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New-Generation Lender Reels in Risk Expertise

Funding Circle appoints CROs from American Express and Barclaycard amid a continuing hunt for talent in marketplace lending

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By Katherine Heires

With online marketplace lending on a growth tear – $7 billion of unsecured consumer loans and $4.6 billion of small-business loans were originated via these channels in 2014, according to Morgan Stanley research – companies like Funding Circle are enhancing their risk expertise accordingly.

Founded in the U.K. in 2010 and now expanding rapidly in the U.S., the small-business-oriented Funding Circle recently added Manpreet Dhot from American Express Co. as its U.S. chief risk officer. Jerome Le Luel, formerly of Barclaycard, in October assumed the position of global chief risk officer, based in London.

“Financial services is undergoing the largest revolution anyone has ever seen, Funding Circle CEO and co-founder Samir Desai said when the appointments were announced in July. “Marketplaces like Funding Circle are at the forefront of this revolution, and we’re investing heavily in scaling the team to address the unprecedented demand we’re seeing in the market.”

Funding Circle – another founder, Andrew Mullinger, was a risk manager at Nomura and Citigroup – is far from alone among so-called peer-to-peer or platform lenders on the credit risk talent hunt. In August, San Francisco-based Lending Club brought in Sandeep Bhandari, assistant chief credit officer at Capital One Bank and venture partner of Capital One Ventures, as chief credit officer. Taking responsibility for credit risk management across all products, Bhandari is replacing in that capacity chief risk officer Chaomei Chen, who will retire at year-end.

At student lending platform operator CommonBond in New York, Vinayak Gurjar was named chief risk officer in April. He was previously global head of governance in Treasury Capital Markets at Citigroup. Before joining Citi he was a director at Standard & Poor's for more than seven years, rating structured finance transactions.

At San Francisco-based Prosper Marketplace, second only to Lending Club in this fast-moving sector, chief risk officer Josh Tonderys, who was interviewed in June 2015 for GARP [Risk Intelligence], added the title of chief operating officer in January.

International Experience

Whether online or in a traditional loan setting, "the role of risk manager is to create stakeholder value," says Funding Circle U.S. chief risk officer Manpreet Dhot.

Dhot, Funding Circle's San Francisco-based CRO for the U.S., was previously chief credit officer for the Latin American market at American Express. Global CRO Le Luel was chief risk officer at Barclaycard, overseeing a £40 billion portfolio across the U.S., Europe and Africa. Before that he oversaw marketing and analytics at Capital One in the U.K.

Sam Hodges, Funding Circle co-founder and managing director in the U.S., stressed in an interview that both Dhot and Le Luel know how to oversee professional risk teams as well as expand and scale up risk capabilities. "There is a difference between administering systems and building them out, and these two individuals have strengths in both of these areas," Hodges said.

He added that both risk managers will have much to do as, as in the aftermath of a $150 million round of venture capital funding led by DST Global and completed in April, the firm is embarking on an 18-month investment plan. This entails updating and deepening the capability of its technology, including its risk management, credit analysis and analytics systems.

"We believe Funding Circle is the future of small business finance globally, and it's a vision we share with some of the largest and most respected investors in the world, Desai said when the funding was announced. Hodges added that the capital injection "will allow us to accelerate efforts in the United States and help us better serve the 28 million Main Street small businesses many banks have left behind."

Meanwhile, the search continues for risk and data science professionals.

“We are constantly evolving how we think about risk analytics and the precision of our data science, the kinds of risk models and depths of data that we use,” Hodges pointed out in the interview.

Move to Fixed Rates

Funding Circle announced that as of October it was moving away from its auction-based interest rate model in the U.K., to a fixed-rate system. According to Hodges, the U.S. operation has always offered fixed rate pricing, using “our own risk assessment methodology. The rate the borrower received (via a fixed rate system) was more fair and consistent, and that informed the decision to change the pricing approach in the U.K.”

Outside observers have said the shift and standardization of rates will facilitate securitizations of small-business loans in the future, a prospect that is still in early, exploratory stages.

Other new Funding Circle developments include a partnership with tax preparation and accounting services company H&R Block that is expected to attract more small-business borrowers; and the addition of a risk tier in June that extends the range of eligible borrowers.

“It is very likely we will continue to broaden our risk tier range, sometime in the early or middle part of next year,” Hodges said. Currently, the firm categorizes borrowers in tiers from A-plus through D.

Technology Plus People

Responding to email questions, CRO Dhot said that Funding Circle is currently working on a number of enhancements to the way it approaches risk assessment. This effort includes building data capabilities from diverse consumer and commercial sources; continuing to identify new and informative business performance signals, then combining them with linear indices that improve the discrimination power of risk models; deploying machine-learning algorithms to improve risk models; monitoring and improving credit abuse and fraud checks for applicant and business verification; and combining all of these advances with manual underwriting capabilities.

“Combining the power of automated scoring models with experienced human underwriters is key,” Dhot said. “We strongly believe models and underwriters play a very complementary role with a two-way feedback loop that leads to robust underwriting decisions.”

He noted that every loan application on the Funding Circle platform goes through an underwriting process to which both proprietary, rich-data-based credit models and human judgment are applied.

When asked to compare his current posting with previous work at traditional financial institutions, Dhot said that the risks faced in both environments are very similar.

”In both scenarios, the role of risk manager is to create stakeholder value by ensuring credit and fraud losses are in line with the expectations and risk appetite of the organization,” the U.S. CRO explained. “This, in turn, ensures predictability of returns for investors and shareholders.”

Balance-Sheet Considerations

He added that although Funding Circle does not carry the receivables on its balance sheet, the firm is still responsible for managing risk from an end-to-end perspective.

“At American Express, the owned and managed parts of the portfolio went through the same risk management framework as what we use at Funding Circle,” he said. “The key learning for me over the years has been the need to synthesize diverse consumer and commercial data sources to create a 360-degree view of a small business.”

In the third quarter of 2015, investors lent $312 million globally through the Funding Circle platform. The loan size averages $125,000, and the typical U.S. borrower has been in business eight or more years, has 10 or more employees and has more than $1 million in annual revenue. Since 2010, the firm has lent $1.5 billion to more than 12,000 businesses. The company has signed on to the Small Business Borrowers’ Bill of Rights, as previously reported.

Hodges says interest rates for U.S. borrowers currently range from 5.50% to 22.7%. The firm gets its revenue charging a 1% to 5% administrative fee to the borrower and a 1% to 2% annual servicing fee to the lender. Investors in the U.S. see an average 10% return on their investments, while 2% to 3% of U.S. loans go bad each year.

The managing director acknowledges that small-business credit risk management can be quite a challenge. The sector has no equivalent of the FICO consumer credit risk score, though there is an abundance of signals to monitor.

“At Funding Circle, we are able to bring to bear traditional credit risk assessment with some non-traditional data sources, geographical information and industry trends,” Hodges says. “We couple that with very thoughtful and experienced underwriting to drive strong credit performance and, as a result, we continue to see very low credit losses in the digital small-business-loan space.”

Katherine Heires (mediakat@earthlink.net) is a freelance business journalist and founder of MediaKat llc.