times, yet the word unprecedented has become one the key phrases of the Covid-19 crisis as governments and lenders attempt to support hard-pressed borrowers through the economic impact of the pandemic.

Alternative lenders haven’t been immune to the outbreak and have had to adapt their working and lending practices. Fintech firms have also been used in a variety of ways in different countries to support struggling small businesses while keeping their own operations afloat.

For many platforms in the UK, it is the first test of how they can perform in an economic cycle. Zopa was the only P2P lender around during the global financial crisis and subsequent recession in 2009.

It has also been a test of how they can keep investors and borrowers happy at the same time as they manage requests for withdrawals on the supply side and the need for payment breaks and further financial support on the other.

Withdrawal delays and lending changes

Platforms such as Assetz Capital and RateSetter found themselves hit with a deluge of requests for withdrawals as investors panicked in the early days of the pandemic in March, which led to delays for those accessing funds.

“We don’t directly manage withdrawals as they are funded mainly by new investors buying the portfolio off of exiting investors and that balance has shifted as always in a crisis and liquidity became poor for a while,” says Stuart Law, chief executive of Assetz Capital. “We have brought in a new access account marketplace so that now and next time people can create their own liquidity by offering discounts if they wish to accelerate their exit.”

Rhydian Lewis, chief executive of RateSetter, acknowledged that delays were frustrating for investors but added that liquidity was still maintained.

“RateSetter continued to deliver investor liquidity every day and positive investment returns throughout this downturn,” he says. “During the past 10 years, as well as delivering more than £175m of interest to investors, we have delivered close to £1bn of liquidity.”

Many of the major P2P lenders either temporarily paused lending or altered their criteria. RateSetter stopped taking on new investors at the start of May 2020 and by August had agreed a deal to be acquired by Metro Bank which would fund all its unsecured lending. Assetz Capital initially lowered its loan-to-value to below 65 per cent and Zopa temporarily stopped lending to higher-risk borrowers in its C, D and E risk bands.

“We’ve been tightening our credit criteria for some time, including two rounds of tightening prior to the Covid-19 outbreak,” says Natasha Wear, head of Zopa’s P2P business. “We acted swiftly in response to the crisis to make further, significant changes to our credit policy, including taking the temporary step to only lend to new customers in
Section 3: Covid-19 And Alternative Lending’s Future

Lending CEO Survey

Has Covid-19 impacted your lending in an adverse way during 2020?

Yes 75%
No 25%

Source: AFN Survey of lending CEOs August 2020

Do you expect your overall lending volumes to be higher or lower in 2020 compared to 2019?

Higher 41%
Stay as the same level 18%
Lower 41%

We’ve been tightening our credit criteria for some time, including two rounds of tightening prior to the Covid-19 outbreak.”

Forbearance

One of the Financial Conduct Authority’s first actions during the pandemic was to order firms to allow three-month payment breaks to personal loan borrowers affected by the Covid-19 outbreak. This technically didn’t apply to non-bank or P2P lenders but most such as RateSetter, Zopa, Funding Circle and Assetz Capital followed suit.

Iana Vidal, head of policy and government for fintech trade body Innovate Finance, highlights that it wouldn’t have put the P2P sector in a good light from a reputation perspective if a customer expected forbearance but wasn’t given it during the pandemic.

“The level of borrowers who took payment breaks that have resumed paying or come back shows that providing that goodwill has been a good business decision,” she says. “These platforms have helped keep their customers in business.”

Fintech lenders have taken different approaches to payment breaks though, according to sector investor Pollen Street Capital (PSC). It runs alternative finance-focused investment trusts Honeycomb and Pollen Street Secured Lending and has previously backed loans through Zopa and Funding Circle before shifting to working with platforms that do secured and balance sheet-based lending in recent years.

“Business models geared up to speaking with their customers have generally performed better, they are in contact with customers on a monthly basis to understand how they are doing,” Matthew Potter, a partner at PSC, says.

“There was a missed opportunity to do more with fintech.”

Government support

Beyond forbearance, P2P and alternative lenders were keen to get involved in state-backed emergency financial support.

The Treasury launched two schemes. The Coronavirus Business Interruption Loan Scheme (CBILS) provided businesses impacted by the pandemic with an interest-free...
Section 3: Covid-19 And Alternative Lending’s Future

She said the US and some parts of Europe were better at getting alternative lenders involved with their own emergency finance packages.

European business lender October has been accredited to provide state guarantee loans in Italy and France. Similarly, non-bank lender Ebury is facilitating government support in Spain, The Netherlands and Italy. Others have come up with their own schemes.

Irish P2P lender Linked Finance launched a Deferred Start Loans for businesses affected by Covid-19. The 15-month loan allowed businesses to borrow up to €100,000, with repayments due in 12 monthly instalments after the first 3 months, during which no interest or capital repayment was due.

Niall Dorrian, chief executive of Linked Finance says around 30 borrowers have accessed these loans, with many others supported by different finance through the platform as well as government schemes. Meanwhile, Funding Circle was approved to provide the Paycheck Protection Program in the US a week before its UK platform was accredited for CBILS.

“The US government had measures in place, and it took a few weeks to get funding out,” says Vidal. “Whereas in the UK it was a lot slower. We are pleased to see a number of fintech lenders have now been accredited.”

Vidal adds that the Treasury and British Business Bank were a “victim of circumstance” as they had to put mechanisms in place quickly and used the existing structure of the Enterprise Finance Guarantee, which was geared toward banking.

“There were difficulties in truly understanding what the coverage of the non-bank lending sector was,” she adds. “The government view was that if it speaks to the top five institutions then it has covered most of the sector. But we have found that around 30 per cent of small businesses access finance through alternative lenders.”

In retrospect, it would have been better to understand that there is a role for incumbents and non-bank lenders which cover specific sections of the market that customers are used to and can get out fast.”

John Cronin, an analyst for Goodbody, believes the government still could have done more for the fintech sector. “Funding assistance ought to be procured in order for the UK to continue to benefit from a competitive environment for credit provision,” says Cronin. “Indeed, many of these non-bank lenders disburse funds to underserved communities and there are risks that many of the underlying borrowers will be forced into the arms of loan sharks.”

Many of these non-bank lenders disburse funds to underserved communities and there are risks that many of the underlying borrowers will be forced into the arms of loan sharks.”

Funding Circle has shown the contribution that systems to deal with such high volumes.”

loan, overdrafts, invoice finance or an asset finance facility for the first-year worth up to £5m and with 80 per cent guaranteed by the government.

This was followed by the launch of the Bounce Back Loan Scheme (BBLS) which provided business loans of up to £50,000, interest-free for the first year and 100 per cent guaranteed by the government. Lenders had to be accredited by the British Business Bank to provide the support. Of the 115 accredited CBILS lenders, 60 per cent can now be classed as alternative or fintech firms but it took a while to get to this level.

The early days of the schemes were plagued by criticism that funds were only being channelled through mainstream banks and it took weeks until the first alternative lenders were accredited.

The first swathe of accredited lenders, unveiled at the end of March, mainly featured high street banks and mainstream brands. It wasn’t until 11 April that OakNorth became one of the first fintech lenders to gain accreditation, which was followed a week later by Funding Circle.

Marketplace lending platforms such as MarketFinance, ThinCats, Assetz Capital, Folk2Folk and LendingCrowd have since been accredited among more than 100 other banks and alternative lenders.

“We would like to have seen the power of the sector seen more in this crisis,” says Vidal. “There was a missed opportunity to do more with fintech. These funds were being funneled through seven banking institutions initially who had already closed their offices and didn’t have the
alternative lenders can make. It originated £300m of CBILS finance as of 30 June 2020, representing 16 per cent of approved loans at the time.

Starling Bank, another accredited CBILS lender, also said it had funded £227.75m of the emergency finance to small businesses via Funding Circle.

“This shows how big an impact online lending has and can have on the whole economy,” says Lisa Jacobs, Europe managing director for Funding Circle. “It is easy to criticise what has been done. The government has had to put in measures that we never thought it would be doing, it had to move quickly and in doing so used existing infrastructure which was geared toward the traditional finance sector. It has tried to bring others on board quickly but there are structural issues that make it challenging to do this at scale.”

There has been a downside to Funding Circle becoming a CBILS lender though. It temporarily closed to retail investors to focus solely on providing CBILS, which can only be funded through institutional lending. Others such as Assetz Capital and Folk2Folk allowed retail investors to fund non-CBILS loans but Funding Circle’s decision meant its secondary market was also closed.

“Over the past ten years, retail investors have played a key role in helping businesses to access funding through our platform,” Jacobs adds. “While there are conditions that prevent retail investors from participating in CBILS and BBLS, we hope to reinstate retail lending through our core loans products in the future. We will keep investors updated along the way.”

Vidal adds that CBILS and BBLS are “the biggest games in town” as most businesses will be seeking these, but she said new firms will still need to access funding that can be backed by retail investors.

Long-term impacts

The Covid-19 crunch has already pushed the UK into a recession. This could spook investors into further withdrawals, but it also gives alternative lenders such as P2P platforms a chance to fill the lending gaps left by banks, which is what gave rise to many fintech firms in the aftermath of the 2008 financial crisis.

“There is a big role for non-bank lenders to play now and in this next period of recovery.”

“The adoption of online lending has accelerated throughout this period,” says Jacobs. “It shows just how much of an impact the sector is having on small businesses and the economy. There is a big role for non-bank lenders to play now and in this next period of recovery.”

Jacobs said the pandemic has caused behaviour and expectations to shift permanently as businesses and consumers have been able to access loans quickly and easily online. Vidal said the government will hopefully have learned lessons from the early days of the crisis so will make better use of fintech lenders to boost the recovery. “The technology and expertise and rapid response that fintech lenders can throw at these problems is perfectly designed for this sort of situation,” she says. “Fintech firms have open banking and accountancy tools that can help forecast how businesses are likely to cope.”

She said this could also be done in partnership with banks to assess their existing loans.

PSC’s Matthew Potter warns some marketplace lenders may struggle to survive though due to the way they are funded. He said many retail-focused lenders were struggling with originations even coming into the Covid-19 crisis.

This has already partly played out and there have been casualties such as business lender Growth Street, which announced it would close after failing to secure institutional funding, while RateSetter is set to have its unsecured loans solely funded by Metro Bank if the proposed takeover proceeds.

“Liquidity is key,” Potter adds. “Businesses such as marketplace lenders who essentially generate most of their revenue from originators but don’t have committed capital are at risk. If funders aren’t lending, effectively you can’t originate, which puts pressure on viability. Balance sheet lenders with a committed facility like what we provide have a stream of income and can continue to lend so are in better shape to ride out an uncertain background.”

It appears the unprecedented environment is set to remain precedent set for the time being.
How Post-Covid Problems Provide Opportunities

By Justin Fitzpatrick

Autumn 2020 represents something of a cliff-edge for businesses affected by the Covid-19 pandemic and lockdown. The CBILS (Coronavirus Business Interruption Loan Scheme) and BBLS (Bounce Back Loan Scheme) initiatives that provided businesses with access to government-backed loans are due to end in September and November respectively.

At the same time the Coronavirus Job Retention Scheme, which has furloughed millions of workers across the UK is due to finish at the end of October. Leaving many SMEs uncertain about whether the government will extend or replace the critical support that kept them going through the Spring and Summer months.

While those schemes provided a much-needed lifeline to companies affected by the lockdown, it marked a dramatic increase in government intervention in the market. CBILS and BBLS were dominated by high-street banks who had access to cheap capital through the Bank of England’s Term Funding Scheme.

Greater state intervention and incumbent-led distribution had the unfortunate consequence of distorting the market and freezing out many alternative lenders that had previously challenged the status quo. Combined with a slow accreditation process, this left alternative lenders unable to take part in an unprecedented surge in SME lending. This challenging environment even saw P2P lender Growth Street begin the process of winding down the company.

On the situation facing alternative lenders and what needs to happen next, Charlotte Crosswell, CEO of Innovate Finance said: “We have worked tirelessly over the past 6 months to recognise the importance of the non-bank lending sector, which provides over half a million small firms
with financing. These lenders, many of whom were born out of the 2008 financial crisis, have a vital role to play as we rebuild our economy following Covid.

We now have the chance to collaborate across government, regulators, banks and alternative lenders to ensure we have a sustainable lending model for the coming months and years. We therefore urge policy makers to recognise the pivotal role non-bank lenders can play in the economic recovery."

As state-backed loans and subsidies disappear, the huge lending gap that existed before Covid-19 will likely leave thousands of businesses facing a credit crunch not dissimilar to the one that followed the 2008 financial crisis. Even worse, this is in an environment of demand and confidence that has been slow to recover, and where the uncertainty of additional health and safety measures loom. This should represent a huge opportunity for alternative lenders to fill the gap left by others and supply SMEs with the credit they need.

The added complexity of digital transformation

Where this crisis differs from the post-2008 recovery is the rapid digital transformation that's unfolding alongside the economic damage. Many city centres still resemble ghost towns, as office workers stay away, and although the long-term impact of remote working remains to be seen, footfall for businesses with a physical presence has plummeted, necessitating changes to business models.

One such example is The Gluten Free Bakery, an SME based in South London that supplied gluten free goods to restaurants and cafes. When the lockdown hit, they were forced to transform their business model, pivoting to e-commerce and selling direct to consumers who were now eating at home.

What was also clear during the early days of the lockdown, when CBILS and BBLS were being rolled out, was just how far behind many financial providers were when it came to a digital offering. Many still expected SMEs to fill out paper forms, call up local branches and spend weeks waiting for a decision, adding stress and forcing many into liquidation.

As a consequence, loans were approved at a much slower rate than they could have been. Although BBLS distributed money a lot faster than CBILS, this was in large part due to the 100% state guarantee. Banks were also able to bypass the need for stringent compliance during onboarding by mainly lending to existing customers.

Adopting a company-specific approach to risk

The point at which the post-Covid lending gap and the opportunities provided by digital transformation collide is exactly where alternative lenders could and should provide essential funding. But, how can lenders fill this gap without adding an unhealthy level of risk to their book of business?

As SMEs pivot to new business models and new companies are created to take advantage of phenomena like remote working, new opportunities are created, but so are new risks. A financial organisation that can’t build an accurate real-time picture of those risks, will struggle to onboard and monitor companies efficiently.

Leading banks are already trying to solve this problem by building a more company-specific picture of risk, as McKinsey explains: “In response to the crisis, leading financial institutions are beginning to approach underwriting and monitoring with a new configuration of sector analysis, borrower resilience, and high-frequency analytics. A key trend we have observed is that leaders are moving relatively quickly from a sector view to a subsector view and finally an obligor view, using real-time data and analytics, which then supports decision making.”

Alternative finance providers are already well placed to adopt this company-specific mindset, thanks to their digitally native approach. The use of cloud-technology, AI, machine learning and ecosystems creates a smooth user experience and allows lenders to use insights on SMEs that can be scaled to an individual level. Ultimately benefiting both SMEs in need of funding and companies bringing innovation to the lending market.

Justin Fitzpatrick is the CEO and Co-founder of DueDil, a company that provides insights on millions of SMEs, helping financial services companies to get a real-time view of their customers.
Section 5: Property Lending

Safe As Houses?

Like just about every other lending market, property has been hit brutally hard over the past 12 months by the twin forces of Brexit and Covid-19.

While alternative finance and non-bank property lending has certainly tightened—and acutely so in the past six months—the sheer diversity offered by secured lending in the UK and Europe means that the market has remained functional as we shall see.

This is in contrast to high street lenders, who represented some 49 per cent of the property lending market in H2 2019, according to CASS Business School’s Report on Commercial Real Estate Lending. The majority of these traditional lenders have instead reined in their lending, focusing on shoring up their existing loan books in these uncertain times and, in some cases, closing the door to new borrowers entirely.

In this article we’ll explore the various shocks to the property market, the policy response, the impacts on alternative lenders especially in the world of residential lending, and the long tail of change which could affect the property lending market in the UK for years to come.

A market shook

On 23 March 2020 the UK property market was frozen as the country went into lockdown, with transactions stopped dead, construction sites closed, valuers unable to visit sites, and lenders hesitant to lend.

A series of policy changes came into effect which further weighed on the minds of lenders, including the 6-month moratorium on evictions from 18 March, mortgage payment holidays of up to three months from 17 March, and introduction of a mandatory 6-months’ notice on evictions from 28 August.

The impact of the above was that UK residential property transactions fell off a cliff during the second quarter of 2020. According to HMRC, registered transactions fell from 82,820 in February 2020 to 37,240 in April, a year-on-year decline of nearly 60 per cent.

Real estate group JLL took these figures and in May forecast that home sales and housebuilding transactions in 2020 would fall to 650,000, a level below that seen during the global financial crisis, and wouldn’t return to pre-Covid-19 levels of c.1.2m transactions until as late as 2024. Meanwhile, the housing construction industry in the second quarter of 2020 also ground to a halt, according to the Office for National Statistics, with output at its lowest since 2010 when housebuilding was still struggling to get back on its feet after the financial crisis. By July 2020 monthly residential property transactions had returned to over 80,000, down just 23 per cent year-on-year, according to the ONS, while Halifax’s House Price Index showed that the average property price reached a new all-time record in August of £245,747.

“Pretty much everyone, every development lender in the market with a single source of cash from wholesale institutional capital had to stop lending.”
Section 5: Property Lending

A lack of institutional capital was a key reason for this. UK property funds with an estimated £12bn worth of assets have been frozen since March, with the market locking down after valuers were unable to accurately price assets. At the time of publication, the UK's largest fund managers St James's Place and Columbia Threadneedle were only just starting to reopen their funds for investors. "Pretty much everyone, every development lender in the market with a single source of cash from wholesale institutional capital had to stop lending," said CrowdProperty CEO and co-founder Mike Bristow.

However, the stoppage wasn't universal. As can be seen in our data for the AltFi Platform Survey in Section 13, responses from property lenders show three quarters (72 per cent) are upbeat and believe borrowers will continue to need cash, with alternative residential property lending especially robust.

Indeed, Bristow says that his peer-to-peer lending platform—which is funded by a mix of retail and institutional backers and offers development finance and bridging loans largely to residential developments and originated £28.7m in new lending in 2019 according to Brismo's data—continues to see £200m+ worth of applications a month, with many of them being funded by the platform's investors. "We bailed out many developments where traditional sources of funding have just pulled not only offers, but also drawdowns on their projects," says Bristow.

Likewise, CapitalRise, the development finance platform for prime property which originated £33.9m in new deals last year (See Section 1), saw another "sharp increase" in deal flow and investor appetite as developments increasingly turned to alternative sources of borrowing. CEO Uma Rajah says her team facilitated: “almost as much lending as we did in the whole of 2019 during the first six months of 2020.”

Rajah believes part of the reason is that equity investors are seeking stability amid turbulent global stock markets and secured lending on prime property in a city like London, where average property prices still sit below their 2014 peak.

Impact on lenders

Across development finance, residential lending and commercial lending, whether spanning office, retail, hotels, healthcare, student accommodation and more, the impact of Covid-19 and its subsequent policy response has varied wildly.

However, the most common lender reaction rollercoaster of the last six months was simply to stop lending entirely. As Gareth Taylor, real estate director of Excellion Capital, wrote in May, just as the market began to reopen: "Although many lenders have stated they are still open for business, the reality is many are unlikely to complete new transactions or grant credit committee approvals until they have a clearer picture of what the market will look like after the crisis."
Section 5: Property Lending

peaks, is an attractive alternative. “If you’ve got the funds to acquire a site, develop it out for the next 18 to 24 months and then put it on the market when Covid-19 is now history, that’s a fantastic position to be in.”

Rajah says residential property as a whole is seeing a lift from changing consumer demands, as people are now prioritising outside space, home offices, and flexibility having just spent six months reassessing their personal space.

Other alternative lenders have similarly performed strongly with LendInvest, one of the standout players in the space responsible for nearly £1bn of lending in 2019 (See Section 1), announcing a £10m bridging loan for a Greenwich development with 272 flats. Meanwhile, Hilltop Credit Partners extending £8.6m in development finance to a 16-unit project in Brondesbury, North West London.

However, peer-to-peer property lenders have also been greatly affected by the supply/demand imbalance created by the lack of ‘normal market conditions’ leading several platforms, including The House Crowd and Assetz Capital, to delay withdrawals due to reduced liquidity.

Some areas of alternative lending exposed to property are showing more significant cracks. CrowdLords, which let investors fund buy-to-let and development loans through a mini-bond structure, ceased trading after the FCA’s move to ban the marketing of such speculative illiquid securities. HNW Lending, a secured property and asset lender, is currently under investigation by the FCA with the regulator having placed a pause on some of its activities. Concerns are rife that poor standards of due diligence among some alternative property lenders may be exposed and exacerbated by Covid-19 and the inability of valuers to visit development sites.

Outside of peer-to-peer, challenger banks have also played a large role in the lending landscape over the past six months. Aldermore, Oaknorth, Shawbrook and Paragon have closed a range of deals from a £10m office-to-residential development in Hounslow by Paragon, to OakNorth which extended an additional £20m loan-on-loan to Hilltop Credit Partners.

The future

While the UK property market continues to break records, there are undoubtedly structural changes arising as a result of Covid-19.

In the short-term, the UK looks set to remain in recession, with large numbers of job losses and rising unemployment, save for an 11th-hour “moonshot” solution to Covid-19. For the property market, this means a temporary stamp duty reduction and heightened demand from lockdown will not support it forever and prices will likely suffer.

As the Centre for Economics and Business Research (CEBR) wrote in their September report noting the current “paradox” of the UK property market: “What most of these factors have in common is that they are transitory in nature. Moreover, pent-up demand from the period of lockdown will eventually work its way out of the system in the coming weeks.”

The CEBR predicts the residential market will therefore enter decline throughout the first half of 2021, aside from a spike in demand as stamp duty is reinstated.

And while demand falls, it will also likely change. As Zoopla’s Hometrack House Price Index noted in July the demand for larger living spaces prompted by months of lockdown has changed buyers appetites: “At a regional level there has been a noticeable jump in demand for 3-beds in London and the South East of England as households seek out more space. Four-bed houses are now selling faster than the average flat.”

For residential lenders, this changing market creates a moving target of falling and shifting demand, while BTL lenders continue to be impacted by emergency government interventions such as the moratorium and now 6-months’ notice on evictions having a hugely negative impact on their borrowers.

“Very simply, commercial landlords have had little or no income for 9 months and don’t have the cash resources to make mortgage payments which will have an impact on the wider economy,” said Heather Powell, partner and head of property at law firm Blick Rothenberg.

However, as we have seen, agile, technology-enabled and diligent lenders have and will continue to thrive in this landscape, bolstered by an absence of traditional competition.
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Section 6: Alternative Lending’s Big Numbers

Crunching the numbers behind the trends

£25bn
The amount of money lent by UK alternative lenders since 2011.

£3bn
Starling Bank’s deposit base in July 2020.

1.3m
The numbers of businesses across the UK that lenders have supported through government-backed coronavirus lending schemes.

6 minutes
The average time Funding Circle’s average loan applications are being completed in.

7 seconds
The average time Funding Circle now takes to make loan decisions following the automation of its underwriting.

10.7% vs 12%
Year-on-year growth rate of UK originations in 2019 compared to 2018.
Section 6: Alternative Lending’s Big Numbers

UK Net Return and Yield 2010-19

73% vs 58%

European alternative lenders that have carried on hiring during the pandemic compared to UK-based alternative lenders.

£12m

The price paid by Metro Bank for RateSetter

£12bn

The amount of money lent by UK and EU alternative lenders in 2019

80%

The growth rate of EU originations in 2019 compared to 2018.

Source: AltFi Research, HM Treasury, Brismo/Loanclear
For alternative lending platforms, the shift towards institutional capital and away from relying on peer-to-peer (P2P) structures has been in motion for the better part of a decade.

Since well before the onset of the Covid-19 crisis, it had become clear that scaling a lending platform using only retail cash is close to impossible. But the pandemic has accelerated this shift, and in addition to perhaps putting the final nail in the coffin of retail-driven peer-to-peer lending, it has also shifted the power dynamic between originators and institutional funders in favour of the latter.

A good case in point is Lending Works, a UK peer-to-peer consumer lender. The company announced on 3 July 2020 that it is set to be acquired by Intriva Capital, a private equity firm specialising in distressed situations, for an undisclosed sum, pending regulatory approval.

The deal is part of a plan to create a new balance sheet vehicle to lend money to the platform’s customers, with Intriva stumping up equity capital in cahoots with investment banks, which will supply the senior tranche.

This switch to predominantly institutional capital in fact predates the arrival of Intriva, according to Matt Powell, Lending Works’ chief financial officer. “It’s been a bit of a roller coaster,” he said.

Powell explained that Lending Works had been working on a fundraising deal with a different company—one not dissimilar to Intriva—which had been due to close in mid-March. Then the outbreak of Covid-19 sent markets into meltdown, and the investor pulled out, leaving Lending Works in a precarious position—all the more so given that the platform was also experiencing a rise in retail investor redemptions.

“Intriva Capital looks set to become a key player in European alternative credit—a market which is becoming “more focused as to who is playing in it, rather than becoming broader,” according to Ravi Anand, managing director of the small business lender ThinCats.
Section 7: A View From The Alternative Lending Investors

The fund managers

There are a handful of influential European alternative credit investors that boast relationships with multiple platforms or act as a key partner to a single originator. Broadly speaking, these companies can be placed into buckets.

Perhaps the most active group are the specialist credit funds, of which Waterfall Asset Management and Pollen Street Capital stand out. Some of these, it should be noted, take the form of listed investment trusts—drawing inspiration from P2P Global Investments, the first big institutional capital provider in the sector.

The New York-based Waterfall has lent hundreds of millions of pounds through platforms such as Funding Circle, ThinCats and the consumer loan specialist Lendable.

Christian Faes, chair of the mortgage lending platform LendInvest, said these types of investors are “typically looking for double-digit returns,” which means they either have to try to take warrants in whatever platform they’re lending through, or hike the price of any facility. “I think it is a difficult path for these funds to carve to find quality origination that can scale,” Faes added.

Then there are more traditional asset managers. Prominent examples include M&G Investments, which has some £352bn under management, and the £681bn asset manager Insight Investment, which have lending relationships with Zopa and ThinCats respectively.

For context, the total size of the UK alternative lending market—composed chiefly of marketplace lenders—was £6.26bn in 2019, according to Brismo, the analytics firm recently acquired by LoanClear.

The third group of investors, and the most coveted, is comprised of pension and insurance funds. The Dutch financial services giant Aegon has lent hundreds of millions of pounds to small and medium-sized businesses through Funding Circle, while ThinCats boasts a relationship with BAE Systems Pensions. Though highly sought after, there are precious few examples of this last group of investors working with platform lenders.

“There are very, very few in the UK that have the capability and bandwidth to do it. It is the holy grail, but they are very slow,” said Anand. “They’re the best money to some extent because it’s less complex. There’s no leverage, it’s a straight allocation. And their target returns reflect the risk more appropriately.”

Enter the challengers

Last but not least are the challenger banks. Certain European banks have been playing in the alternative finance space for some time. Hamburg-based Varengold Bank and Portugal’s Banco BNI Europa, for instance, have put hundreds of millions of pounds of savers’ cash to work through lending platforms.

EstateGuru in the Baltics, Grover in Germany and Lender & Spender in the Netherlands are just a few of the platforms that use debt facilities provided by Varengold. Alison Harwood, who heads up the bank’s London branch, said the company typically provides capital to lending platforms at an early stage in their development.

“We’re happy to take the risk of an early stage originator, but we want to start tentatively,” she said.

That tentative approach is evident in the protections Varengold puts in place whenever it signs an agreement with a platform. The bank says that 99 per cent of its fintech deals include a first loss piece, while 95 per cent come with an equity kicker.

“One of the things that is really important to us is to ensure an effective alignment of interest, not only on the upside but also on the downside, and so a first loss piece is a must-have in every financing structure for us,” said Harwood.

This means that any platform that takes money from Varengold must contribute their own capital as junior financing in a Special Purpose Vehicle structure. That junior financing will typically make up 10-30 per cent of a funding commitment, Harwood said. Larger asset managers will also demand these protections, according to ThinCats’ Anand.

The equity kickers, which take the form of warrants, give investors like Varengold the chance to benefit from the growth of whatever platform they lend through.

In the past six months, Starling Bank, a digital bank that has amassed millions of current account customers, has burst onto the scene as an alternative credit investor—which it is doing alongside building up a loan book of its own. While the digital bank has been lending through Zopa since September 2019, the government’s emergency lending schemes, formed to ease the burden on businesses struggling through the pandemic, have accelerated its lending programmes.

£300m

The size of the funding deal between Starling Bank and Funding Circle.
Section 7: A View From The Alternative Lending Investors

“There are other institutions looking at opportunities to buy their own platforms.”

In May, Starling agreed to lend £300m to SMEs through the Funding Circle platform under the Coronavirus Business Interruption Loan Scheme, which guarantees up to 80 per cent of loans. The startup has extended significantly more than that to its own small business customers directly through the government’s Bounce Back Loan Scheme, which offers a 100 per cent guarantee.

Declan Ferguson, chief strategy officer at Starling Bank, said that Starling’s deposit base passed £3bn in July 2020, up from £600m from this time last year.

“This led us to have conversations with non-bank lenders to have what we would call a forward flow arrangement,” he said. Under these arrangements, the platform—Funding Circle or Zopa—maintains responsibility for servicing the loans financed by Starling.

Ferguson said Starling’s deposit base serves as a cheap source of funding for lending platforms, and that the performance of the Zopa loans it invests in has been strong thus far. He said it is too early to comment on the performance of the Funding Circle loans.

“It’s really a way to augment the balance sheet for us,” Ferguson added.

Metro Bank could be seen as having pioneered such tie-ups when it began lending deposits through Zopa back in 2015. On 3 August, the challenger went a step further by announcing its intention to acquire former P2P heavyweight RateSetter for the relatively paltry sum of an initial £2.5m.

The deal, which is subject to regulatory approval, will effectively lead to the winding down of RateSetter’s retail peer-to-peer operation. What remains without that is a loan origination engine that Metro will fund—seemingly exclusively. This, coupled with other deals in the market, points to an emerging trend.

Owning your originator

One commentator, an adviser to institutional investors who wished to remain anonymous, described this trend as “buying your own originator.”

The person pointed to the Lending Works and RateSetter acquisitions as examples of an investor taking the position that a platform’s equity isn’t worth much without the investor’s lending capital.

“There are other institutions looking at opportunities to buy their own platforms,” added the person. “And the reason that’s happening is because, if you’re a fund manager in private debt and you’re managing a billion quid, you get paid on deploying that billion quid—there’s no point sitting there with it undeployed... How do you guarantee you can deploy it?”

Lending Works’ Powell said the Intriva deal isn’t about the investor taking all of the platform’s origination. The Lending Works Capital vehicle, when it materialises, will be financed by Intriva and investment banks, but Powell hasn’t yet given up on retail investment—which the platform has currently paused—returning to the platform.

“We’re very much keeping our options open,” he said. “Intriva are not saying, ‘We have to fund everything.’ They’re saying, ‘We can fund everything but if there’s a better option at the table, we’d be open to it.’”

In what may remain a distressed environment for platform lenders for some time yet, it wouldn’t be a surprise to see a flurry of alternative credit investors vying to own their own originators. Starling Bank is currently in the process of looking at additional opportunities to put its deposit base to work through alternative lenders, according to Ferguson.

Asked whether the business had considered simply acquiring one such lender, Ferguson said, “I’d be lying if I said we hadn’t looked at a few of those.”

Perhaps more digital banks will follow Starling’s lead in mulling over such deals. After all, the likes of Revolut and OakNorth have both floated the prospects of hunting for M&A bargains during the pandemic. Neither is short on cash, and lenders are an obvious target.

Whether or not ‘owning your originator’ truly gives funding providers an edge will be the key to more deals getting done.
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The last 12 months have certainly brought huge changes to the online small and medium-sized enterprise (SME) lending market, not least because the Covid-19 emergency has injected vast amounts of state capital into the alternative finance sector.

But bubbling away underneath this huge stimulus package it is possible to comprehend some profound changes in the lending market, not least as new products slowly eat into the dominance of conventional loan structures, overdrafts, and term loans.

For many observers, the key development is that the SME lending market is becoming fractured with new lending types starting to become “normal”. The central driver is the demise of the overdraft. In 2008 there was roughly £20bn available to SMEs in overdraft funding, by September 2014 this was down to £14bn, whereas in the last set of Bank of England data it is now just over £9bn.

It’s relatively easy to understand why the overdraft became increasingly unpopular with ‘legacy’ bank lenders. A debenture—a central component of the overdraft—gives a floating charge over all the unencumbered book assets of a business. These are difficult to monitor and control en masse.

Only at default will it crystallise into a fixed charge, by which time those assets might have disappeared. For ‘legacy’ banks, overdrafts are also on-demand so that means the bank can have zero exposure one day and full exposure the next. This is not cost-effective for the banks as they need funds to facilitate that and it weighs heavily on what’s called their Risk Weighted Assets. For a fuller explanation see the box below.

These overdrafts formed the central component of banking finance for general working capital facilities to SMEs. These are now being slowly replaced by new structures, away from the traditional banks, including single/selective invoice finance, merchant cash advance, supply chain finance and...
funding of guaranteed monthly revenues. In addition, there has also been a big increase in R&D Tax Credit loans.

“Currently you are not seeing substantive SME lending defaults, principally as Banks have provided formal short-term forbearance on repayments and covenants.”

A deep dive in alternative SME Lending

Let’s look in a bit more detail at some of these new innovations starting with guaranteed monthly revenues business lending model, which works very well with businesses such as software as a service (SaaS) providers. To understand how this works imagine signing up to say up to HubSpot for their Sales CRM add-on, which means you, as the customer, agree to pay for 12 months at £25 per user. If you cancel before the 12 months finish, you are still liable for the remaining term. So, in this example, the SaaS provider, HubSpot, has £300 income stream guaranteed for the next 12 months. They can accelerate some of that cash flow by selling the rights to a lender. A lender might thus lend £150 and charge £25 for the privilege—this novel structure is called micro-scale invoice finance and businesses that operate in this space include Supafin.

R&D tax credits financing is another example of a relatively new lending product. If a company invests heavily in R&D to develop proprietary systems for the business, that cost can be offset against Corporation Tax but only if an application is made to HMRC. Some businesses have an annual cycle of doing this and have years of successful claims. SME R&D relief allows a business to deduct 130 per cent of their qualifying costs from their yearly profit in addition to the 100 per cent already claimed. It can also be claimed if loss-making. In rough terms, this means that up to 33 per cent of the expenditure could be a tax credit which a lender can then use as a future cash flow to lend against. Businesses in this space include ArchOver and Rocking Horse Group.

Because of the issue with the blanket coverage of a debenture, many of these new forms of lending look to ring-fence assets or revenue streams—for instance, merchant cash advance specialists will control card payments by installing their own card terminals in shops. Controlling an asset or revenue stream allows for more risk management by alternative lenders but it required greater due diligence and is time-consuming which in truth the banks hate. As a result, the alternative finance space has seen an explosion of new niche lenders in the working capital; space although result, the alternative finance space has seen an explosion of newer lenders in absolute distress.

The irony though is that even as defaults increase, there’ll still be a ready supply of new capital—according to one observer “there’s a ton of money looking for a home detrimental to those platforms that have been accredited.”

A number of SME lenders informed me that they had provided forbearance to c.40 per cent of their borrowers in Q2.

“With SME lenders being able to access CBILS and bounce back facilities the significant liquidity in the market ensures it is unlikely you will see any material increase in defaults until Q4 2020, increasing thereafter. The sectors where you are seeing defaults are those that have been hardest hit by the lockdown, notably retail, leisure and the travel sector.”

“The market will become more difficult to base lending on a pure cash flow analysis.”

Many observers have also worried that newer players in the SME lending market might be disproportionately badly hit. But again, so far Webb hasn’t seen any strong evidence of newer lenders in absolute distress.

“Currently you are not seeing substantive SME lending defaults, principally as Banks have provided formal short-term forbearance on repayments and covenants.”

According to Webb: “Currently you are not seeing substantive SME lending defaults, principally as Banks have provided formal short-term forbearance on repayments and covenants. A number of SME lenders informed me that they had provided forbearance to c.40 per cent of their borrowers in Q2.”

And what of the peer-to-peer SME lenders? “From what I can see the peer-to-peer market, like much of the alternative lending market, is seeing a modestly higher level of defaults than other sectors, however, this merely reflects the increased risk profile of this sector with the increase returns as compared to mainstream lending reflecting the risk,” he says. “There are clearly exceptions to this with some lenders seeing higher defaults which is a reflection of their historic lending practices and sector exposure.”

The irony though is that even as defaults increase, there’ll still be a ready supply of new capital—according to one observer “there’s a ton of money looking for a home at reasonable yields. It seems easier to raise £500m for a lender than it is to raise £25m at present.”

This experienced observer expects to see new lenders

Section 8: SME Lending
Section 8: SME Lending

looking for ever more niches in the lending landscape. Webb at RSM says “There is significant global liquidity and there are a range of investors looking to buy distressed debt. Any opportunity to buy distressed debt will attract a range of interested parties.”

The future

Eventually though, the Covid-19 emergency is sure to pass, and the global economy picks up steam again. What trends should we watch out for in an upturn? One area could be what is loosely term asset-backed lending. The innovation here is that a traditional debenture is that it is too loose and whilst it gives the lender controlling powers on business failure, they need to be able to very closely monitor each asset.

By moving to asset-based lending, the lender can control income streams. So, for SaaS lenders, for instance, they will tell the provider to have direct debits paid to a client account under the control of the lender. The same model works with merchant cash advance and single invoice finance. Another experienced observer also says that they are hearing moves of new entrants into the R&D tax credit market.

And last but by no means least, what future is there for the traditional term loan? Most experts think the traditional loan still has a place, especially for larger asset purchases, arguing that management buy-outs/buy-ins will still be funded this way although the collateral that supports the loans may be diminished by specific charges to other lenders. Experts also reckon that securing loans on commercial properties will become challenging as the effects of Covid-19 force businesses to fold and commercial prices to fall due to the large number of vacancies. In simple terms, the credit environment will be challenging. Says one expert: “The market will become more difficult to base lending on a pure cash flow analysis.”

David Stevenson is a columnist for the Financial Times and Andrew Holgate is CEO of Equitivo.

What Killed Off The Humble SME Overdraft?

To understand why bank SME overdraft lending has declined so rapidly, it’s first important to understand how a set of regulations called Basel III tightened the criteria for banks. It moved away from blanket sector reporting to granularity on an asset by asset basis. Each individual loan now has to have a risk weighting. The risk-weighting is a complex calculation but at its heart are two factors: Probability of Default (PD) and Loss Given Default (LGD).

PD is the expectation of the loan going bad. If a lender had a portfolio of 1,000 similar loans and 10 went bad, you could argue that the PD is 1 per cent for that type of loan. The smaller the asset pool the lower the confidence level you have on PD and vice versa. So if as a lender you have just 1 loan and it goes bad, you have 100 per cent PD.

To be truly accurate a lender needs millions of homogeneous transactions in order to derive a figure. In SME lending the asset pool is very heterogeneous due to the multitude of variables. Therefore, PD is largely quantitative but has an element of qualitative elements and should be treated as an estimation of default across an asset class or sector, albeit a very good one.

The other measure, the LGD is what would you lose if a loan went into default. In secured lending, the LGD is relatively low. If you have a 50 per cent loan-to-value (LTV) loan secured on a valuable and highly resalable property, your LGD is 0 per cent. In property lending, you’d only hit an LGD if you were 75+ per cent LTV in markets with high volatility and poor resale ability but the huge tracts of data on property values allow for a high degree of quantitative analysis to be done.

A debenture offers security but it’s not as sturdy as property. Stock is portable and quite liquid, as are debtors. So, whilst a balance sheet might have lots of assets, in a default situation they could be severely depleted. In that scenario, a lender might have an LGD of 50 per cent or more. Here an element of qualitative inputs is used to determine the outcomes. In unsecured lending, your LGD is probably 75 per cent or more but is gauged on a lender’s extensive past performance.

All of which leads to the expected loss (EL). This is simply PD x LGD.

Let’s assume 10 per cent PD. In the three scenarios above the EL would be 0, 5 and 7.5 per cent across those pools of assets. This is then used to look at things like Risk Adjusted Return on Equity (RAROE) and Risk Weighted Assets. The higher the EL the more cash a bank has to hold in reserve.

Pre-2009, A-rated issuances had 0.25 per cent PD and C had 5 per cent. According to one expert, SMEs are C- at best but run to Unrated. Those curves were at 5 per cent to 15 per cent pre-crisis. Therefore, SME lending is perceived to be riskier thus more cash is needed to be held at the point of issuance. Home loans by contrast have PDs at 2-3 per cent. Most banks place the average SME PD at 16 per cent.

One last factor worth considering is the difference between a loan and an overdraft. A loan decreases in value over time, thus your risk of loss is diminishing (a bit like the chords in a 90’s Brit Pop single). An overdraft has to be viewed as a full risk for the term of issuance. It may never be used up until the final day but is then fully drawn. It is, says one banking expert, a “horrible and clunky mechanism for the banks to operate and many have now reduced the term of overdrafts to try and match working capital cycles or switch them to cash flow lending, a 3-5-year loan that fully amortises. The latter isn’t great for working capital cycles.”
AltFi Digital Wealth
State of the Market Report 2020

Our landmark report will explore the key trends of Europe’s flourishing €23 trillion savings and investments market, including insights on the key sectors of disruption within wealth management, savings, stockbroking, aggregation and crowdfunding.

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Six months on since the initial impact of COVID-19 was felt, the nation is gradually adapting to a new normal as we manage the longer-term impacts of COVID.

Workers are slowly returning to their offices, and lenders who paused new business during the pandemic are returning to market. However, some changes are likely here to stay. Since the pandemic hit, we’ve witnessed a dramatic rise in the use of digital solutions and new data; a shift which will undoubtedly impact many industries, including the lending market.

Now is a golden opportunity for lenders to respond to an increasingly digital-focused customer base by harnessing new technology. Open Banking can both improve the customer experience and provide lenders with access to new, richer sources of customer data to make more informed, responsible lending decisions.

How can Open Banking help?

Access to real-time data is a game-changer for lenders. Today it is already an essential part of the lending process, but it is needed even more so in these uncertain times. Open Banking provides a real-time view of a person’s financial behaviour and answers many of the questions lenders have about applicants, such as: have they borrowed in the past few days; how has expenditure changed; have they been furloughed; have they lost their job?

Employment has changed rapidly in a short space of time. Britain suffered the biggest drop in employment since 2009, and employees on payrolls fell by 730,000 since March.

The lending market needs help to determine income traumas with immediacy. According to McKinsey, “the conventional sources of data typically used in credit-risk assessments became obsolete overnight... creative approaches to acquire and utilise high-frequency data are the order of the day.”

Open Banking not only enables the lending community to continue to lend responsibly in this market, but also allows lenders to return to growth.

As Christian Faes, Co-founder of LendInvest, said: “Fintech companies have a huge role to play in helping drive the fortunes of the lending industry – especially when it comes to Open Banking. The time is right for new partnerships and new technologies to ensure the lending sector thrives in the new normal.”

Income and employment

Around the globe, there has been huge instability in both people’s income and employment status as a result of COVID-19. In the UK alone, 9.6M Britons have been furloughed since April and 183,336 have been made redundant - with this likely to increase further when the furlough scheme ends in October.

The unpredictable nature of this pandemic poses significant challenges for lenders when trying to assess affordability, with traditional methods of assessing income like payslip review causing huge operational inefficiencies, and bureau data being out of date.

Open Banking-enabled solutions allow lenders to better determine changing income streams more quickly - for example when a furloughed employee returns to work or when a freelancer sees their working hours drop off. Features such as Credit Kudos’ Income Shock Indicator help lenders accurately detect and account for recent loss of, or reduction in, income.

On the other hand, lenders are also able to identify key workers through Open Banking which can help them
understand if someone’s income is likely to be stable for the foreseeable future. Credit Kudos’ Employer Industry Indicator labels income sources, enabling lenders to identify employer name and industry.

**Customer Management**

Payment holidays are ending and borrowers are having to resume payments, all against a backdrop of declining state support. Cultivating a fair system where a customer’s personal circumstances and needs are considered by lenders is the responsibility of the entire lending community post COVID-19.

A key part of this equation is managing customer distress and understanding customer recovery. Using enriched Open Banking data, which is both real-time and reliable, can help lenders to offer improved products and experience to customers. Credit Kudos’ Liquidity Score identifies customer earning and spending trends and predicts potential financial difficulties.

Open Banking can also aid in the creation of sustainable payment plans for customers experiencing financial difficulties. This way, lenders can do everything in their power to protect vulnerable customers from additional financial challenges.

**Traditional data sources**

The pandemic has been a challenging and uncertain time but one thing that remains constant is how stringent the Financial Conduct Authority is about assessing affordability, and supporting vulnerable customers. Yet traditional data sources are no longer adequate for lenders. For example, resources such as ONS expenditure data are now not representative given the rapidly changing circumstances of individuals.

An increasing number of lenders have already embraced these new data sources and technologies to help understand borrowers in the new normal. Open Banking is the new standard for credit assessments, providing lenders with real-time financial behavioural insights that can help lenders responsibly return to growth.

Freddy Kelly is the CEO of Credit Kudos.

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**Challenges**

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<th>Income &amp; Employment</th>
<th>Customer Management</th>
<th>Data availability &amp; accuracy</th>
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<tr>
<td>Income uncertainty</td>
<td>Understanding customer resilience</td>
<td>Out-of-date data</td>
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<td>Inability to understand changing income streams</td>
<td>Heightened levels of customer distress</td>
<td>Rapidly changing circumstances</td>
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<td>Understanding non-salaried workers</td>
<td>Calculating sustainable repayment plans</td>
<td>Operational costs of manual document processing</td>
</tr>
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**How can Open Banking data help?**

- **Real-time bank verified information**
  
  Access real-time insights of a borrower’s financial situation and behaviour

- **Affordability Assessments**
  
  Verify income and expenditure using up-to-date data

- **Rich Risk Insights**
  
  Identify recent borrowing and liquidity profile

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**Income**

<table>
<thead>
<tr>
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**Consistency**

- **Amount**
  - 85

- **Regularity**
  - 80

- **Longevity**
  - 75
Not much has changed in the world of lending for millennia. It was and remains easy to dish cash out. Not so easy to get it back. That fundamental truism is what sits at the heart of a successful lender.

That being said, the past 10-15 years have probably seen the greatest period of innovation for lenders and borrowers of that money—as well as investors in credit—for a very long time.

This is due to the emergence of fintech start-ups, the ubiquity of smartphone adoption and a global shortfall in the provision of credit for businesses and consumers. Call them what you like, from the many names the alternative lending sector takes, non-bank lenders embracing the digital sphere have boomed.

But has progress stalled? In short, no. But new fronts of innovation have opened up with a host of new competitors taking on incumbents and the mature disruptors whose business models have been put to the test in recent years.

The latter’s story, which saw the emergence of the marketplace or peer-to-peer model of alternative lending has started to shift thanks to a number of innovation trends like open banking, automation and new data sources. And those were already underway before the world familiarised itself with the word ‘lockdown’.

Now, Covid-19 is prompting a whole new wave of change. Samir Desai, Funding Circle CEO and founder, says the listed firm which launched a decade ago is continuing to look to technology-led innovation while the pandemic has accelerated the adoption of online lending and shown how critical fintech lenders are in supporting SMEs.

“By investing in data and technology, fintech lenders continue to transform the customer experience in a market that was in desperate need of disruption a decade ago,” he said.

The alternative lending sector’s biggest pivot to date (and most recent) is being a conduit of government-backed rescue packages for SMEs. In the UK the Coronavirus Business Interruption Loan Scheme (CBILS) and Bounce Back Loan Scheme (BBLS) have provided over £50bn of funding to firms, at the time of writing, with much of this coming from fintechs and alternative finance providers.

“By investing in data and technology, fintech lenders continue to transform the customer experience in a market that was in desperate need of disruption a decade ago.”

Several fintech lenders such as Funding Circle and Nucleus Commercial Finance have used the period to implement different forms of automated lending that negate further the need for human underwriting and therefore speeding up access to cash for firms facing a tough 2020.

“Our bespoke instant decisioning technology means that we can now offer loans within one minute, helping businesses to get fast and affordable finance at a time when they need it most,” Desai said.
Section 10: Automation, Open Banking And New Sources Of Data

We are proud to have played our part as the fifth largest provider of CBILS loans, with c.£2bn approved in funding through UK and US Government schemes. It is small businesses that will power the economic recovery, with every £1 lent generating £2 in GDP,” he added.

Nucleus’s own digitised underwriting provides automated underwriting decisions for SME loans up to £250k including, like Funding Circle, lending through CBILS.

Its CEO and founder Chirag Shah says the firm has long held the objective to offer ‘one-click’ lending. Its automated underwriting started in September 2019 but ran the process alongside its underwriters. But with CBILS, Shah says the firm became “pretty comfortable” and now almost 95 per cent of its deals are being auto underwritten.

“Our comfort level is increasing with every passing day. We expect the loan size to be going higher and higher as we get more comfortable,” he said.

Nucleus has also embraced open banking functionality to speed up its lending which saw a huge boost from CBILS demand.

“"When we launched CBILS, we were expecting significant volumes, but the volumes we actually received in the first two days, we’re about 10 times our expectations.""

“"When we launched CBILS, we were expecting significant volumes, but the volumes we actually received in the first two days, we’re about 10 times our expectations,” Shah said.

“One of the core things we did after that was to make sure that open banking was at the centre of our offering. So, after the first few days, we have been open banking-only on CBILS. We are averaging over 150 applications a day. All of them are being processed by open banking.”

“[Borrowers] should be able to enter the name of their business and via API’s built with every third party to gather all the information, we are able to make a decision on the business and offer them the rate then and there. If they accept, they should click and that should be the only click.”

Innovation in a crisis

Necessity is the mother of invention and for alternative lenders this is certainly true in 2020.

Freddy Kelly, CEO of Credit Kudos, a new credit bureau using open banking to connect with major banks to factor account data into real-time credit decisioning is bullish that the move towards open banking and its natural extension to a wider remit will revolutionise lending further.

“With open finance on the horizon we’re starting to think about what are the other financial data sources that could be opened up through new API’s,” he said. “You’ve got people like iZettle, PayPal, Amazon looking at trading data and seller ratings on eBay or Amazon, cash flows from iZettle terminals. At the banking level, it could be savings accounts and mortgages, pensions, investments, taxation income. That stuff would help people build a fuller picture of an individual’s financial standing.”

He says the most pertinent lending innovation in the pandemic is happening in figuring out how to lend now because old models don’t cut through the pandemic induced uncertainty.

“When you look at previous financial or economic shocks, there’s always going to be some massive impact on risk profiling and trying to discriminate the right customers to lend to and split the risk,” he said. “I expect continued innovation going into that space in terms of just understanding what a customer’s risk profile looks like using new data to achieve that.

Beyond that, he adds, will come a suite of new products that help mitigate the potential unknowns of lending both for consumers and SMEs. He says a number of firms are starting to take a new stance on how they lend to customers and how they onboard them including things such as salary streaming, or smoothing, as well as pre-paid or subscription-based lending models.

Also, on the consumer side, CreditLadder another fintech in the credit scoring space provides a tool to help borrowers use on-time rent payments to improve their Experian credit score. It holds partnerships with lenders, including Nationwide and Starling.

Buy now. Hopefully, pay later

Consumer lending’s elephant in the room however is the ‘buy now, pay later’ boom. This is most evidently expressed in the valuation of Swedish fintech Klarna although PayPal has also recently entered the zero interest ‘buy now, pay later’ world.

Klarna, which is the most highly valued European fintech (at the time of writing) closed a $650m funding round at the end of the summer implying a valuation of $10.65bn (£8.26bn). But is Klarna actually a lender in the traditional sense?

“It’s a good question, says Kelly and it depends how you define lending.

“In the letter of the law, some of it is a regulated function, and some of it isn’t. It’s kind of one of these ‘if it looks like a}
duck, swims like a duck, and quacks like a duck’ questions.”

Klarna makes money from the fees it charges to the merchant, not from interest-bearing loans, but its competitors are increasingly lenders such as credit cards and overdraft providers and still has to go through many of the same processes to manage risk.

“I guess it depends how kind of pedantic you are in the definition of lending,” Kelly said.

“I in the letter of the law, some of it is a regulated function, and some of it isn’t. It’s kind of one of these ‘if it looks like a duck, swims like a duck, and quacks like a duck’ questions.”

Embedded time

One of fintech’s newest buzzwords is ‘embedded Finance’. It basically means non-financial firms ‘embedding’ financial products provided by others into their existing operations and adherents think it is going to be very, very disruptive.

Could this bring together a host of new innovations for both SMEs and consumer lending including automation, open banking and new data sources?

Very large balance sheet lenders such as banks are looking at the customer relationships they hold, from fluctuating financial circumstances and shifting buying behaviours, Kelly says.

They are then asking how they can provide them appropriate and affordable credit and using the loyalty data to provide more competitive credit than on the open market.

Covid-19 is bringing forward many new challenges for lenders but also huge opportunities to meet the changing needs of individuals and businesses.

95%

The rate of SME loans’ underwriting being automated by Nucleus
Section 11: Listed Direct Lending Funds’ Performance

A Stormy Year

by Ewan Lovett Turner

It has been a tumultuous 12 months for Direct Lending Investment Companies (ICs). Share prices have been weak after some significant credit issues in a number of portfolios hit before the onset of Covid-19. The economic impact of lockdowns has led to widespread increases in provisions based on the expectation of rising defaults and uncertainty about the outlook for portfolios, as well as several dividend cuts. In addition, shares have come under pressure from a number of large institutional investors seeking to exit the sector. The share prices of most ICs are now trading at substantial discounts to their net asset values (NAV), but most investors are struggling to assess value given inconsistent and often poor levels of disclosure.

The listed structure means that investors have options to deal with some of these issues. Dissatisfied investors can push a Board for change. As a result, the last year has seen a significant amount of corporate action, including funds adopting realisation strategies and returning capital as underlying loans mature or through accelerated portfolio sales. In addition, there have been changes to the manager at some funds, whilst others have been subject to M&A.

NAV returns hit by credit issues

Even before the onset of Covid-19 several funds experienced credit issues in their portfolios which led to uncertainty over valuations and write-downs in portfolios. In particular, SQN Asset Finance Income (now called KKV Secured Loan) experienced issues with its Anaerobic Digestion plants, which led to a widening of the discount, and following a move of the management contracts to a new entity, KKV. The new manager has indicated concerns over the valuation of large portions of the portfolio. The discounts on both share classes remain wide, at over 40 per cent. Hadrian’s Wall Secured Investments also saw issues in 2019 with provisions against a number of loans, including to Biomass plants and a renewable energy engineering company. The fund went into wind-down and was renamed HWSI Realisation. It has since returned 19p to shareholders, but in May it highlighted that c.80 per cent of the remaining portfolio had requested some form of forbearance.

The deteriorating economic conditions in the face of Covid-19 restrictions led to increases in provisions under IFRS 9, which includes a provision for the expected defaults in the next twelve months, even for performing loans. The impact of this varies by fund with March NAVs included increased provisions of 0.5 per cent and 2.6 per cent for Honeycomb IT and VPC Specialty Lending, respectively, reflecting a full
Section 11: Listed Direct Lending Funds’ Performance

Share Price Total Returns – 1 and 3 Years (per cent pa)

Discounts(-)/Premium(+) to NAV

Changes in Shareholder registers

Share price returns have also been impacted by the shifting nature of shareholder registers. Many Direct Lending ICS were launched with relatively concentrated shareholder registers, backed by a small number of large institutional investors, particularly Woodford and Invesco. These investors have faced high-profile issues and as a result have sold their stakes in various Direct Lending ICS and this has contributed to widening discounts for several funds. Most of these stakes have now been sold, and so the perceived overhangs are having a lesser impact on sentiment.

M&A and corporate action

The Investment Companies sector is sometimes accused of being a sleepy area for M&A. However, there has been significant corporate action in the Direct Lending ICS sector to tackle underperforming funds. In the face of limited new sources of investor demand, adopting a realisation strategy has been a popular option. This path has been taken by HWSI Realisation (Hadrian’s Wall) and SME Credit Realisation (Funding Circle SME Income), whilst SQN Secured Income and KKV Secured Loan – C shares (formerly SQN Asset Finance Income) are also set to adopt a wind-down approach after failing continuation votes. Intriguingly, the KKV Secured Loan ordinary share class passed its continuation vote effectively giving it a stay of execution, no new investments until a further continuation vote next year.

It was interesting to see the Board of HWSI Realisation agree a recommended cash offer from PETRA Group, a subsidiary of Blue Compass Management, a firm focused on acquiring loan and credit portfolios. It was unsurprising to see the Board had received irrevocables from more than 75 per cent of share capital to accept the bid given it provides a quick and clean exit, at a substantial uplift, 91 per cent, to the trading price, equivalent to an 11 per cent discount to the June NAV. Note: There are also other live M&A situations in the sector. Numis cannot provide comment on Pollen Street Capital.

Hard to assess value

We believe the Hadrian’s Wall situation was a good result for shareholders and also raises the question of whether there is a fundamental mispricing across the Listed Direct Lending Sector. Most funds are trading on substantial discounts to NAV. In some cases, this reflects credit specific issues experienced in the portfolio and the potential impact of the uncertain economic outlook. However, a number of funds have performed reasonably well to date, but failed to match over-inflated expectations at launch, or been hit by a forced selling from large shareholders. In the face of a lack of demand from wealth managers, traditional buyers of many listed funds, discounts have ballooned. As a result,
we believe that some of the discounts are as much about the technicals in the listed markets, as the underlying performance, which may point to a mispricing in the listed market. In addition, the use of IFRS 9 factors in expected losses into valuations, effectively discounting NAVs, whilst potential bidders may look more at amortised cost and take their own view on expected credit losses.

In general, defaults have not been as significant as initial expectations, but it remains early days and uncertainty remains, particularly around conditions once government support comes to an end. Ultimately, it is difficult to make generalisations about the expected performance of private debt funds given the diverse nature of portfolios, the strength of the underlying collateral and the nature of specific credit agreements, e.g. position in the capital structure, rights on collateral. The ability to assess value is hampered by limited disclosure. Improvements have been made by most funds, but disclosure remains patchy and inconsistent between funds, meaning evaluating and comparing risk is difficult. RM Secured Direct Lending and Honeycomb have provided amongst the most extensive disclosures on LTVs and risk metrics.

What is the future?

We believe there remains a place for the Listed Direct Lending sector to generate returns in areas of specialist lending that have been neglected by banks since the global financial crisis. In addition, we believe there may currently be value on offer. However, we expect the sector to contain fewer funds following the current crisis as credit processes undergo a severe test. Funds that deliver and establish themselves will strong track records may see discount narrow and have scope to grow in the medium term, although funds that do not deliver are likely to come under further pressure to return capital or wind-up. The list of ongoing funds has reduced and now includes just: GCP Asset Backed Income; Honeycomb IT, RM Secured Direct Lending and VPC Specialty Lending. The latter passed its continuation vote in June but only after shareholder support came to an end. Ultimately, it is difficult to make generalisations about the expected performance of private debt funds given the diverse nature of portfolios, the strength of the underlying collateral and the nature of specific credit agreements, e.g. position in the capital structure, rights on collateral. The ability to assess value is hampered by limited disclosure. Improvements have been made by most funds, but disclosure remains patchy and inconsistent between funds, meaning evaluating and comparing risk is difficult. RM Secured Direct Lending and Honeycomb have provided amongst the most extensive disclosures on LTVs and risk metrics.

Ewan Lovett-Turner is Director at Numis Securities.
The roller coaster ride enjoyed by investors in the UK’s largest listed lending fund, Pollen Street Secured Lending (PSSL), speaks to a broader story of rampant enthusiasm followed by declining expectations for Britain’s nascent, initially online, direct lending space.

Launched in May 2014 as Peer-to-Peer Global Investments (dubbed P2PGI), and managed by MW Eaglewood, the fund raised well over £850m during its first 12 months of its existence. Investors were lured in by the promise of deploying capital into fast-growing internet-based peer-to-peer lending platforms such as Lending Club in the US and Zopa and Funding Circle in the UK.

The fund’s managers targeted returns in the 6 to 8 per cent range, well above the income from equivalent alternative assets in the age of quantitative easing, with interest rates heading rapidly towards zero.

Pretty much all the way through to the end of 2015 that scramble for yield was so intense that the fund’s shares even traded at a premium to net asset value. But by 2016, the shine had come off the fund as it failed to hit dividend targets and the share price started to sag below the net asset value per share.
“Whatever the final outcome for this pioneering fund, one thing is clear; peer-to-peer lending as a mainstream asset class has firmly fallen out of favour with most institutional investors. Investors have run scared from the potential for sustained losses even in the best of times.”

The next phase in the fund’s transformation had begun. Suddenly all sorts of awkward questions were starting to be asked about the fund’s business model. Why were US returns, especially from the leading online lending platform Lending Club, stuck in the low single digits?

The extensive US exposure was also dragging on returns via the extensive hedging operation that forced the manager to hold a large quantum of cash. But doubts also emerged about the riskiness of its UK lending partners. Funding Circle’s losses from SME lending also seemed to be higher than expected, prompting a crisis that saw lenders owning a separate listed investment trust vehicle (which is now in wind down).

As these concerns snowballed, investors continued to sell down the shares with prices starting to trend below 800p a share. By the time of the Brexit vote in June 2016 the discount had hit 25 per cent—more radical change was obviously needed.

In 2017 the board of P2PGI had initiated a strategic review which resulted in the fund manager MW Eaglewood—a vehicle originally backed by hedge fund Marshall Wace—merging into Pollen Street Capital, an already well-established credit manager behind the rival Honeycomb Investment Trust.

By 2019 the fund had been rebranded as Pollen Street Secured Lending—those last two words signifying an important change in strategy. Already by late 2016, the fund had been moving away from US consumer lending and by 2018 new lending into internet focussed platforms such as Zopa and Funding Circle had stopped. The new emphasis was on secured lending to other direct lending platforms, many of which boasted almost no internet presence.

For a while investors seemed happy and the share price stabilised above 800p, pushing the discount on the shares to something approaching the industry average, but by the end of 2019 controversy had returned.

A December 2019 factsheet released in January included a recommendation from the investment manager, Pollen Street Capital, to raise the quarterly dividend from 12p to 15p for the final three months of the year.

The board seemed unimpressed but by 25 February, that dispute was trumped by the announcement of a 900p-a-share offer by a rival credit manager, the US-based Waterfall Asset Management for the fund.

Yet within just a few weeks of that offer, events were overtaken by Covid-19 as the shares at one point crashed below 500p, before stabilising above the 600p level. As the global economy tumbled into a deep recession, investors started to worry about the potential for huge defaults by lenders.

Section 12: Pollen Street Secured Lending

But the relationship between the board and Pollen Street Capital had also totally broken down. Letters between the two were flying around along with allegations of a lack of cooperation by the manager in disclosing information to Waterfall, and the fund’s board.

All of which brings us to the current day. By August, Waterfall had been appointed preferred successor manager by the board despite Honeycomb investment trust (managed by Pollen Street Capital) offering a merger between the two funds which it more recently has retracted.

Not unsurprisingly the share price has rallied above 800p as investors contemplate some kind of final conclusion to this saga—a managed down perhaps or a renewed offer by Waterfall?

Whatever the final outcome for this pioneering fund, one thing is clear; peer-to-peer lending as a mainstream asset class has firmly fallen out of favour with most institutional investors. Investors have run scared from the potential for sustained losses even in the best of times. Ironically, Pollen Street’s move into more secured lending structures was probably better in tune with institutional investor’s own risk appetites but the Covid-19 crisis has overtaken even this strategy.

Investors don’t now seem to distinguish between online or secured lending—what they worry about is that all lenders, internet or otherwise, will be hit by a rising tide of defaults, by consumers as well as SMEs.

David Stevenson is a columnist for the Financial Times.
By this point, I’m sure you’re well aware that 2020 has been a bit of a rollercoaster. The economic turmoil and resilience, or lack thereof, of fintechs has been widely covered throughout the pandemic, with standout stars stepping up to the plate and others struggling to keep their head above water. Given the current economic crisis, alternative lenders could not be more important to the survival of SMEs across Europe. So, to get a gauge on the temperature of the market and exactly what alternative lenders think the next 12 months could look like, AltFi surveyed the top 44 players across Europe.

The lenders we spoke to varied from smaller firms specialising in specific areas of finance, to some of the largest in not just Europe, but the world. Respondents to the survey ranged from alternative lending juggernauts like Funding Circle, Capital on Tap, ThinCats and Assetz Capital, all the way to smaller regional players like Folk2Folk and Linked Finance. We asked lenders across several different sectors including SME lending, property finance, consumer and those who specialise in invoice financing.

“The unprecedented support for businesses has in the short-term stemmed a flood of insolvencies and maintained employment levels.”

As Graham Martin, head of lender relationships at Invest & Fund who took part in the survey, said: “Coronavirus and the subsequent lockdown has resulted in a number of challenges and it’s hard to think of a sector or business that has not been impacted to a greater or lesser degree.”

To paint a full picture of the lending landscape we asked questions on whether or not Covid-19 had adversely impacted lending, what lenders expect their volumes to look like over the next 12 months, if they’ll be able to find attractive borrowers in the next year, if their capital
availability has been impacted and if they expect this to change in the next year.

So, without further ado, here are the results of AltFi’s State of the Market Platform Survey 2020.

The impact of Covid-19

Unsurprisingly, three quarters (75 per cent) of lenders surveyed said that Covid-19 had adversely impacted their lending. Of the remaining quarter that said the pandemic had not affected their lending, over half (55 per cent) operated within the SME lending sector, with the same proportion of those unaffected also participating in a government-backed lending scheme. Similarly, 55 per cent of respondents who said Covid-19 had no impact on their lending operated solely within the UK, of the remaining lenders, 36 per cent only operated in mainland Europe (including the Republic of Ireland) and nine per cent operated in both markets.

Across the board, the vast majority of alternative lenders (84 per cent) are bullish on the future and expect their lending originations to increase over the next 12 months, while nine per cent of the remaining lenders felt the level of originations would remain the same and seven per cent think originations will decrease over the next 12 months.

But what exactly does this all mean? Well, it’s clear to see that, firstly, the world of alternative lending has not been immune to the Covid-19 pandemic but secondly, and perhaps more importantly, alternative lenders seem fairly undeterred by this. We can see from the results of our survey, nearly two-thirds of lenders surveyed (64 per cent) feel their ability to find attractive borrowers will improve over the next 12 months, with 37 per cent believing that it will remain at the same level.

Katrin Herrling, CEO and co-founder of Funding Xchange, said: “The unprecedented support for businesses has in the short-term stemmed a flood of insolvencies and maintained employment levels. However, it has also introduced huge structural distortions—for businesses, banks and lenders—that will need to be unwound to ensure small businesses have the chance to emerge from this crisis and continue to be supported by a robust banking and lending sector.”

“A significant rise in unemployment as the furlough scheme comes to an end could also become a drag on the strength of any economic recovery.”

Government support

When the gravity of the Covid-19 pandemic began to set in, just before countries across Europe were ordered to stay at home, many governments introduced emergency state aid measures for businesses and employees alike.

In the UK, Chancellor of the Exchequer Rishi Sunak introduced the Coronavirus Business Interruption Loan Scheme (CBILS) and the Coronavirus Large Business Interruption Scheme (CLBILS), although only one survey respondent ThinCats took part in this particular scheme, and later the Bounce Back Loan Scheme (BBLS). As of 18 August 2020, the UK government has helped to facilitate over £53bn in government-backed loans to the nation’s SMEs, a sizeable chunk of which comes from alternative and non-bank lenders.

Ravi Anand, managing director of ThinCats, said: “The alternative lending market has responded well to the challenges raised by the pandemic by delivering significant volumes of funding to UK businesses. Whilst it would have been ideal for alternative lenders to have been included in the government support schemes such as CBILS earlier, the key point of allowing non-bank lenders to access Bank of England funding on the same terms as the banks rumbles on. Given this is the first major economic shock since the financial crisis it is interesting to see default rates currently remaining low, but clearly, we aren’t out the other side of this cycle yet.”

Of the lenders that said they had not been adversely impacted by the Covid-19 pandemic, nearly half (46 per cent) had participated in a government-backed lending scheme. Whether it be the UK’s CBILS or the BBLS or a European equivalent, such as the Italian Government Guarantee or the French SME support loan scheme (BPI).

Samir Desai, CEO and co-founder of Funding Circle, said: “The pandemic has accelerated the adoption of online lending and shown how critical fintech lenders are in supporting SMEs. We are proud to have played our part as the fifth largest provider of CBILS loans, with £460m approved as of the end of June. It is small businesses
that will power the economic recovery, with every £1 lent generating £2 in GDP.” Funding Circle was one of the first non-bank lenders to gain accreditation at the beginning of April 2020 and has since been a key fintech lender for SMEs, having dished out over £300m in CBILS loans, in addition to a £300m loan facility supplied by Starling Bank specifically for its SME Covid-19 lending.

To furlough, or not to furlough?

As well as government loan schemes intended to keep businesses ticking over, governments across Europe also implemented job retention schemes such as the Coronavirus Job Retention Scheme (the so-called furlough scheme) here in the UK or the Kurzarbeit programme in Germany. Of the lenders AltFi surveyed, it was pretty evenly split down the middle whether or not they had made use of the government-backed job retention schemes. Across all respondents, 52 per cent made use of the programmes, while the remaining 48 per cent did not, with the lion’s share of those using the schemes hailing from the UK (70 per cent).

Ravi Anand, managing director of ThinCats, said: “Looking forward, the main concern for businesses seeking future funding will be the impact of further regional or national lockdowns and we expect revised government-backed schemes to launch which is crucial to supporting many businesses through the next stage of the crisis. A significant rise in unemployment as the furlough scheme comes to an end could also become a drag on the strength of any economic recovery.”

Interestingly however, a considerably larger proportion of lenders on the continent have continued to hire throughout the pandemic, 73 per cent of them in fact, while only 58 per cent of UK firms have been in a strong enough position to take on new hires. Across the board, only just over a third of lenders (34 per cent) have had to make redundancies because of the Covid-19 pandemic or otherwise, while the remaining 66 per cent have managed to keep all staff on board.

Sector by sector

Within the different alternative lending sectors, lenders have reacted differently to the pandemic and the current economic turmoil. For instance, of the lenders surveyed who specialise in property lending, nearly three quarters (72 per cent) believe that their ability to find attractive borrowers in the next twelve months will increase and just 14 per cent think it will go down.

Graham Martin, head of lender relationships at Invest & Fund, said: “Secured residential property development has fared relatively well; house building was one of the first industries to be allowed to return during lockdown and property prices have held up well, most recently evidenced by the Nationwide House Price Index reaching an all-time high in August. Lenders against residential property enjoy a number of protections and returns have held up well, especially when compared to the volatility exhibited in equity markets and the large cuts to dividends we have seen in 2020.”

He continued: “While the immediate future will continue to present challenges we have seen enough evidence to confirm our view that good quality well located residential property remains attractive and that if structured and monitored correctly lending against such property can provide lenders with attractive risk-adjusted returns.”

Interestingly, lenders appear to be more bullish on their own ability to lend than they are of their wider sub-sector. When asked about lending within their sub-sector, most respondents (43 per cent) felt that lending was decreasing and just 30 per cent felt that it was on the rise, compared to the bullish origination responses we saw above when asked about their own platforms.

Niall Dorrian, CEO of Linked Finance, Ireland’s largest peer-to-peer lender, said: “Linked Finance took a very proactive approach in offering payment breaks at the start of the lockdown due to Covid-19, we felt it was important to offer support to our borrowers during this challenging
time. What we are seeing now is a very positive response from our borrowers to get back on track with payments as the economy starts to open up again.”

Despite Dorrian’s optimistic outlook, SME lenders, on the whole, are the most pessimistic about their ability to find attractive borrowers. Just 57 per cent of SME lenders feel they will be able to find more attractive borrowers over the next 12 months than they have over the past year, and nearly one fifth (19 per cent), think this will decrease over the next year.

**Conclusion**

Despite ongoing pandemic and the worldwide economic downturn, it appears that lending across Europe is fairly steady, with many lenders believing that it will remain that way over the next 12 months. It’s hard to deny the impact of Covid-19 on the alternative lending market, but, and this is a big ‘but’ given the situation, alternative lenders appear to be hesitantly optimistic about the next year. From the survey, we have seen that nearly two thirds (64 per cent) of lenders think that their ability to find attractive borrowers will increase over the next 12 months. Just seven lenders, most of which come from the SME lending sector, believe that they have less of a chance at finding attractive borrowers over the next 12 months.

Similarly, it’s a positive sign that the alternative lending sector as a whole has not had to dramatically decrease its headcount, unlike other areas of fintech which have had to make redundancies to stay afloat, such as Monzo making 285 members of staff redundant across the UK and US. However, from the survey results, we can see that UK lenders may be slightly more hesitant about hiring new talent in the current climate, given that only 58 per cent have brought on new staff, compared to 73 per cent of European lenders.

Across the board, we can see that 84 per cent of lenders are expecting the number of originations to increase, while only 40 per cent of alternative lenders expect their lending volumes to increase, with the same number of lenders expecting volumes to go down. In the same vein, just under half of the lenders surveyed (48 per cent) predict that loan defaults will remain the same, while 38 per cent expect them to rise and just 14 per cent are forecasting defaults to decrease over the next 12 months.

Ultimately, it’s hard to tell exactly what the alternative lending market will look like over the next 12 months and how well it might cope with another lockdown, however from the lenders surveyed most have a positive outlook.

There are also rumblings in the industry that governments, particularly the UK government, could extend financial aid programmes well into winter 2020 to help prevent further economic collapse in the event of a second lockdown, something which I’m sure alternative lenders will welcome.
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