Verband deutscher Kreditplattformen

# Taking marketplace lending to the next level

*By Romy Ritter, COO Exaloan AG*

**Digital lending is increasingly peaking the interest of institutional investors. Return potential, transparency, and liquidity of the asset class are crucial aspects for institutional investors to tap this market at scale. Equity-like return potential and low correlation with other asset classes add a high value in an investor's asset mix. Market standards are being established to increase transparency. Now, a secondary market brings the last puzzle piece to adopt digital lending as an asset class.**

Over the past decade, marketplace lending has developed into a vital part of the lending ecosystem. Providing funds for millions of individuals and SMEs it plays a crucial role in reducing the global funding gap and fostering financial inclusion today. While on the borrower side of the business the market has seen a wide diversification with originators extending their offering with different loan types and products, the refinancing side remained comparably stable strongly relying on retail investors. Institutional investors, and thus the evolution and diversification of investment products, have only slowly entered the market.

Today, still a significant share of already approved loan applications remain unfunded due to missing supply of funds. For lending platforms the key to scale their business and meet borrowers' demand is to bolster and diversify their investor base and integrate larger funds in their refinancing processes. A sufficient capital supply, for the matter of size, can only be met by institutional investors such as asset managers, pension funds, insurance companies, and alike.

## Digital lending: a highly attractive asset class for investors

As shown in an earlier study analyzing the impact of digital lending in an investor's asset mix, digital lending offers a highly attractive investment opportunity to investors. Overall, digital lending exhibits an investment performance with equity-like return potential. It adds a high value in the asset mix due to a low correlation with other asset classes and allows investors to tap into new risk premiums. Short durations due to comparably short terms and mostly amortizing payment schedules allow investors to benefit from significant compounding effects through high reinvestment rates.

**Market standards bring transparency as known from traditional asset classes**

With increasing demand from institutional investors, requirements as known from traditional asset classes evolve, specifically with regard to the processing of these transactions.

Standardization in processes and taxonomy is key in order for institutional investors to compare offerings and build trust as well as reliable and robust portfolios. Here, industry representatives like the Verband deutscher Kreditplattformen and official regulators introducing e.g. the EU Crowdfunding Regulation are taking important measures to increase standards and transparency in the industry.

For all stakeholders, marketplace lenders in particular, end-to-end process automation will be key in order to cope with increasing transaction volumes in the future.

**Secondary market offers liquidity and increases asset attractiveness**

Liquidity is key for raising attractiveness to investors. Therefore, making available secondary market transactions will become crucial for scaling in marketplace lending. Being able to buy or sell off loans from their portfolio in a quick and easy way under well-established regulatory processes will increase liquidity of a so far illiquid asset. Price discovery on a secondary market can in turn add value and improve the pricing of new loan applications.

This can be achieved by combining new technologies with an established regulatory framework. The arrival of distributed ledger technology (DLT) and tokenization brings the tools that enable a fungible secondary market and thus the emergence of a truly digital financial asset. Tokenization is the process of converting assets into fungible value stores that can be exchanged between parties via blockchain. The genius of this is that it enables the transfer of ownership for virtually any type of asset among network participants in a secure, transparent, and traceable manner. Yes, almost anything, from shares in a corporation to artworks and loans, can be tokenized. STOs or Security Token Offerings**,** are cryptographic assets linked to traditional financial assets like equity, debt, profit sharing rights or any other instruments. STOs can also be qualified as ‘transferable securities.’ One key highlight of STOs is that they are asset-backed and comply with regulatory governance.

Combining digital assets like STOs with digital lending effectively opens up a secondary market for institutional investors. The respective infrastructure has been set up in a partnership by Exaloan and UI Enlyte, a Universal Investment company, as announced earlier this year. The new setup firstly allows investors to benefit from a truly fully digital financial asset. Investors can source and fund individual loans, build their loan portfolio based on their preferences and sell off parts of their portfolio. All in real time and in a secure and regulated environment. Through the new infrastructure, both whole and partial loan receivables can be funded and traded. This not only digitizes the entire funding process but

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also creates a secondary market for loan receivables as these tokens are immediately transferable on a peer-to-peer basis. Ultimately, this paves the way for investors to manage their loan and private debt portfolios as efficiently and dynamically as liquid fixed income portfolios.

With equity-like return potential, increasing transparency, and a secondary market building liquidity for investments in marketplace lending, this adds the last puzzle piece for institutional investors to tap this market at scale.

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