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Testing Times

MPL Platforms Addressing Coronavirus Impact

As an expansion-era product, marketplace lending securitisation is expected to be tested for the first time by the COVID-19 fallout. Joseph Cioffi, partner and chair of the insolvency, creditors' rights and financial products practice group at Davis & Gilbert and author of Credit Chronometer, tells SCI how platforms are preparing for a potential recession.

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Q: Why and how are MPL securitisation seller/servicers likely to be tested by the current volatility/potential recession?

A: Where to begin? There's a certain irony to the crisis this time around for originators versus the 2008 crisis.

Back then, with lending and credit markets in tatters, it was fertile ground for MPL to take root and flourish by serving underserved markets in ways that traditional lenders could not. They nibbled away at the banks' market share, expanding from sector to sector. This time around, I believe the corona-crisis will turn out to be MPL's greatest challenge yet.

On one hand, MPL and fintech are perfectly positioned to gain market share, given consumers' desire for contactless transactions due to the coronavirus. However, the question is whether they will be able to take advantage of the situation if there is a liquidity crunch.

MPL has the advantage of being generally nimbler than banks and with their technology can quickly adapt their lending standards. But the current environment, with the heavy hand from the US government in the largest consumer debt markets, is going to tilt the playing field in favour of large, well-diversified and well-funded originators. They have an advantage in surviving a liquidity crisis.

The government is providing both consumer relief in mortgages and student loans and liquidity to the related ABS markets through the resurrection of the TALF programme. But consumer loans are not currently included and without government intervention in the sector, there will be liquidity issues.

In addition, current government plans focus on getting banks to offer small-dollar loans to customers with financial hardship, which will only increase competition against MPL. They could pick off the stronger borrowers, leaving marketplace lenders to make higher risk loans, which would only increase costs further.

A bright spot could be participation in the expanded SBA programme under the stimulus programme, if allowed. The new stimulus bill, while not explicit, opens the door to qualify new lenders if they meet the operational requirements.

Q: Are MPL platforms more vulnerable to underperformance and/or negative rating actions than non-fintech issuers?

A: MPL is not getting the attention that is going to mortgages and student loans. I believe the crisis is going to put enormous pressure on non-banks.

Risk premiums could rise sharply, desired ratings may not be achieved and securitisation may no longer be an option. Winning will not just be about the technology, it will be about liquidity.

Much depends on the effectiveness of the stimulus programme to keep consumers afloat and for how long, and, in turn, those consumers' willingness to stay current on their debt beyond mortgages and auto payments.

Q: Does asset class matter; in other words, are refi student loan providers likely to perform better than unsecured consumer loan providers?

A: I would normally say yes, but the economic crisis this time around may be the great equaliser. Even student loan refis, which has been a bright spot, could suffer as a professional degree does not provide immunity to the employment fallout.

Q: Are there any outliers among platforms in terms of being better/worse prepared for a downturn?

A: Platforms that focus on folks with lower credit scores and use alternative data have been able to find opportunities outside the usual FICO range. But even then, they might face a struggle when those borrowers start to lose jobs and default. It really all depends on the effectiveness of the stimulus and the spread of the virus.

Business lending can be a bright spot, given the stimulus package. Small-business focused fintechs could eventually get their wish and be allowed to participate in the SBA programme.

Q: Could we see tiering emerge between MPL issuers?

A: It's hard to say at this point. It is possible that the better capitalised, larger issuers will be able to better weather the storm, while the smaller lenders might not make it through the crisis. On the other hand, smaller niche lenders with less exposure to more impacted markets could find themselves outperforming larger platforms.

Q: What can platforms do to strengthen their readiness and liquidity ahead of a recession?

A: Platforms need to reduce costs, reduce costs and reduce costs. They also need to get granular on underwriting to reduce risk and explore their eligibility for government funding to get through the crisis. I don't expect platforms raising interest rates to raise revenue, if they want to remain competitive.

Q: How are platforms addressing the coronavirus impact on their borrowers and investors, and are they going far enough in their efforts?

A: Things are being done to improve resiliency, such as lowering approvals for higher-risk borrower populations and increasing income and employment verification requirements. Restricting access to credit is going to have to be a by-product of these initiatives. Satisfaction is a function of expectations and they are doing the right thing by lowering expectations among investors and partners.

How long the virus impacts society and the economy will determine whether these efforts go far enough to protect investors.

Platforms have been asked by the Marketplace Lending Association and various state regulatory agencies to take steps to alleviate borrower stress, including providing impacted borrowers with forbearance, loan extensions and other repayment flexibility that is typically provided to borrowers impacted by natural disasters. State agencies, such as the New York Department of Finance, have also asked all licensed lenders to consider all reasonable and prudent steps to assist businesses that have been adversely impacted.

It may seem like being asked to accept inordinate risk. But then, if you think about the size and scope of the government's commitment to maintain employment and keep employers afloat until the virus subsides, it might be the best medicine for those with the liquidity to take advantage of it. Once the virus dissipates and impacted borrowers are able to resume working and making payments, the platform may emerge with a stronger market position and valued portfolio.