



Credit & Lending



Class 7: Overview

- Facebook Libra Update
- Trends in Credit
- Impact of New Data Technologies, Products, and Models
- Marketplace Lending
- Credit Scoring
- Professionalism & Academic Integrity

What is Libra Cryptocurrency?

Facebook hopes to leverage its growing empire of over [2.6 billion](#) monthly active users to create a fast, stable and secure digital currency that will improve financial access across the globe.

Libra uses blockchain technology to connect a permissioned network of secure servers to manage the issuance and transfer of digital tokens. While the original plan was to peg the value of the Libra against a 'basket' of international currencies and government debt, fears of destabilising the value of established currencies and money laundering have forced Zuckerberg to find a plan B.

The Libra Association now claims the cutting-edge digital currency will use a ["college"](#) of regulators, central banks, and enforcement agencies from over twenty countries in a bid to scale-back its approach and receive regulatory approval from the Swiss Financial Markets Supervisory Authority (FINMA).

Facebook hopes its cooperation with major financial institutions will help them work around regulatory concerns and build a reputable digital currency with global exposure. While Zuckerberg appears to be doing all the right things, his unwavering battle against the regulators calls the sincerity of his vision into question.

Will Facebook Libra Be a Stable Cryptocurrency?

One of the biggest differences between cryptocurrencies and traditional currencies is the fact that they don't comply with our classical understanding of monetary theory.

We usually attach value to a currency based on one of two factors:

- The weight of precious metals is used as a benchmark to denote value.
- If the state will accept the currency as a form of tax, we attach value to it.

The inability to attach physical value to a digital entity, combined with the lack of regulation around most cryptocurrencies means that the likes of Bitcoin, Ethereum and Facebook Libra don't meet either of the above criteria. This critical distinction between traditional currencies and cryptocurrencies triggers concerns over the volatility of Libra if it were to get the green light from regulators.

The Libra Association has responded by announcing the proposed launch of “stablecoins” that will be valued against an undecided assortment of currencies such as the US Dollar, the Euro and the Pound.

Cryptocurrency Regulation: Should Facebook Be Regulated?

Calls for tightened government regulation of Facebook is largely due to concerns over monetary sovereignty and the stability of official state currencies.

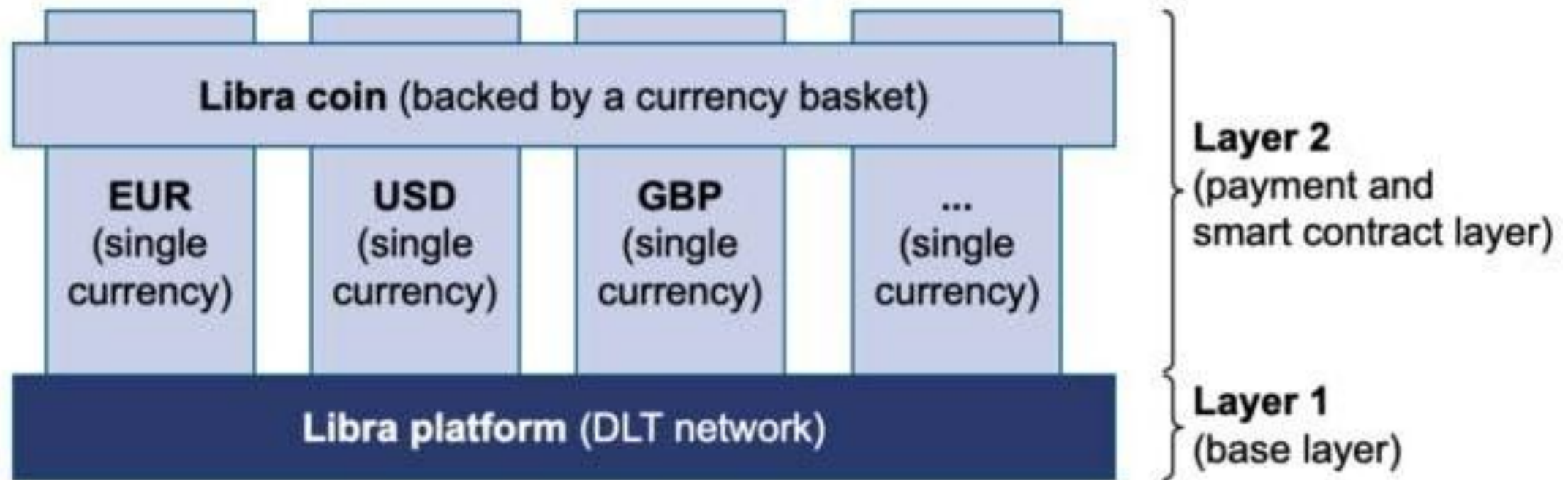
While the proposition of pegging Libra against a 'basket' of international currencies and state debt will go a long way to moderate its value, many governments fear Facebook's seemingly infinite access to customer data could give the tech giant an unfair advantage that could warp the value of state-owned currencies.

Crucially, economists are worried about a fundamental shift whereby the value of the basket of state currencies becomes reliant on the value of Libra, not the other way around.

[This](#) fascinating video by TDLR News on the future of cryptocurrency and [China's latest DCEP currency](#) explains how Facebook's ability to control the weighting of currencies in their 'basket' could manipulate the value of other currencies and distort entire economies.

Smaller nations with weak domestic currencies are particularly fearful of the impact of Libra and other stablecoins on their economy. With this in mind, Zuckerberg has his work cut out if he wants to realise his grand vision of creating affordable and accessible finance to developing nations across the world.

Libra 2.0



Source: 'Understanding Libra 2.0: A compliant global platform for the digital programmable EUR, USD, GBP & Co.', Philipp Sandner (2020)

Libra 2.0



Source: <https://hackernoon.com/can-facebooks-libra-20-live-up-to-its-promise-eql3x3y>

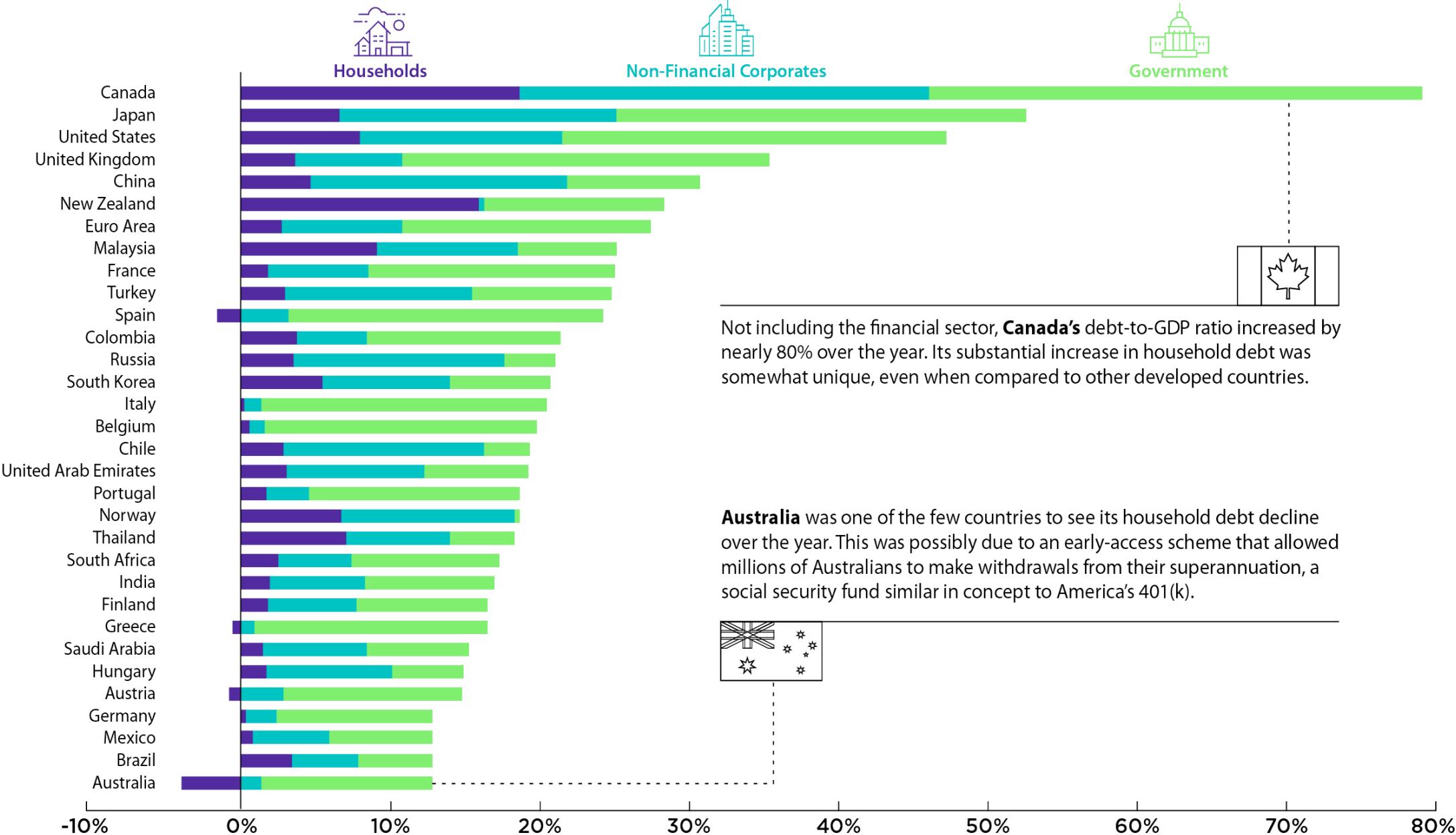
Credit Sectors

- Household:
 - Mortgages, Auto, Personal Loans, Student Loans
 - Secured, Unsecured, Term, Revolving
 - Purchase, Debt Consolidation, Refinance, Point of Sale
- Corporate:
 - Small Business, SBA Loans, SME / Mid Market, Large Enterprise
 - Bonds, Loans
 - Investment Grade, High Yield, Leveraged Loans

Household Debt as Percent of GDP

CHANGE IN DEBT-TO-GDP

(Q42019–Q32020)

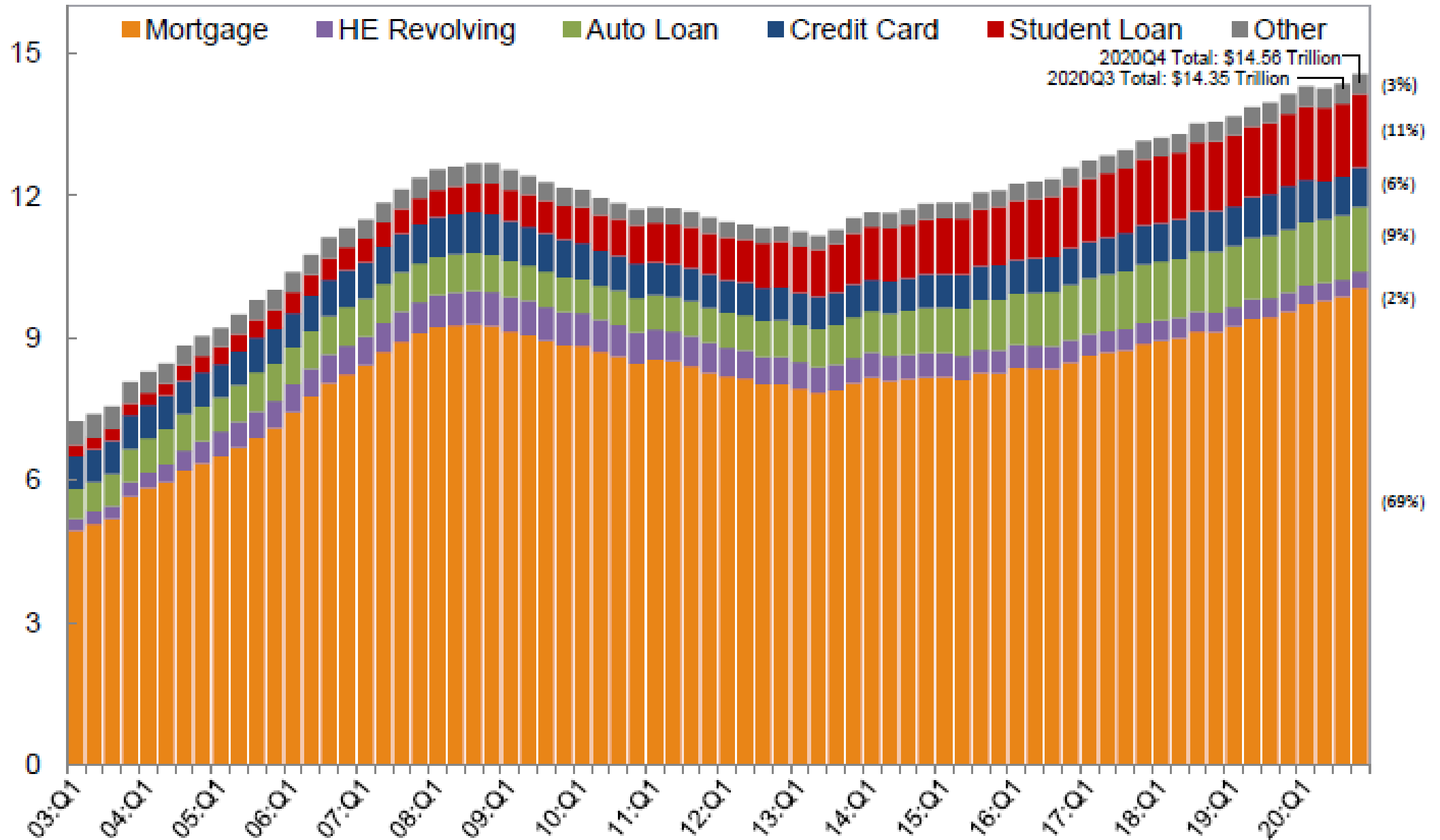


Not including the financial sector, **Canada's** debt-to-GDP ratio increased by nearly 80% over the year. Its substantial increase in household debt was somewhat unique, even when compared to other developed countries.

Australia was one of the few countries to see its household debt decline over the year. This was possibly due to an early-access scheme that allowed millions of Australians to make withdrawals from their superannuation, a social security fund similar in concept to America's 401(k).

Total Debt Balance and its Composition

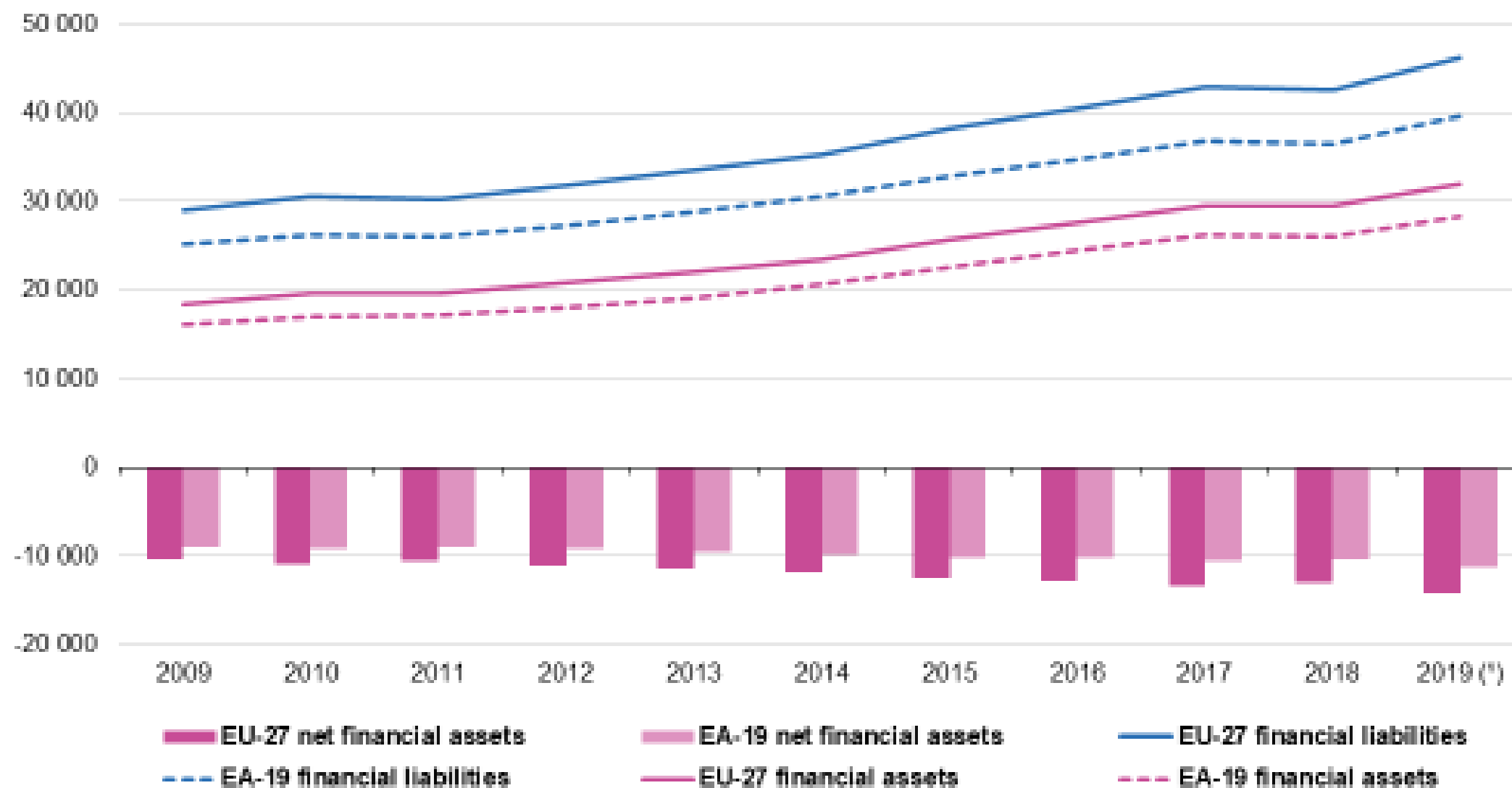
Trillions of Dollars



Source: New York Fed Consumer Credit Panel/Equifax

Developments for total financial assets and liabilities of non-financial corporations, EU-27 and EA-19, 2009-2019

(billion EUR)



Note: break in series, 2012, 2014 and 2016.

(*) Provisional.

Source: online data code (nasa_10_f_bs)

Credit and lending solutions

1. Business cards

Gain more control over employee spending with the ability to separate business and personal expenses, as well as manage business transactions online.

2. Overdraft

Minimise the risk of unplanned overdrafts. Improve your cash flow management by having the option to easily access funds.

3. Revolving loans

Boost working capital to cover short-term or day-to-day expenses by drawing, repaying and redrawing cash as needed within the limits of the facility.

Impact of New Data Technologies, Products, and Models

Categories	Purpose/Scope	Impact			
		Financial Inclusion	Privacy & Security	Financial Stability	Job Creation
New Data	<ul style="list-style-type: none"> New data sources 	✓	✓		✓
New Technologies	<ul style="list-style-type: none"> Blockchain/distributed ledger technology (credit information sharing system, ID, trade suppliers, commercial registries) 		✓		✓
	<ul style="list-style-type: none"> Payment transactions (retail, remittance, small and medium-size enterprise [SME], and government payments) 			✓	✓
	<ul style="list-style-type: none"> Cloud computing 				
	<ul style="list-style-type: none"> Biometric technologies 	✓			
	<ul style="list-style-type: none"> Artificial intelligence/machine learning 	✓			
New Business Models	<ul style="list-style-type: none"> Lending (crowdfunding, peer-to-peer lending, online lenders, SME lending) 	✓	✓	✓	✓
	<ul style="list-style-type: none"> Risk management techniques (development of scoring models and fraud detection to provide financing or lending) 	✓	✓	✓	✓
	<ul style="list-style-type: none"> Regtech and suptech (to support compliance and supervision) 			✓	

Source: <http://documents1.worldbank.org/curated/en/587611557814694439/pdf/Disruptive-Technologies-in-the-Credit-Information-Sharing-Industry-Developments-and-Implications.pdf>

Marketplace Lending - What is P2P Lending?

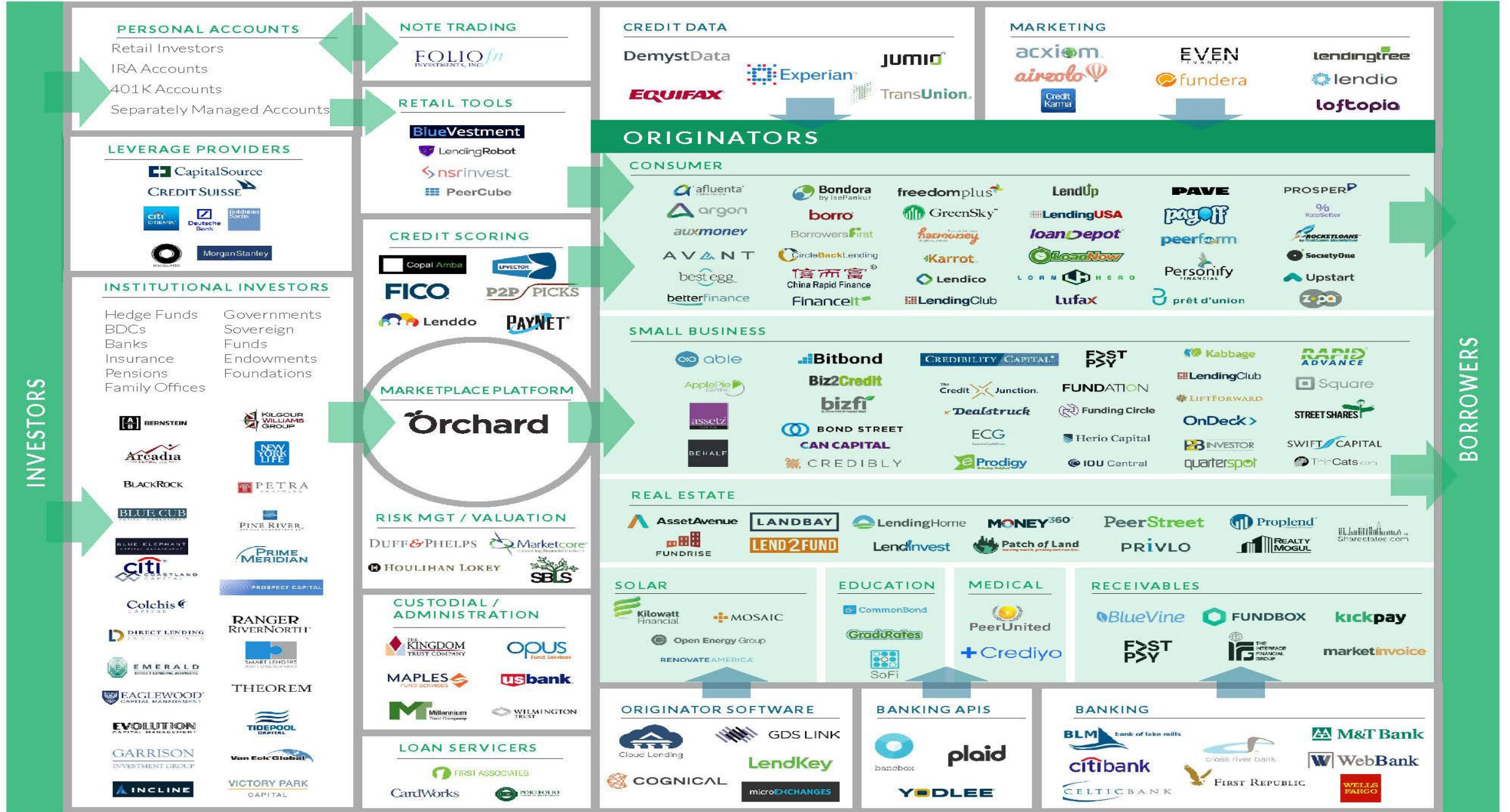
- **Individuals lending money to other individuals without a banking intermediary.**
- **It is a type of crowdfunding that facilitates loan originations outside of the traditional banking system by connecting lenders and borrowers through an Internet platform.**
 - Generally, the platforms do not make loans; instead, they serve as matchmakers, pairing borrowers and lenders.
- **P2P lending platforms have distinguished themselves from traditional lending by employing innovative credit modeling and underwriting processes.**
 - The platforms incorporate a wide range of data elements to move beyond traditional credit scores.

The Platforms — Marketplace Lenders

Consumer	
Pay Day	
Purchase Finance	
Education Financing	
Real Estate	
Merchant Cash Advance	
SMB Credit	

Source: “A Million Dollar Market by the People, for the People,” Foundation Capital

Online Lending Ecosystem



As of late 2014, the U.S. Peer-to-Peer lending space has a range of players and is expanding. While not comprehensive, the above is intended to serve as a simplified illustration of what Orchard believes are typical interactions between some of the categories of industry parties. The illustration should not be interpreted to imply a relationship (or lack thereof) between Orchard and any named company and is not an endorsement by Orchard of any named company.

The P2P Lending Process

- Before a loan is posted on a platform's website, a prospective borrower submits an application to the platform for consideration.
- The platform obtains a credit report on the applicant and uses this information, along with other data, in proprietary models to assign a risk grade to the proposed loan and sets an interest rate corresponding to the assigned risk grade.
- If accepted, a loan request is posted on the platform's website, where investors can review all loans or search for specific loans that meet their desired risk/return characteristics.

The P2P Lending Process

- If there are enough investors to fund the loan (a single loan is typically divided into many pieces to allow investors to diversify their portfolio and distribute the default risk among multiple investors), the loan is then originated by a bank.
- The originating bank then sells the notes associated with the specific loan to the platform, which, at the same time, sells the notes to each lender that has agreed to fund the loan. The notes issued by the platform are specific to each borrower, and some notes may be registered with the SEC.
- The notes issued by the platform (also referred to as “borrower payment dependent notes”) are guaranteed by the underlying loan. Investors are only due payment by the platform if the underlying borrower repays the loan.

Marketplace Lending

- **“Marketplace lending” is a better name to describe this new system, which is fundamentally about creating platforms to connect borrowers with lenders.**
 - Charles Moldow, General Partner, Foundation Capital
- **Four maxims — the keys to marketplace lending**
 - Data, data, data
 - Connections and liquidity
 - It’s not just about matchmaking but also about market-making
 - Formidable barriers
 - Built to last
 - Displace, not just disrupt

Hedge Funds and Marketplace Lending

- **NY Hedge Fund Roundtable survey**
 - P2P lending platforms will increasingly rely on larger hedge funds to fund their expansion.
 - Given the rapid growth in the sector, alternative investors will need to participate in P2P platforms to diversify investments.
 - If securitizations backed by P2P loans offer attractive returns, investors will buy.
- **There are concerns about potential imbalances between supply and demand.**

Regulatory Focus

- **To date, regulatory efforts concerning marketplace lending have focused on narrow issues of licensing and securities laws.**
 - Lending laws
 - Lender or loan servicer
 - Applicability of consumer credit laws
 - Statutes relating to financial institutions
 - Securities laws

Systematic Risk

- **The debate between Todd Baker, Managing Principal at Broadmoor Consulting, and Mike Cagney, CEO and Co-Founder of SOFI:**
 - Baker: “While MPLs have introduced valuable innovation into financial services, they carry a fundamental flaw that threatens to undermine their business, destabilize financial markets and cause real economic hardship.”
 - What is this fundamental flaw? Access to funding.
 - Cagney: “MPLS operate marketplaces. The beauty of marketplaces is real-time information feedback.”
 - “MPLS can’t expand their balance sheets and leverage like banks do.”
 - They use very little of their balance sheets for lending and have no real leverage.

More Thoughts on Systematic Risk

“Platform lending doesn’t have the central connection to leverage that traditional banking does. There is no entity that carries a balance sheet with leverage. There’s nothing there that is too big to fail. There is nothing there that requires deposit insurance. There is nothing there that is implicitly subsidized, and there is, therefore, a greater contribution to stability, to the kind of stability that we seek to achieve.”

- Larry Summers, former economic advisor to Obama, head of Treasury and president of Harvard

Growing Involvement of Leveraged Entities

- **With the transition from P2P to MPL, hedge funds, banks and asset management firms have taken over the investor side. These institutions are highly leveraged.**
 - Lending Club announced a partnership with Citibank to provide loans to underserved communities. Citi is providing a \$150-million credit line to Varadero Capital to purchase these loans from LC.
 - J.P. Morgan Chase is using On Deck Capital's platform to help make loans to some of the bank's roughly four million small-business customers. On Deck Capital will help the bank process applications more inexpensively and quickly, in hours instead of weeks.

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Cases in ML

- As discussed, marketplace lenders generally make loans through a partner bank. There are a number of significant cases that may call this platform-bank partnership into question.
 - *Madden v. Midland Funding*
 - *Kane v. Think Finance*
 - *Maryland Commissioner of Financial Regulation v. CashCall*

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Credit Scoring

What Is a Credit Score?

A credit score is a number between 300–850 that depicts a consumer's creditworthiness. The higher the score, the better a borrower looks to potential lenders. A credit score is based on [credit history](#): number of open accounts, total levels of debt, and repayment history, and other factors. Lenders use credit scores to evaluate the probability that an individual will repay loans in a timely manner.

The credit score model was created by the Fair Isaac Corporation, also known as [FICO](#), and it is used by financial institutions. While other credit-scoring systems exist, the [FICO score](#) is by far the most commonly used. There are a number of ways to improve an individual's score, including repaying loans on time and keeping debt low.

Credit Scoring

How Credit Scores Work?

A credit score can significantly affect your financial life. It plays a key role in a lender's decision to offer you credit. People with credit scores below 640, for example, are generally considered to be [subprime borrowers](#). Lending institutions often charge interest on [subprime mortgages](#) at a rate higher than a conventional mortgage in order to compensate themselves for carrying more risk. They may also require a shorter repayment term or a co-signer for borrowers with a low credit score.

Credit Scoring

How to Improve Your Credit Score?

When information is updated on a borrower's credit report, their credit score changes and can rise or fall based on new information. Here are some ways a consumer can improve their credit score:

- Pay your bills on time: Six months of on-time payments is required to see a noticeable difference in your score.
- Up your credit line: If you have credit card accounts, call and inquire about a credit increase.
- Don't close a credit card account: If you are not using a certain credit card, it is best to stop using it instead of closing the account. Depending on the age and credit limit of a card, it can hurt your credit score if you close the account.
- Work with one of the [best credit repair companies](#).

References

'Apple Card: 12 Fintech Companies Driving Credit Card Innovation'

Crunchbase

2016 Schulte Roth & Zabel LLP. Marketplace Lending: Opportunities and Challenges for Private Investment Funds.

<http://www.orchardplatform.com>

<https://www.investopedia.com>