

Wealth Adviser Briefing



Peer-to-peer lending

Understanding the risk profile of
RateSetter

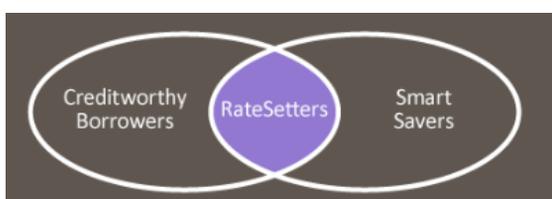
An exclusive insight into peer-to-peer lending for the Wealth Advice community by one of the UK's leading platforms



Peer-to-peer lending is receiving a lot of interest, especially since the sector became regulated by the FCA in April 2014. However, there is much debate around the risks faced by customers who save with these platforms. The FCA's stance on risk was clearly outlined in their consultation paper on crowdfunding*; direct access to equity-based platforms will be restricted to sophisticated investors whereas direct access to debt based platforms (like RateSetter) will be available to all types of retail customer.

This paper is intended to give Wealth Advisers the information they need to help understand the risks associated with RateSetter and peer-to-peer lending, should they choose to advise clients on the topic. Key data are provided, including FE Risk Scores for RateSetter's products, statistics on the Provision Fund and historical performance of the overall portfolio.

What is peer-to-peer lending?



Creditworthy Borrowers want a low cost loan. Smart Savers want a better return. We match them up and ensure everyone gets what they've been promised.

RateSetter for Wealth Advisers

Introducing peer-to-peer lending as a new asset category



Peer-to-peer lending is a nascent industry. Nascent but not insignificant. RateSetter, one of the UK's largest platforms, is currently writing c. 1% of all UK unsecured loans per week. In January 2014, just under £17m of customers' savings were 'matched' with these loans.

Buy why should wealth advisers be interested in unsecured loans? The answer is simple – these loans are a new asset category, a form of debt offered only through peer-to-peer lending platforms. It is essential to understand more about our loans and Borrowers, as this informs Wealth Advisers and Savers about the risk and return they may expect.

RateSetter's Borrowers are prime customers. The majority are home owners, are paid salaries that are higher than average and are in their 40s. These customers can afford to repay their loans and have a track record of paying back debt. It is of no surprise, therefore, that only a very small portion of our Borrowers have ever experienced a problem with repaying their loans. In fact, in our first three years of operating, our default rate was only 0.3% giving us one of the 'cleanest' loan portfolios in the UK. For Savers, this means that the asset category carries little risk. However, there is still some risk.

RateSetter were pioneers in developing the Provision Fund – a fund held in trust that is grown from a small fee charged to Borrowers. This Trust compensates Savers on the rare occasion that a Borrower does default or misses a payment. As such, every RateSetter Saver has received every penny of capital and interest expected. This is unique in the peer-to-peer sector, where all other substantial platforms have, on occasion, had to pass on the bad news of a loss to a Saver. RateSetter's Provision Fund is growing at a rate of approximately 10% per month, reflecting the growth in demand for loans and our burgeoning reputation as an alternative to the mainstream. The RateSetter model has now been adopted by others in the industry, recognising the impact of this innovation.

Regarding the loans themselves, customers can borrow between £1,000 and £25,000 for terms between 12 and 60 months. Once accepted, the money can be in a Borrower's account on the same day that the application is made. Many other lenders cap their maximum loan amount at £15,000 – at RateSetter, we believe that credit worthy individuals should be able to borrow as much as they need, within the bounds of what they can afford to pay back over a given period of time. That being the case, our Borrowers are also able to pay back their loans ahead of schedule, without being charged a fee.

Importantly, the peer-to-peer sector in the UK has decided not to join the Financial Services Compensation Scheme (FSCS). This is because of the cost of participation, which would ultimately be passed on to customers. Peer-to-peer lending gives customers superior pricing, when compared with the mainstream, and this benefit would therefore be eroded by joining FSCS.



A variety of recognised risk rating methodologies exist that score and rank investment products in order to inform Wealth Advisers and their clients of the likely risk / reward profile. However, peer-to-peer lending has yet to be scored for risk by one of these recognised rating providers. One such provider is FE, who's risk scores are referenced throughout the industry by thousands of Wealth Advisers. RateSetter has partnered with FE to quantify the risk for each product that is currently available to customers.

FE measures the risk of investment products relative to the volatility associated with cash (scoring 0) and the FTSE100 (scoring 100). As such, an investment product scoring close to 0 is considered less volatile, and therefore less risky. Conversely, a higher score, possibly exceeding 100, indicates that an investment product is more volatile and therefore more risky – there is no cap to the score. These Risk Scores are calculated by analysing more than 18 months of historical pricing. This industry-standard methodology is relied upon by thousands of Wealth Advisers in the UK to make informed decisions during the advisory process.

RateSetter partnered with FE to produce new indices for each product with the aim of calculating risk scores. Daily pricing for each product from the last 18 months was provided and subjected to FE's industry-recognised quantitative methodology (See below). The results show that RateSetter's products carry a risk score that is marginally higher than cash, suggesting that they are suitable alternatives to similar cash-like products on the market.

It is important to note that these scores are for RateSetter's products and should not be used as a proxy for peer-to-peer lending in general. Each company's business model is different and these scores reflect RateSetter's unique market positioning.



RateSetter Product	FE Risk Score
Monthly Access	1
One Year Bond	1
Three Year Income	1
Five Year Income	1

Note that FE Risk Scores quantify the volatility of an investment product. They do not account for qualitative factors such as the risk of late payments / defaults on loans. This is where RateSetter's Provision Fund Fund plays an important role.



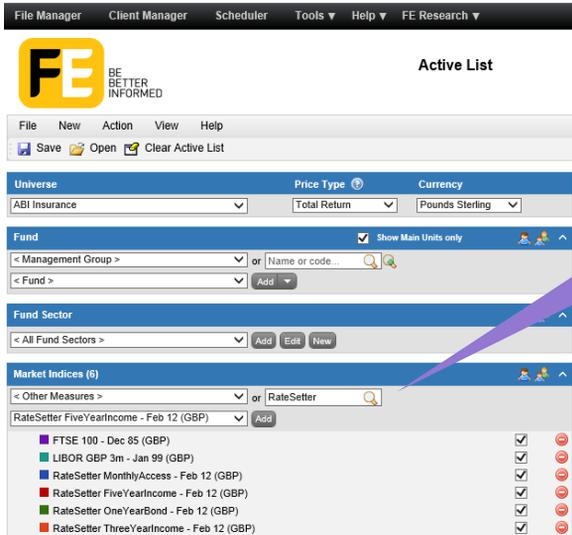
RateSetter for Wealth Advisers

Finding RateSetter's risk scores on FE Analytics

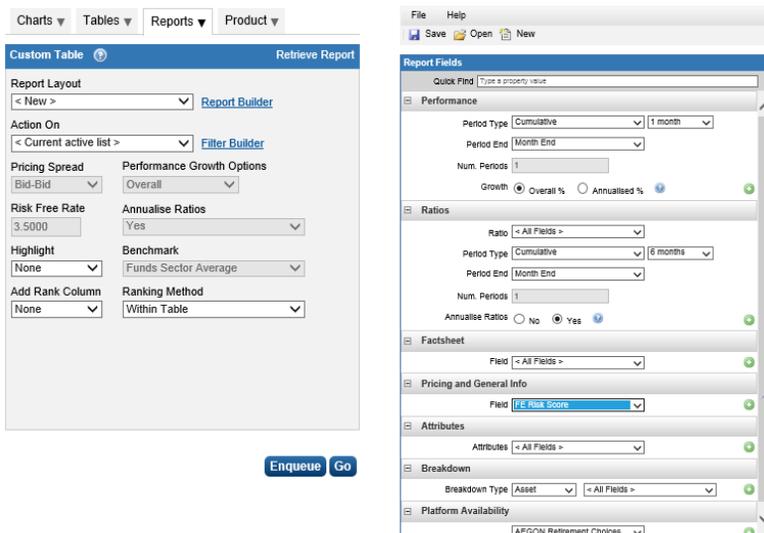


RateSetter's risk scores are accessed through FE Analytics. The following steps should be followed when researching the risk scores by a Wealth Adviser.

1. Login to FE Analytics and search for "RateSetter" under Market Indices



2. Go to Report Builder to produce the FE Risk Scores in a custom report

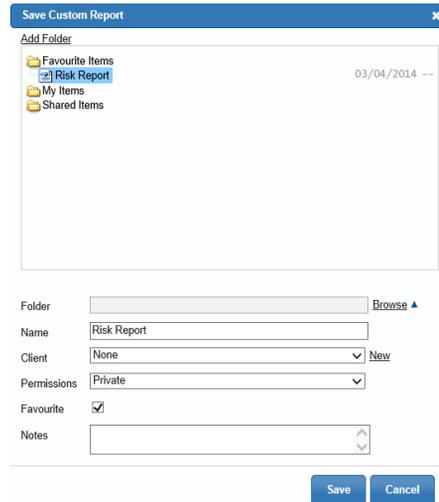
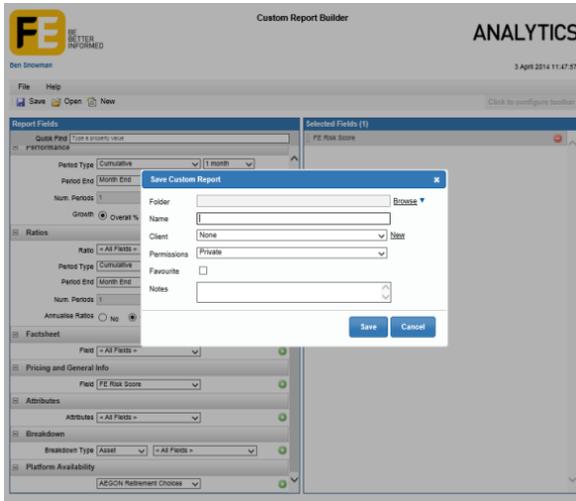


RateSetter for Wealth Advisers

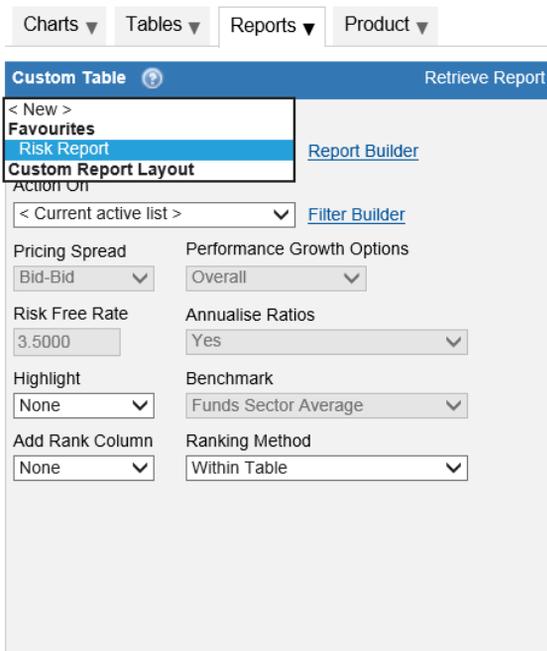
Finding RateSetter's risk scores on FE Analytics cont.



3. Save the custom report into your Favourites



4. Produce the custom report



Customise Columns	FE Risk Score	Select
Index FTSE 100 TR in GB	100	<input type="checkbox"/>
Index LIBOR GBP 3m TR in GB	0	<input type="checkbox"/>
Index RateSetter FiveYearIncome TR in GB	1	<input type="checkbox"/>
Index RateSetter MonthlyAccess TR in GB	1	<input type="checkbox"/>
Index RateSetter OneYearBond TR in GB	1	<input type="checkbox"/>
Index RateSetter ThreeYearIncome TR in GB	1	<input type="checkbox"/>

Select 'go'

Queue Go



Founded in 2010, RateSetter is the only established peer-to-peer lending platform in the world where every Saver has received every penny of capital and interest expected. All other platforms have, at some stage, had to pass on the bad news to one of their customers that they had made a loss. How has RateSetter achieved this outstanding track record?

FE Risk Scores are only part of the story. When RateSetter was set up, de-risking the products for Savers was one of the most important considerations – and this went beyond volatility, the metric quantified by the FE Risk Scores. The most powerful innovation was the Provision Fund – a fund that is grown from Borrower contributions, which compensates Savers in the event of a default or late payment. This set the standard in the industry and has since been adopted by other platforms. The Provision Fund is one of the main measures used to de-risk Saving through RateSetter.

Stringent credit checks

Everything starts with our underwriters. Not only do we ensure that our customers have a good track record but we make sure they can afford to repay any loan that they may eventually take. Peer-to-peer lending relies on the fact that we match credit worthy Borrowers with people that are happy to lend them money, in exchange for a higher return than they can get through a bank. The secret, therefore, is to ensure that our Borrowers are prime customers. In fact, up to 75% of loan applicants are rejected – a number we are proud of because it is a direct reflection of the high quality of our loan portfolio.

The Provision Fund

As mentioned above, defaults do still happen. In fact, in the first three years of operating, nearly £395k worth of loans had defaulted. Fortunately, all of our Savers that were affected, were compensated by the Provision Fund, which is growing at a rate of 10% month on month. That said, the historical default rate is less than 1% and RateSetter has one of the best performing loan portfolios in the UK.

As a function of the way in which loans are funded, Savers' money tends to be spread amongst a number of Borrowers. On average, money from Savers is spread between 20 to 25 loans. However, the Provision Fund ensures that Savers' money is protected, even if matched with only one loan. All of these measures combine to give RateSetter an extremely powerful means of de-risking the Saving process. This is why no Saver has ever been out of pocket with RateSetter.

Further information on how we manage the risks of saving with RateSetter can be found on our website: http://www.ratesetter.com/lending/need_to_know.aspx



RateSetter believes in sharing important information to help make Wealth Advisers and their clients aware of the risks involved with Saving. In this way, Wealth Advisers and their clients can consider the facts required to make informed decisions on whether to Save money with RateSetter or not.

Key information on the Provision Fund

Anticipated bad debt: <1.6% total Loan portfolio
Coverage Ratio: 1.8x

The Provision Fund Key Data	
How much is in the Fund?	£3,821,242
Claims met by Provision Fund	100%
How much has been lent out?	£205,678,856
How much capital has been repaid?	£73,878,833
How much is currently on loan?	£131,800,023
Anticipated bad debt rate	<1.6%
Anticipated bad debt	£2,104,113
Coverage ratio	1.8

Key information on today's Loan portfolio

On-time repayments: 99.74%
Payments >2 months late: 0.04%

Current Loan Book		
Current state of loan	Amount	% of Money on Loan
Loans on time	£131,452,699	99.74%
Payments late < 30 days	£17,887	N/A
Loans 1 month late	£272,920	0.21%
Loans 2 months late	£56,516	0.04%

Historical bad debt

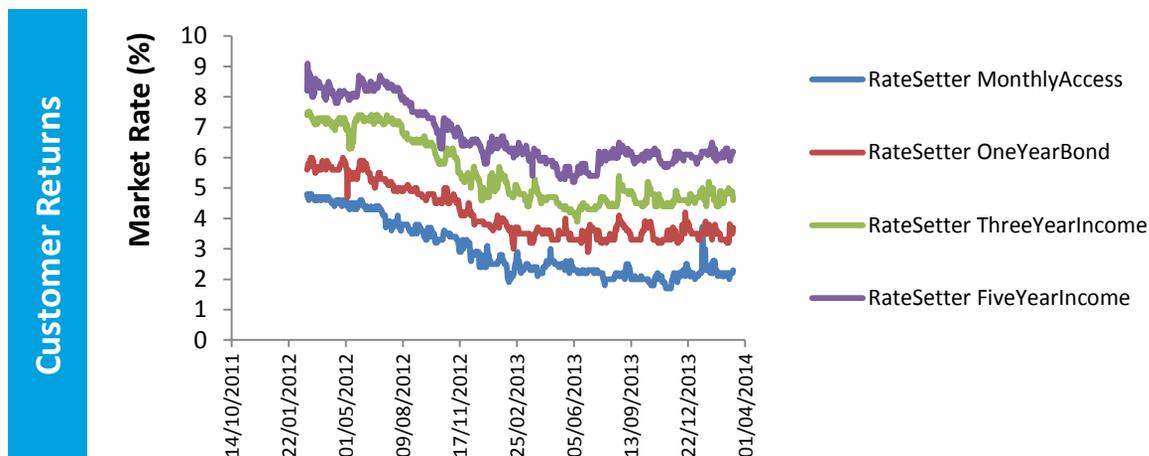
Total bad debt: 0.50%
Total written off debt: 0.04%

Bad Debt		
	Balances	% of Money Matched
Total Bad Debt Incurred	£1,030,155	0.50%
- Recovered	£56,456	0.03%
Net Bad Debt Incurred	£973,698	0.47%
of which In Default	£886,950	0.43%
of which Written Off	£86,748	0.04%

About RateSetter

RateSetter was launched in late 2009 by **Rhydian Lewis** who, after working closely with banks in his role at Lazard, felt the opportunity for peer-to-peer lending was ripe. He was soon joined by **Peter Behrens**, who practised as a solicitor at Ashurst, before joining RBS as a banker. They have raised £8m from angel investors. RateSetter reached breakeven in January 2013.

Historical performance of RateSetter's products



Important Notes

- The market rate is a contracted rate of return that a customer receives when their money is used to fund a loan – this is the rate they get, it does not change
- Customers are protected from losses by the Provision Fund; RateSetter is the only peer-to-peer lender worldwide where every Saver has received every penny of capital and interest expected
- Each product has a FE Risk Score of 1 (as of 31 March 2014) based on the analysis of more than 18 months of daily data

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